

OECD Papers

Volume 1, No.6

Contents

37. Linking Leadership to Performance in Public Organisations, by Patricia W. Ingraham
38. Firms, Workers and the Changing Workplace: Considerations for the Old and the New Economy, by Robert Taylor
39. Bridging the Digital Divide: Issues and Policies in OECD Countries, by Patrick Xavier
40. Improving the Environmental Performance of Agriculture: Policy Options and Market Approaches
41. Non-Member Economies and the OECD Guidelines for Multinational Enterprises, by Christopher Wilkie, Catherine Yannaca-Small, France Benois and Edward Smiley

Linking Leadership to Performance in Public Organisations

by Patricia W. Ingraham

Unclassified

PUMA/HRM(2001)8/FINAL



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

18-Jul-2001

English - Or. English

**PUBLIC MANAGEMENT SERVICE
PUBLIC MANAGEMENT COMMITTEE**

**PUMA/HRM(2001)8/FINAL
Unclassified**

LINKING LEADERSHIP TO PERFORMANCE IN PUBLIC ORGANISATIONS

**HRM Working Party Meeting
Paris, 25-26 June 2001**

For further information, please contact
Deok-Seob SHIM, Tel: +33-1 45 24 17 58; E-mail: deok-seob.shim@oecd.org OR
Kirsi AIJALA, Tel: +33-1 45 24 92 20; E-mail: kirsi.ajjala@oecd.org

JT00110982

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English - Or. English

LINKING LEADERSHIP TO PERFORMANCE IN PUBLIC ORGANISATIONS

By Patricia W. INGRAHAM

1. Introduction

1. Effective leadership for public organisations is an important objective for most nations. The necessary qualities of leadership, however – as well as the characteristics of “good” or “effective” leadership – may be different in different national contexts. Nonetheless, global and consistent pressures of reform, technological development, and calls for improved accountability and performance have emphasised the importance of leadership in new ways. E-governance, “hollowed government”, and the need to link leaders and leadership to building institutional and managerial capacity challenge traditional definitions of leadership (OECD, 2000). Leadership for the future has been described as more about “knowing who”, rather than “knowing how”; that is, about relying on a network of external experts, rather than hiring expertise into the organisation; about redefining the nature of work in new political and technological environments; and about leading networked and more transitory organisations. Linking leadership to performance, and linking the performance of public organisations to greater accountability and better governance are concerns for elected officials, members of the public service, and citizens.

2. The rigid hierarchical structures for which public organisations have long been noted are under attack in many national settings, but have not been dislodged or significantly altered in most places; the behaviours and constraints they create remain a reality for public officials and other leaders. Leading toward current and future demands, while still constrained by older structures and procedures, has severely tested the higher public service in numerous countries. To bridge the “talented leadership” gap that has emerged, OECD Member countries and others have created a variety of strategies for the acquisition and development of leadership talent and capacity. It is clear, however, that fundamental issues related to leadership and leadership development demand additional analysis and attention.

2. Choices About Leadership Styles and Behaviours

3. There is a broad diversity of perspectives about leadership, as well as about what constitutes effective leadership within organisations. The literature, for example, has explored personal characteristics of leadership, relationships between leaders and subordinates, the role of leadership in organisational change, and the differing effectiveness of various leadership styles in different settings and environments (Stogdill, 1974; Atwater, *et al* 1999; Ulrich, Zinger, and Smallwood, 1999).

4. Very generally, however, conceptual models of leadership style and behaviour can be summarised into four broad categories: the hierarchical, command/control model commonly associated with large bureaucratic entities emphasises rules, regulations, structure, and stability. Leadership, *per se*, is related to the authoritative giving of orders and the expectation that those orders (or decisions) will be followed (or implemented). In Follett’s (1936) terms, the relationship between leader and subordinates is one of “power over”, not “power with”. Power or authority sharing diminishes the quality and the strength of leadership.

5. Transactional leadership (Bass, 1985) moves to recognition of necessary leader/subordinate exchange in the interests of rewarding desirable behaviour (in pursuit of leader or organisational goals) and punishment or corrective action to discourage behaviour and activity not deemed productive. In public organisational terms, behaviour and characteristics of transactional leaders are closely related to adherence to procedures and commitment to process, and internal organisational relationships reflect essentially standardised patterns.
6. Transformational leadership (Bass, 1985) moves more proactively to linking leadership to positive change. In transformational leadership behaviour, personal characteristics of the leader (including charisma), individualised consideration of follower needs, the ability to view problems or objectives from multiple perspectives, and the ability to communicate a vision or a path/purpose to change are significant factors. Although transactional and transformational behaviour are not completely separable patterns, because effective leadership behaviour and style must be contingent on context, there is some empirical evidence that suggests that transformational behaviour can be linked to higher performance in ways that transactional behaviour cannot (Howell and Avolio, 1993). That is, transformational leaders motivate employees to higher levels of productivity and organisational commitment. Further, the emphases of transformational leadership on change and innovation fit closely with the values inherent in models of administrative and organisational change underpinning many public sector reform efforts. As a result, reliance upon the general model has been extensive in reformed settings.
7. Nonetheless, transformational leadership theories and behaviours have also been challenged by new models of leadership emphasising nearly constant change, changed patterns of communication, shared horizontal authority and responsibility, and leadership within organisations whose boundaries are open to complex and often unpredictable pressures and demands. Integrative leadership perspectives argue that effective leadership is not a free-floating phenomenon, but must be more specifically linked to organisational abilities and performance (Ulrich, Zinger, and Smallwood, 1999).
8. This integrative view of leadership may be particularly apt for public leaders, who necessarily operate in organisational contexts and environments where conditions and parameters are often determined externally. Public leaders are dependent upon a systemic organisational base over which they do not have complete control for the implementation of policies and programmes. At the same time, public leaders must utilise and build upon the existing base if critical organisational capacities are to be created and higher levels of performance are to be achieved. Systemic capacity, in this sense, becomes critical to the leader's ability to perform and for that performance to be linked to overall organisational effectiveness. Fundamental systemic capacities include the organisation's human capital, its internal management capabilities, information and knowledge management skills, and the ability of the organisation and its members to evaluate and learn from previous efforts and experience. The leader in this setting must integrate all of these component parts into broader organisational strength and potential. This must be done with an eye toward building for future capacity, as well a clear focus on present performance. The ability to achieve this balance is a core characteristic of the integrated leadership model.
9. The boundaries between the general leadership categories just described are not rigid; both theorists and real world leaders recognise the need to tailor behaviour and style to contingent need and context. There is good evidence that effective leaders move from one set of behaviours to another depending on context and demand, essentially picking and choosing from strategic options to obtain optimal outcomes.
10. Differing definitions and utilisation of leadership models also reflect differences in the fundamental nature of organisations and the environments in which they are nested. Level of economic development and stability, extent of social integration within the broader society, the nature of the governmental structure, and the nature of the political environment and the national political culture are all broad environmental influences on public organisations and the roles they can play.

11. Turbulent organisational environments, on the other hand, are now a given in most nations; awareness of turbulence –or potential turbulence—is a factor common to leadership and organisational change models around the world. Organisations in both public and private sectors are subject to increasingly intense and complex changes created by technology, e-commerce and e-government, and knowledge management challenges. These challenges will necessarily reshape leadership roles and actions in the near future, if they have not done so already.

3. Forging the Links to Performance in the Public Service

12. Demands for better accountability and improved performance have resulted in administrative reforms that strongly emphasise new leadership and leadership development models (Pollitt and Bouckert, 2000). A primary target of such efforts – often summarised as New Public Management reforms – is the narrow traditional model of “leadership” found in many national bureaucracies. Leadership development in this model relied on “growing your own” leaders, or on training and grooming persons who are already inside the organisation for leadership positions. Leadership capacity occurs or develops in tandem with ever increasing skills and expertise in programme, policy, or administrative functions. Long-term service to the organisation results in promotion up through narrow “stovepipes” of expertise or experience, and culminates over time in promotion to management, upper-management, and finally “leadership” positions. Leadership development/training opportunities occur at specific promotion points. Because formative experiences for many leaders who emerge from this mold revolve around process and bureaucratic procedure, many characteristics of transactional leadership model also fit this internal development model.

13. The strong points of this pattern include long-term development of public service values and creation of an intense institutional knowledge and memory base about specific programmes, policies, and administrative practices. The negatives are also important: transforming the narrow perspective acquired over time into a broader organisational view is difficult. Inter-programme or inter-organisational mobility moves, one very widely accepted strategy for increasing broader vision, have been, at best, only moderately successful in most countries. The second major negative associated with the internal promotion leader model is a possible lack of diversity at those levels of the organisation which create the feeder pool for leaders, and a consequent continuing lack of diversity in the leadership cadre.

14. Some early reforms, such as the creation of senior executive services, were intended to combat the narrow organisational and performance perspectives fostered by the “grow and promote your own” model. Better management skills, greater ability to cross organisational boundaries and to communicate more effectively with elected officials and other public leaders, and an improved capacity for creative leadership skills were perceived to be necessary for more effective leadership in the public service. In addition, because members of the senior executive services were more directly accountable to political officials – and therefore to external measures or perceptions of performance – important early connections between leadership and performance were established.

15. Other components of these reforms were equally significant. Recognising that some external “refreshing” of the higher service was also part of a leadership development strategy, many senior executive efforts included hiring in new leaders from outside the organisation and outside the public service. These reforms were direct challenges to the “grow your own leaders” philosophy of leadership development; they marked a serious rethinking of the nature of leadership and the development of leadership capacity in public organisations. “Growing your own” was not an adequate answer to the public leadership capacity problem, according to those who supported the reforms. Rather, “buying” or hiring in leadership talent was either a necessary replacement for, or supplement to, the strategy.

16. In effect, the reforms and their proponents argued that neither hierarchical nor transactional models of leadership behaviour and performance reflected the real needs of modern public service and governance. A move toward more transformational, performance based leaders and leadership development was necessary. A part of that move would also be away from a process based public service – although one strongly grounded in core public service values – to a leadership cadre and service more grounded in market values and more receptive to new demands for performance.

17. Many national governments initially addressed these perceived tensions not only by hiring in, but also by explicitly adopting private sector contract models for the executive cadre of the public service. New discretionary authority and flexibilities were created to facilitate performance-based behaviour and to more accurately reflect conditions found in private sector organisations. Recruiting into executive positions from outside the public sector was not just one part of, but critical to, the creation of more effective leaders and higher levels of performance. Reforms in Canada, New Zealand, the United Kingdom, and the Netherlands are examples. Just as growing your own leaders could have limited ability to produce the broad strategic perspective now deemed significant, however, the practice of hiring in or buying leadership talent sometimes produced limited capabilities in understanding and committing to core public service values. Further, the blending of internal and external talents and perspectives in a leadership cadre, while theoretically energising and refreshing, has been demonstrated to require careful balancing if it is not to lead to a fractured and fractious leadership group.

18. While these performance reforms have not been abandoned, more recent developments place leadership in an ever more complex, but more specifically public context. New perspectives on both performance and on the role of leaders in achieving high performance results emphasise the **preconditions** for performance and the extent to which leaders and managers have the necessary tools, skills, and organisational capability to attain performance objectives. Improved performance, in other words, relies not just upon leadership, but also upon a combination of factors. The integration of these factors and the synergy among them contribute to an improved performance dynamic and to positive performance potential. In this perspective, capacity assumes substantial significance as an interim objective that effective leaders can work to develop, but also as an effective launch pad for improved performance in the longer term. This conceptualisation of leadership closely resembles the integrated leadership model described earlier.

19. There are other factors to consider as well. One of these is the set of relationships between leaders and managers, or between leadership and operations, in public settings. Distinctions have frequently been made between the two activities: leadership is most frequently viewed as providing the vision and direction for an organisation and serving as organisational voice for primary mission and values. Managing, on the other hand, has been viewed as more concerned with organising daily activities in pursuit of longer-term organisational objectives.

20. However, as organisational boundaries both within and across organisations become more open and less distinct, it is clear that the boundaries between managers and leaders must change as well. Leaders will necessarily build systems that enable managers to be more flexible and effective, but they can only do so with the participation and assistance of managers and operating staff; managers will assume some leadership responsibilities in being more proactive, more accountable, and more directly connected to organisational performance. They can only be effective if leaders are willing to share authority and responsibility. Jointness of managing and leading is one contributor to improved organisational capacity for change and performance, but assumes unusual skills for both leaders and managers.

21. It is also important to note that emerging concerns with the link between performance and governance – rather than the more simple definition of performance as productivity – have placed the citizen and citizen satisfaction with public performance very squarely into the effective leadership

equation. For leaders of public organisations, this broad external – sometimes-instantaneous – evaluation of organisational performance is a new dimension. In this setting, organisational boundaries and constraints alone do not define parameters for performance; citizen expectations also contribute. The need for effective communication, listening and learning is exponentially increased. The ability of leaders to acquire, process, disseminate, and use good information effectively, while always significant, becomes even more critical.

4. Potential Learning Models From Public Organisations

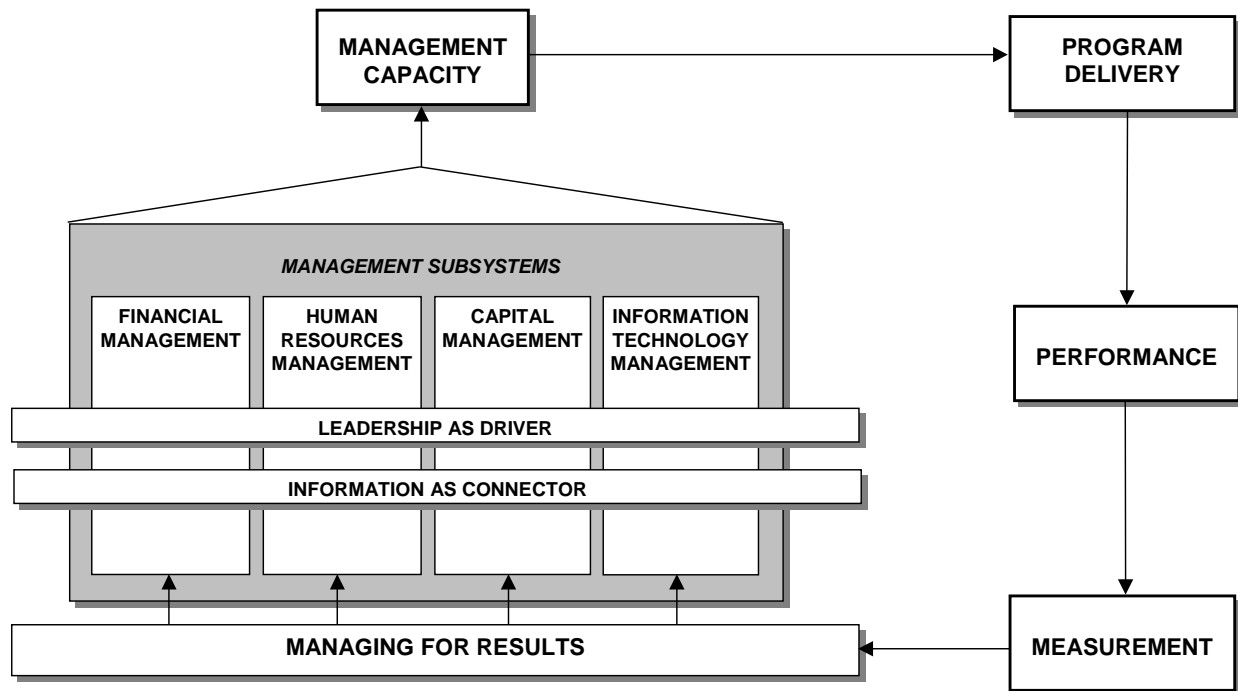
22. As governments have redesigned and reformed leadership and management policies in the past, the private sector has been the most frequent source of ideas for change. Increasingly, however, the duration of reform and the diffusion of reform ideas across governments have created a set of public models from which to draw ideas and lessons. Reforms such as senior executive service, executive contracts, and performance based executive pay can be examined in any number of national and sub-national governments. Lessons about leadership recruitment, development, and reward can be drawn. While it is safe to say that virtually all-public reforms have moved away from the hierarchical, transactional leader models, full descriptions of precisely what governments are moving toward are just emerging.

23. One set of lessons with potential utility in framing public leadership models is provided by an ongoing analysis of public management capacity at all levels of government in the United States. The conceptual model underpinning the Government Performance Project specifically adopts the integrated perspective in its analysis, arguing that a core component of capacity is created by the management systems found in most governments: human resource management, financial management, infrastructure management are common factors across governments. Information management is viewed as a critical integrating factor; results based management is identified as fundamental to the ability to move to improved performance. Leadership, however, is viewed not only as the major integrating influence, but also as a key driver of improved organisational capacity and performance potential.

4.1. *The Government Performance Project*

24. In the period from 1997- 2001, the Government Performance Project surveyed all 50 American states twice (in 1998 and 2000), 30 federal agencies, and the 35 largest cities (by revenue) in the United States. In 2001-2001, it will analyse the 40 largest counties in the US and an additional set of federal agencies. The project represents the largest and most systematic examination of managing government ever undertaken in the United States. The model presented in Figure 1 provides the basis for criteria development for each of the systems. (Samples of the criteria are included at Appendix One). The analysis is based on surveys, interviews and documentary analysis. The conclusions were presented in summary form as grades, one for overall capacity and one for each of the management systems examined. Additional information is available on the GPP Website.

Figure 1. Government Performance Project Performance Model



25. Although leadership was defined early in the process as a critical factor in both management capability and potential for performance, the GPP pilot studies demonstrated that leadership *per se* was a topic too politically sensitive to be addressed as a separate issue. As a result, information and conclusions about leadership were drawn from questions relating to sources and/or incentives for change, framing visions for creating capacity and improving performance, understanding of overall organisational goals and objectives, and managing for results.

26. Overall, the findings of the Government Performance Project to date include:

1. **Creating Capacity.** Governments demonstrate very different levels of ability to create the capacity for performance. For each of the levels of government studied, and for each of the systems, there were few high performers and a similarly limited number of governments that did not do well. For each of the analysis years, about one in 10 of the governments studied demonstrated strong performance potential in each or most of the management systems (average grades for selected systems in each year of the analysis are included at Appendix 2).

In each of these governments, there was also a readily identifiable leader or leadership team. A slightly lower number of governments were rated uniformly low against the criteria for all of the systems. The performance potential of the remaining, and largest number, of governments varied – sometimes dramatically – across the systems.

2. **Budgeting and Financial Management.** The system for which governments consistently received the highest grades was budgeting and financial management. The most problematic systems were consistently human resource management and information management. (It must be noted, however, that following the Y2K “crisis”, state governments demonstrated great progress in information technology and management). The findings for budget and financial management systems are of interest, of course, because of the central function that effective budgetary systems play in governmental effectiveness and accountability. The GPP

analysis demonstrated clearly that both elected officials and leaders from the career public service frequently view budget systems as the core strategic driver for leadership vision and values. Some state and local government leaders, in fact, argued that a strong budgetary system and process that reflected strategic vision, values, objectives and measures obviated the need for additional and less publicly accessible strategic documents.

- 3. Human Resource Management.** Findings related to human resource management systems are also of particular interest. As noted, governments generally were struggling in this area. At the same time, there is a growing recognition that human capital investment and management are fundamental to success. Leaders of effective reform around the world consistently describe human resource management flexibility and capability as central to their ability to meet performance objectives. Yet the contemporary effort to recruit, develop and retain human resources has been described as a “war for talent” in one private sector study (McKinsey, 1998). Governments at all levels face a similar struggle to acquire necessary expertise and to manage it for maximum effectiveness.

Initially, governments responded to the need for new approaches to recruitment, retention, and reward by extensively and rapidly decentralising human resource activities. Decentralisation was intended to provide leaders and managers with as much flexibility as possible to pursue the talent search. In the first set of governmental analyses conducted by the GPP, decentralisation was the favoured strategy in both state governments and at the federal level. The 2000 analysis of the states, however, demonstrated a sharp movement back toward what the states termed a “strategic balance” between central oversight and decentralised activity. One city in the 1999 analysis described their system as “co-ordinated decentralisation”.

To some extent, this demonstrates the changing lines between leading and managing in government. While there is a continued recognition of the need for decentralisation if necessary flexibility and discretion is to be present, there is also a need for leadership to retain strategic direction and co-ordination of decentralised efforts. The shared responsibility that emerges balances both needs and, at a minimum, provides key decision-makers with enough information to understand what the organisation is really doing and how it is doing it.

- 4. Managing for Results.** Managing for results (or performance) systems are present and evince strong expressions of support at all levels of government in the US. These systems are also very modestly developed in many settings, however, and are clearly evolutionary in levels of sophistication and utility. Many continue to reflect the initial emphasis on getting measurement right, rather than obtaining useful information. Further, most do not cross into the political environment to provide information to elected decision-makers. Rather, the most common information targets are professional staff members of career bureaucracy who are involved in early shaping of budgets and plans. Nonetheless, in cases where managing for results systems have been carefully developed and refined, they provide leaders with critical tools and information for co-ordinating and streamlining processes and services and for targeting resources to desired results. The gathering and subsequent dissemination of performance information does serve an integrating function within the organisation, but also identifies barriers to further improvements. This is one area, however, in which strong and consistent leadership is absolutely critical. When leaders are committed to using the system and the information it provides, other members of the organisation buy in. When leadership was not committed in the governments studied by the GPP, managing for results systems became just another paper generating activity.

5. **Leadership.** Despite the centrality accorded effective leadership in the results of the GPP – leadership clearly emerged as a decisive factor in the top five performers each year, while absence of leadership was clearly discernible in the lowest performers. Styles and patterns of leadership varied in the governments analysed, as did leadership strategies. Strong leaders were identified following two primary methodologies. First, based on average grades, high performers and low performers were identified and separated. Common characteristics of high performers were identified. Then, following backward mapping processes, common characteristics were traced back to underlying influences. In the high performers, the major influence was leadership. In addition, although public attention and discussion often centred on one individual, closer examination revealed the existence of a team or teams of leaders. Significantly, composition of the strongest teams included both elected/appointed officials and career members of the public service, that is, the leadership teams combined longer-term career expertise with political direction and support for change. At the local levels of government, personal style of the top political official was often a key factor in defining the nature of leadership; even in those cases, however, the leader created – or was creating – an institutional base on which to depend for implementation and additional support.

27. There were several striking commonalities among the top leaders and leadership teams in the governments studied. These included:

- A clear and sometimes very sharp definition of purpose accompanied by specific identification of strategic priorities.
- Identification of a clear base of support or specific strength from which to pursue the priorities.
- A demonstrated willingness to defend the priorities.
- A clear strategy for pursuing the priorities and a delineation of applicable boundaries and standards.
- Building of (initial) capacity around priorities, with clear implementation and assessment objectives.
- An emphasis on acquiring talent necessary to meet priorities.
- Longer-term focus on creation of crosscutting or integrating mechanisms with emphasis on improved communication.
- Clear oversight of the management and implementation activities related to achieving priorities.

28. The statement of purpose or vision was communicated in a variety of ways. It was often articulated in a budget statement or summary. It was sometimes the core of a broad strategic or performance plan. It was frequently placed at the heart of a governor’s state of the state or a mayor’s state of the city address. In some cases, the statement of purpose was unwritten, but frequently stated and clearly supported by budget priorities. In the federal government agencies, it is a mandated part of the strategic plan prepared under the provisions of the Government Performance and Results Act. In all of the settings in which leadership was judged to be most effective, however, the core message was repeated over and over again, to a wide variety of audiences. One widely acknowledged leader told the GPP staff that “I say it over and over again to anyone who will listen, and when I can’t bear to hear myself talk about it any more, I find someone to say it to one more time”.

29. Introducing clarity into the message and consistently refining focus was most difficult for leaders in the federal agencies, where conflicting missions – or sometimes, “mission creep” – render limiting

priorities and targeting resources quite difficult. In the agencies studied over the three-year period by the GPP, even those whose performance was relatively high indicated that the dual problems of limiting mission and targeting resources to priorities were constant. In these cases, the leadership team's ability to communicate effectively and often beyond organisational boundaries – and thus to win external support – was a key factor in the ability to maintain and meet some performance objectives.

30. The choice of – and reliance on – a core system as driver of change is also notable. Budget systems are an obvious choice in this regard, but information technology and management and managing for results also proved to be significant. One state that received strong ratings in both years of the analysis observed that while it was striving for excellence in broad strategic leadership and management, it was committed to strong financial management systems as the cornerstone of that effort. Another state, utilising its high-tech environment, used information management as a base for further capacity building and as an integrator across government systems and functions.

31. In the federal government, where dealing with multiple and sometimes conflicting management systems is a reality, it is not surprising that the managing for results systems mandated by the GPRA became a vehicle for achieving some internal coherence and co-ordination. Again not surprisingly, agencies whose missions were clear or relatively coherent, who had a product or service that allowed understandable measurement, and who had created well crafted measures to chart progress were agencies in which leaders were most able to capitalise on the potential benefits of managing for results. Even in some of these agencies, including one with a clear revenue producing bottom line, leaders scrambled to keep performance activities on track when the Congress consistently diverted its revenue into the broader general fund, thereby reducing the agency's resource base.

32. Finally, it is important to note that the leaders and leadership teams that we observed in the Government Performance Project appear to have taken a building block approach to improving capacity and performance in their governments. This may speak to the long-term nature of change in public organisations. But the choice of very clear and limited objectives and priorities, of a single system to serve as the capacity building base, and the gradual adding on of capacity in other management systems and in integrative processes demonstrates a consistent belief among effective leaders that the creation of a sustainable institutional base is as important to public leadership as is leadership style and/or behaviour. This also demonstrates quite clearly that, although effective leadership can be a precondition for more effective performance, it is not the only condition. There are strong and committed leaders in many governments and agencies whose overall capacity is weak; they readily acknowledge that, despite their best efforts, the organisation is not likely to achieve high levels of performance. Absent capacity and alignment within the organisation – or the opportunity to create them – leadership is a squandered resource.

5. So What? Implications for Developing Future Public Leaders

33. While transferring lessons from one national setting to others is somewhat risky, it also affords an opportunity to consider possible implications for future leadership development efforts. Further, because many governments have adopted various management reforms but continue to operate with essentially unreformed bureaucratic structures, the lessons related to organisational capacity and conditions necessary to support effective leadership have broad application. That is, in fact, one of the most significant findings to emerge from the GPP study:

- While effective leadership can be linked to, and have a positive impact on, performance, good leadership alone is not enough. Effective leadership is only one of several pre-conditions necessary for higher performance to occur. A comparatively clear mission, relatively predictable resources, and the potential to create or build upon internal organisational capacity are all component parts of the performance equation. Particularly in the absence of potential for organisational capacity, however, the ability for leadership to

make a difference is thwarted. Further, in such a setting, well-designed development programmes may only produce transformational and integrative leaders who are trapped in transactional settings. Thus, the investment in leadership will have very low returns.

- The need for leaders and leadership teams to work through organisational systems to create additional capacity points to concomitant needs for a fundamental understanding of public management systems and values. These needs are based partly on the relationships that must be built with managers who operate existing systems, and who will be instrumental in the success or failure of capacity building efforts. The needs also emerge from recognition of the role that values play in underpinning and shaping change and performance. In the public sector, both processes must reflect core public values, integrating, for example, the concern for effective governance with a focus on productivity and performance.
- Of equal significance, there is an on-going need to understand that all of the constraints on public management systems are not ill intended, but may be based on very real legal and constitutional limitations. That is not to suggest that past structures and processes did not impede performance, but only to note that many older public management systems represented the gradual accretion of rules and regulations, rather than a strategic design. Some of the rules and regulations probably remain legitimate. Effective leadership in capacity building and related changes must recognise, therefore, the unique limits that the public context can place on their efforts. While internally grown leadership candidates likely will have an understanding of these issues, those recruited from outside of the public service will be less likely to possess this insight. In both cases, problems in understanding the parameters of potential change and the points in the change processes where effective leadership will be decisive are presented. A better understanding of systems and values also supports the building block approach to capacity building, which necessarily rests on a good understanding of how management systems will fit together in the longer term.
- Both of these previous points suggest the need to develop leaders with very strong communication and bridge building capabilities and skills. The consistent need for good communication with elected officials and citizens; the above-mentioned need for excellent communication within the organisation, not only about goals, but about progress toward them; the need to communicate effectively across organisations and within networks; and the emerging need to be an effective knowledge manager and translator all point to communication skills not often found in public managers and leaders – or any other leaders, for that matter.
- The GPP conclusions point strongly to the need for future leaders to lead in a decentralised, but well-co-ordinated, setting. While good lessons exist about leading in one or the other of these situations, the combination poses special challenges. Determining the kinds of information gathering and oversight necessary for co-ordination, without reverting to hierarchical direction, is an emerging art. Setting and respecting accountability boundaries in settings of discretionary authority and flexibility will also be a part of the emerging leadership skill set.
- Not related directly to GPP findings, but of central significance to leadership and leadership development issues, is the problem of diversity. Developing and maintaining a leadership cadre that reflects the diversity of society and public organisations has been a challenge met with varying degrees of success by OECD nations and others. In some cases, inability to recruit and retain a diverse workforce has been the issue. In others, internal promotion procedures and processes are obstacles.

- Both the ‘growing your own’ and hiring in options for acquiring leadership are somewhat problematic in regard to diversity. If recruitment, placement, and promotion practices of the past have limited diversity in the leadership pool of the organisation, continuing to rely on those practices and on that limited pool by growing your own leaders will only reinforce lack of diversity. The hiring in option, while offering an immediate solution to lack of diversity in the leadership cadre, also creates a bit of an “insider-outsider” difference if many or most of the external hires look different from the internally grown pool. This requires special emphasis on creating and reinforcing common values and purposes.
- The emerging emphasis on strategic decentralisation mandates careful specification of overarching governmental objectives and values, as well as clear means of linking decentralised accountability into central and obvious accountability mechanisms. The implications of this for leadership development strategies and assessment are very clear. The strategies must focus on the centre, centre values, and critical information needed by the centre for effective co-ordination at the same time that they develop strong abilities in decentralised leadership, management and accountability. The seamless integration and alignment necessary for such strategies to be effective can only be achieved with clear direction from the centre and joint participation by decentralised agencies or programmes in the design and implementation of development strategies.

Further, the decentralised organisations must play a critical role in development of leaders for their future needs by ensuring that development activities create leaders whose talents and abilities are matched to the real work of the organisation or agency.

6. Conclusion

34. As leadership development strategies for the future are developed, they will have to address many of the issues that previous reforms have ignored – or perhaps created. The needs to balance centralisation with decentralisation, clear accountability with discretion and flexibility, institutional knowledge with external expertise and energy, dynamic knowledge management with routine, and public service values with performance and productivity are present across OECD Member countries. Good guidance on how to achieve these balances and to judge the success or failure of the balancing act is not so evident. Past patterns of transactional leadership will not meet the challenges of the future, but to the extent that old structures and procedures remain, so too will the need for some transactional capabilities.

35. The process of transformation is underway in many national and sub-national governments, but that transformation must proceed with clearly public models and values in mind. Integrative leadership will be necessary for it to proceed effectively, but broad support for re-designing old systems to improve organisational capacity and to clearly link the efforts of public organisations to strong performance must also be created. Getting from here to there is not impossible, as many governments have demonstrated. But it will require nimble leaders who can act in new ways, and who are undaunted by the requirements to do so.

36. Finally, if new leadership development strategies are to be amenable to assessments of success or failure, they must be linked to the real work that public organisations perform. That real work is, in a fundamental way, connected to the systems and institutional processes of government that permit public organisations to fulfil expectations for governance, as well as performance. If leadership development is to be effective, a focus on aligning talent, values, and systems will be important. Systems, as both the setting and mechanisms for public action, are particular manifestations of the publicness of the leadership endeavours examined here. Aligning them to work together, and in support of governance and performance objectives, will be one key measure of public sector success. For higher levels of performance to occur and

be sustained, all parts of the performance equation must be in place: the potential for performance must exist. In public organisations, both leadership and systems are critical components of that potential.

APPENDIX I
GOVERNMENT PERFORMANCE PROJECT CRITERIA FOR SELECTED SYSTEMS

Human Resource Management

- Clear and Understandable Personnel policies and Procedures.
- Timely Hiring.
- Appropriate Education, Training, and Development for the Workforce.
- Ability to Acquire Necessary Skills; Workforce Planning in Place to Achieve Right Future Mix.
- Effective Compensation, Motivation, and Reward Systems.
- Effective Discipline and Termination Policies and Procedures.
- Agency and Managerial Flexibility in Hiring, Reward, and Disciplining Employees.

Managing for Results

- There is a Strategic, Results-Oriented Plan.
- Key Stakeholders are Involved in Plan's Development and Evaluation.
- There are Measures and Information that Permit Tracking of Progress Toward Desired Results.
- Information From the Evaluations is Available to Leaders and Other Policymakers, Management, and Citizens.
- There is a Clear Process for Communicating Results.

Integration

- Leadership has a Vision for the Organisation that is Effectively Communicated to Other Members of the Organisation and to Stakeholders.
- Leaders are Able to Motivate Employee Performance Clearly Linked to Vision and Goals.
- The Right People (Talent) are in the Right Places (Positions, Systems) at the Right Time (When Needed).
- The Right Information is Available to Key Decision Makers When They Need It and in a Form They Can Use.
- Resources are Predictable and Reinforce the Organisation's/Leader's Key Priorities and Activities.

APPENDIX II
AVERAGE GRADES FOR SELECTED SYSTEMS

Human Resources					
	States 1999	States 2001	Cities	Federal Agencies 1999	Federal Agencies 2000
Average Grade	B-	B-	C+	C+ (2.46)	B(3.2)
High Grade	A-	A	A	A	A
Low Grade	F	D+	D	D	C

Management for Results					
	States 1999	States 2001	Cities	Federal Agencies 1999	Federal Agencies 2000
Average Grade	C+	C+	B-	C+ (2.6)	B (3)
High Grade	A-	A-	A	A	A
Low Grade	F	D	D	C	C

SELECTED REFERENCES

- Atwater, L.E., S.D. Dionne, B. Avolio; J.F. Camobreco; and A.W. Lau 1999 "A Longitudinal Study of the Leadership Development Process: Individual Differences Predicting Leader Effectiveness" *Human Relations* 52(12): 1543-1562.
- Bass, Bernard 1985 *Leadership and Performance Beyond Expectations* (New York: Free Press)
- Follett, Mary Parker 1936 *The Creative Experience* (New York: Basic Books)
- Government Performance Project Website www.maxwell.syr.edu/gpp.
- Howell, J.M. and B.J. Avolio 1993 "Transformational Leadership, Transactional Leadership, Locus of Control, and Support for Innovation" *Journal of Applied Psychology* 78(6):891-902.
- McKinsey Group 1998 "The War For Talent" *The McKinsey Quarterly* (3):44-57.
- Organisation for Economic Co-operation and Development 2000 *Government of the Future* (Paris: OECD).
- Pollitt, Christopher and Geert Bouckert 2000 *Public Management Reform: A Comparative Analysis* (Oxford: Oxford University Press).
- Stogdill, R.M. 1974 *A Handbook of Leadership; A Survey of the Literature* (New York: Free Press).
- Ulrich, Dave; Jack Zenger; and Norm Smallwood 1999 *Results-Based Leadership* (Boston: Harvard Business School Press).

Firms, Workers and the Changing Workplace

Considerations for the Old and the New Economy

by Robert Taylor

Unclassified

PAC/AFF/LMP(2001)3



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

03-Jul-2001

English - Or. English

**PUBLIC AFFAIRS AND COMMUNICATIONS DIRECTORATE
PUBLIC AFFAIRS DIVISION**

**PAC/AFF/LMP(2001)3
Unclassified**

Labour/Management Programme

FIRMS, WORKERS AND THE CHANGING WORKPLACE: CONSIDERATIONS FOR THE OLD AND THE NEW ECONOMY

**Report on a meeting of management and trade union experts held under the OECD Labour/Management
Programme**

Paris, 23rd February 2001

JT00110492

**Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format**

English - Or. English

OECD LABOUR/MANAGEMENT PROGRAMME

**FIRMS, WORKERS AND THE CHANGING WORKPLACE:
CONSIDERATIONS FOR THE OLD AND THE NEW ECONOMY**

Report on a meeting of management and trade union experts
held under the OECD Labour/Management Programme

(Paris, 23rd February 2001)

Formal relations between the OECD and representatives of trade unions and of business and industry in Member countries are conducted through two organisations officially recognised by the OECD Council. These are the Trade Union Advisory Committee to the OECD (TUAC) and the Business and Industry Advisory Committee to the OECD (BIAC). In addition to various forms of policy discussion throughout the year, arrangements provide for meetings at the technical level, which do not engage the responsibility of the organisations. Such meetings are held either in the form of ad hoc discussions with the Secretariat, or under the Labour/Management Programme for which a series of meetings devoted to specific themes is established at the beginning of each year.

After meetings held under the Programme, a rapporteur draws up a report of the discussion on his own responsibility, for distribution to the social partners and to the relevant OECD Committees. The opinions expressed in such reports are those of the rapporteur, except where they are specifically attributed to individual participants, and do not necessarily reflect the views of other participants or of the OECD.

© OECD, 2001

Permission to reproduce a portion of this work for non-commercial purposes or classroom use should be obtained through Centre français d'exploitation du droit de copie (CFC) 20, rue des Grands Augustins, 75006 Paris, France, Tel. (33-1) 44 07 47 70, Fax (33-1) 46 34 67 19, for every country except the United States. In the United States permissions should be obtained through the Copyright Clearance Centre, Customer Service, (508)750-8400, 222 Rosewood Drive, Danvers, MA 01923 USA, or CCC Online: <http://www.copyright.com/>. All other applications for permission to reproduce or translate all or part of this document should be made to OECD Publications, 2, rue André-Pascal, 75775 Paris Cedex 16, France.

TABLE OF CONTENTS

FOREWORD4

AGENDA.....5

FINAL REPORT ON THE MEETING7

PRESENTATION BY DUNCAN CAMPBELL, ILO.....12

PRESENTATION BY RAYMOND TORRES, OECD.....22

ANNEX -- LIST OF PARTICIPANTS30

FOREWORD

Under the OECD Labour/Management Programme for 2001, a meeting of management and trade union experts on "Firms, Workers and the Changing Workplace: Considerations for the Old and the New Economy" was held in Paris on 23rd February 2001. The meeting was prepared in collaboration with the Business and Industry Advisory Committee to the OECD (BIAC) and the Trade Union Advisory Committee to the OECD (TUAC).

Below you will find the Agenda for this meeting, along with the overall report of the discussions of the meeting of experts prepared by Mr. Robert Taylor, designated as General Rapporteur for this activity.

**THE OPINIONS EXPRESSED AND ARGUMENTS EMPLOYED IN THIS REPORT
ARE THE RESPONSIBILITY OF THE AUTHOR
AND DO NOT NECESSARILY REPRESENT THOSE OF THE OECD**

AGENDA

1. Introductory remarks

2. The New Economy: opportunities and challenges

- The New Economy sometimes refers to the advent of an era of higher non-inflationary growth, spurred by the adoption of ICT and globalisation. What exactly do we mean by the New Economy and what are its expected future manifestations? Does the New Economy affect business practices overall or mainly specific sectors?
- Do globalisation and the introduction of ICT go hand-in-hand with specific changes in work organisation, e.g. in the direction of flatter management structures, greater emphasis on team work and outsourcing and new forms of remuneration? In view of assertions that the traditional distinction between time at work and time off work is being blurred, what is the impact of new technology of working time patterns?
- There is some discussion of the impact of ICT on the ability of individuals to create networks, thereby enhancing social capital. On the other hand, others assert that technological change is associated with more individualistic attitudes and lower social capital. What is the relationship between the New Economy and social capital and what is the role of social partners in this area?

3. Labour relations in the New Economy context: evolution or profound change?

- Some observers argue that the distinction between "employees" and "employers" is being blurred as a result of the increasing importance of knowledge, innovation in work organisation and greater use of performance-based forms of remuneration such as stock options. This view is based on the observation that new workplace practices often entail new forms of labour-management co-operation. How are unions and employers' organisations adapting their structures and strategies to the changing economic environment?
- What is the impact of the New Economy on the framework of industrial relations (collective bargaining, individual negotiations, etc.)? What is the impact of the trend towards "individualisation" of work? Is there a need for adapting the legal framework of industrial relations' systems?

4. Policy requirements: how can the benefits of the New Economy be maximised while reducing social costs?

- The role of human capital has probably increased in the New Economy. What can governments do to improve life-long learning for all and how can firms and trade unions contribute to this goal? More fundamentally, do new technologies pave the way for a high-trust, high-performance workplace and how should framework conditions change to seize these opportunities?

- Globalisation and the rapid diffusion of ICT have considerably boosted business opportunities, while also exerting pressure for change in the world of work. In what ways can and should employment regulations and social protection systems be adapted?
- Some perceive the New Economy positively, while others continue to feel insecure about their employment and income prospects – this is notably the case of the unskilled. How can the perception of job and income instability be addressed? More generally, is there a risk of growing digital and knowledge divides, and how can they be bridged?

5. Summary of the results of the meeting by the rapporteur

6. Concluding remarks

FINAL REPORT ON THE MEETING

by Mr. Robert Taylor
Employment Editor
Financial Times
(United Kingdom)

Globalisation and the rapid growth in the use of information and communications technology in the workplace cannot together guarantee continuing economic growth, increased productivity and prosperity in the world's industrialised nations. The success of the so-called "new" economy will depend on how companies and workers adapt themselves to the pressures imposed by constant change. This was the important central argument raised in the one-day conference in Paris that brought together a diverse range of informed participants from employer associations, trade unions and research organisations.

The focus for the discussion was provided by a background paper presented by Raymond Torres (OECD's Education, Employment, Labour and Social Affairs Directorate). Its main message claimed that "work needs to be reorganised to use information and communication technology effectively." As the paper argued: "Organisational change, understood as the implementation of new work practices such as teamwork, flatter management structures and job rotation, tends to be associated with higher productivity growth. Interestingly productivity gains of firms that combine new technology with organisational change are considerable, whereas there does not appear to be much economic benefit in implementing new technology alone."

The presentation signalled a clear shift of emphasis in the thinking about the implications of the growth of the "new" economy that is now going on inside the OECD's secretariat. This recognises that the impact of technological innovation is considerable not just on the intensification of competition and open trade but on the development of labour markets. The policy implication means that national governments will have to develop comprehensive public strategies that it will make easier to carry through organisational reforms in the workplace and beyond that can guarantee growth in the use of information and communication technologies but minimise the costs of corporate change and social disruption.

The OECD paper showed that while such modernisation is taking place across most western industrialised countries, it is often uneven in its incidence. What it sought to do was sketch out an integrated approach that needs to be implemented more consistently.

This involves the encouragement of a number of measures designed to enhance the quality of labour markets. It means an active policy to encourage greater mobility of workers which is both geographical and occupational and will also provide them with the opportunities to develop a wide range of skills in the use of new technology that can help to narrow the "digital divide" which threatens to produce greater social inequality between those who have the skills needed and those who do not.

Such a strategy will require a much higher priority being given in financial support and a focus on raising the quality of human capital available through enhanced education and training programmes. The OECD presentation argued that both governments and companies have so far – despite their rhetoric – tended to under-invest in this key area. It was argued that this disparity between promise and action may be aggravated by the tendency for labour turnover to increase in line with the pace of workplace change, thus discouraging worker loyalty and commitment and as a result the provision of training.

The OECD presentation called for the active promotion of more flexible management-labour accepted practices that can stimulate more workplaces to adapt to the realities of the “new” economy. It was suggested that “institutions that allow a closer contact between management and employees (such as works councils) can help build a high-skill, high-trust enterprise climate” while “collective workplace agreements raise the probability of firms adopting team-working and new work practices.”

The OECD presentation revealed that the proportion of companies which have introduced flexible working practices rose significantly during the 1990s, especially in Australia, France, the United Kingdom and the United States. While self-managing workteams and mini-business units were particularly popular in the United States, autonomous production teams grew more significantly in France. It also argued that quality management techniques and teamwork practices grew in northern Europe.

But the OECD presentation also made the important point that such changes are helping to transform the way in which work is being done. “Employees are becoming involved in managerial tasks, including the evaluation and supervision of their peers, the training of new recruits, the organisation of input supplies, the forming of customer relations and the choice of financial and accounting procedures”, it argued. “What matters is not only the competence in a particular activity of production, organisation, development and marketing but rather general knowledge, the potential to acquire multiple skills and the ability to learn how the experience gained from one skill enhances another skill, which facilitates work rotation and soft skills.”

In presenting the report, Mr. Torres emphasised the policy implications for making workplaces more effective in their application of the new information and communication technologies. He stressed in particular that it was important to ensure workers became better-equipped in so-called “soft” skills such as literacy and numeracy, with an added ability to interact successfully with other workers rather than merely acquire technical paper qualifications. He also argued that labour market regulations should not obstruct workplace adjustments to change but assist in making it easier for companies and workers to accommodate necessary innovation. The need for more flexible use of working hours and the greater portability of pensions for workers as they move from job to job was stressed.

Inevitably there was a wide variety of opinions expressed at the meeting on the nature of the “new” economy and its consequences for the development of workplace organisation. John Martin (OECD’s Education, Employment, Labour and Social Affairs Directorate) was keen to emphasise in his introductory remarks that perhaps there was a genuine danger of exaggerating the newness of contemporary workplace practices. Were we really experiencing a “new economic paradigm”? he questioned. Or were we merely experiencing a “passing fad”? Was there simply too much managerial hype? Were new forms of working such as teleworking, not just a modern version of older forms such as domestic outwork?

By raising such fundamental questions Mr. Martin introduced an initial and sceptical note of caution into the discussion about the true importance of the issues under scrutiny. But the OECD’s own presentation suggested that even if there is a recognisable tendency to hyperbole in contemporary analysis of the “new” economy it would be quite wrong to deny important changes are taking place in the industrialised economies. There may be more continuity and evolution from past practices than enthusiasts might be prepared to admit but this should not lead to an under-estimation of the significance of current innovation in the future of work. Much of the day’s discussion revolved around that underlying and fundamental issue. If the eventual outcome was not clear-cut and more blurred, muddled and indecisive than some may have wished, this was all to the good. By avoiding simplistic scenarios and glib arguments, the meeting revealed a healthy degree of hesitancy and uncertainty.

The first contributions from the representatives of employers and trade unions in the OECD suggested capital and labour were less polarised over the issues raised than might have been thought.

Filip Hamro-Drotz (Confederation of Finnish Industry and Employers) recognised there was an acceleration taking place in the application of technology innovation in companies and this was having a significant impact as much on the old as on the new. He argued the creation of more open world markets, greater competition and the freer flow of goods, services, capital and knowledge were all helping to accelerate workplace change. But he also acknowledged that “human capital is a key contributor in innovation and economic development”.

Mr. Hamro-Drotz highlighted a number of changes taking place in work organisation and business practice that are reshaping corporate strategies. He pointed to the creation of dual income families which were becoming the norm and leading to more flexible working arrangements through greater use of part-time work, temporary employment, homeworking, job sharing and telecommuting. He also emphasised the greater integration of employees into the global activities of companies. But Mr. Hamro-Drotz also argued trade unions were not a necessary force in the workplace to ensure success in the implementation of the new technologies. “Many new economy companies are union-free as employees find greater benefit in individually negotiating contracts with their employers to maximise their personal benefits,” the employers’ paper he presented went on to argue. It suggested “sound research” existed that conflicted with the OECD’s evidence that suggested “new methods are more likely to be initiated if an employee representative system and collective agreement are in place.”

The main emphasis of the employers, however, was on the need for a marked improvement in lifelong learning for workers. Their paper asserted that “educational institutions are behind in their attempt to keep pace with the change in business needs”. The solid base of education should be supported through a dialogue between business, labour and governments to guarantee that educational systems take into account the realities and needs of the new economy workplace.

It was suggested that it was employees and not companies that should take the initiative in developing the transferable skills needed that were neither job nor firm specific. But the employer’s report also argued a diversity of training methods and delivery systems were required and there was “no one-size-fits-all form of training or method of investment in training”.

The employers asserted the “new” economy has turned the “employer/employee employment relationship up side down”. “Employees no longer stay with a single company for their entire career. People entering the workforce today will work for ten different organisations and change careers at least twice.” It was suggested there must be a move from the “old model that relied on individual employers to provide employment and income security” to “cross firm, community-based institutions” that promote mobility, lifelong learning and other services.

For his part David Coats (Trades Union Congress) said he did not believe there had been a paradigm shift to a “new” economy. The big jobs expansion in the western world had taken place predominantly in the private services sector and not in information technology-based areas. Most employment growth had occurred in large and not small or medium-sized firms. There had been an actual decline in self-employment in the UK for example during the 1990s and with not much significant change in the length of job tenure. Insecurity among workers stemmed not so much from fear of unemployment but was due primarily to the faster rate of change taking place internally in companies. The growth of teleworking was mainly due to managers and teachers taking work home with them and not being paid for doing so. The intensification of work was not due to the impact of new technology. Nor was the undoubted extension of job insecurity to cover white-collar as well as manual workers. He suggested that “Fordist”

methods of production still existed. Mr. Coats went on to point out that only 2 per cent of UK workplaces had experienced functional flexibility during the 1990s. He believed we were seeing more continuity than change in the workplace.

However, Mr. Coats also emphasised the crucial role that trade unions should play through the development of workplace partnerships. He argued exhortation for the creation of more effective negotiated arrangements was not enough. Regulation -- albeit of a minimum kind -- was necessary to encourage workplace change by agreement not imposition. Trade unions remain vital institutions for the development of higher quality social capital, a crucial element in the establishment of high performance workplaces.

Duncan Campbell (International Labour Organisation) gave a fascinating presentation on the information economy. He spoke of the growth of what he called a "shared capitalism" with increasing forms of employee participation stemming from the devolution of authority in workplaces, the emergence of performance-related pay systems and the growth of flatter organisations with less emphasis on management-controlled hierarchies. The ILO's latest findings in its employment report have found companies perform the best where they have negotiated labour-management agreements for the achievement of workplace change. Mr. Campbell highlighted other trends, notably a close association between changes in the length of job tenure and improvements in labour productivity. The higher the level of employment mobility the faster the rate of productivity growth. But he admitted the causal link between the two phenomenon remains "unclear".

Neil Anderson (Union Network International) acknowledged the standard form of employment where workers "have a job and a boss and a fixed place of work" is declining. He emphasised the emergence of greater numbers of "new" workers, more diverse, more separated by income inequalities, more different in their "degrees of skill, self-esteem and level of exploitation." This meant such workers required "new types of collectivism" to deal with the problems and issues they find difficult to resolve as individuals. Mr. Anderson argued this did "not necessarily" mean the continuation of "collective contracts in the traditional sense where pay and conditions are specified." Instead, a "new type" of trade union involvement is emerging. He pointed to two examples of this from the US initiated by the Communication Workers union. This has established "alliances" with workers who do not have traditional employment relationships subsidiaries at Washtec and IBM. They are provided with access to a wage database, dispute resolution facilities either with advice or legal support, as well as information on how to secure health coverage and pension rights as well as training to upgrade their skills. It has also meant the provision of recruitment facilities. In addition, the union has sought new collective agreements to provide those workers with intellectual property rights.

Bernd Heinzemann (Confederation of German Employers' Associations) emphasised that most companies wanted to "keep workers with them as long as possible" and were not driven simply by a "hire and fire" mentality. But he added there was a danger of too much regulation not too little in the "new" economy, pointing to a high level of job satisfaction among workers employed in start-up companies. He suggested it was "not a problem" that many new firms are not members of traditional employer associations because they prefer the greater degree of flexibility available outside formalised structures, especially in company start-ups. But he also called for "regular" and "continuous" dialogue within and outside companies on developing a "shared understanding of strategy" with trade unions and workers although suggesting we should "stop talking about collective agreements." Mr. Heinzemann added that in many new firms, workers are more intensively involved in social dialogues and this should provide a good example of what can be achieved in many existing companies.

Odile Sallard (OECD's Directorate for Education, Employment, Labour and Social Affairs) raised a number of questions on what governments should do or not do in response to the "new" economy. In the 1990s cutting costs had been given a high priority. Was more of a balance now required through policies to stabilise work and support the new growth environment? Should more be done to help the socially excluded, especially the young, back into work through an encouragement of more labour migration and training through individual learning accounts? She also wondered whether more should be done to lessen the proportion of state spending on "passive" welfare benefits for the unemployed and greater attention be given to active supply side measures.

John Evans (TUAC) argued that the accelerating pace of change and mounting work pressure was causing widespread anxiety and insecurity among workers. This was not a good foundation for a high performance economy, he argued. "It is high time we go beyond the simplistic notion of labour market flexibility where workers are expected to give up social protection, decent wages or job security. We must restore the objective of achieving full employment by ensuring economic policies that translate potential productivity gains into real social and economic benefits. We were also seeing a shift from external to internal flexibility in companies. A common approach was needed in the development of skills. The role of unions was changing from being advocates of regulation to direct service provider". He pointed out the OECD's own research showed that the presence of trade unions tended to raise the amount of training being carried out by companies. Mr. Evans argued: "In today's individualistic society the importance of unions, of workers acting collectively, may well increase globally, confounding those who predicted unions would wane. Working in a dot.com warehouse is not devoid of old economy realities. New uncertainties are driving workers together, even across national frontiers".

The invaluable exchange of opinions and thoughts at the meeting suggests that this should be the beginning and not the end of a constructive dialogue on the interaction between the new technologies and workplace change that brings together employers, union leaders and academics. In time this could produce a greater recognition of common interests and help to remove the barriers to the creation of the "new" economy without undermining existing social regulations designed to provide some measure of security for workers in a time of rapid transformation.

A particularly fruitful way forward would be for the OECD to carry out a number of case studies of companies in a range of sectors that have gone through workplace change. This would provide an added depth to our understanding and knowledge of what is happening in the world of work. It would also bring particular companies to the conference table to describe and evaluate what they have done. The time has come to move from the macro to the micro level of analysis. Moreover, a case study approach would hopefully help to spread best practice and move the debate from the hype to the reality.

It might also be useful to include chapters on the impact of information and communication technologies on workplaces in some of the OECD annual country surveys. The jobs study agenda has become an integral part of the OECD's work. It would make sense to also include the issues raised at the February conference in the wider concerns of the organisation. The positive and lasting conclusion of the day's discussions was to suggest that the organisation of work should not be seen as of marginal importance or merely an add-on to our wider understanding of the new economy but should lie at its core.

PRESENTATION
BY DUNCAN CAMPBELL, ILO

The Labour – Management Relationship in
the Information Economy: Findings of World
Employment Report 2001

Duncan Campbell
ILO



Emerging institutions of « shared
capitalism » as evidenced by ...

- Increasing forms of employee participation and devolution of authority
- Increasing types and use of performance-dependent income: 20% US workers own shares in their companies
- Flatter hierarchies consistent with greater need for speed and greater access to information

Reasons:

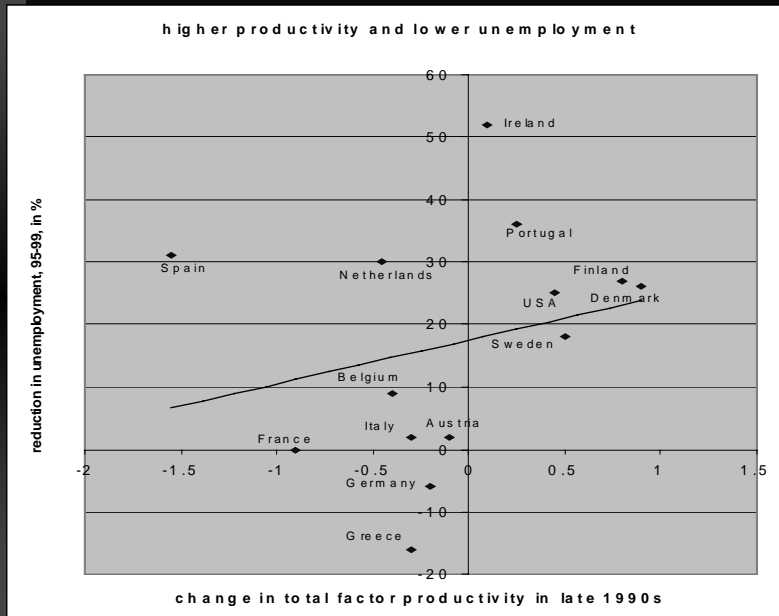
- « Time-to-market » pressures from shorter product life cycles
- Greater information symmetry lessens need for and value of levels of information intermediation
- Greater bottom-up decisions increase innovation and speed: importance of tacit knowledge

Employee participation:

- Appears both (1) to be most diffused and (2) to work best in unionized settings
- In non-union settings, lowers workers' propensity to support unionization

Outcomes:

- Better performance measured variously
- Correlation between work organization changes and multi-factor productivity growth
- Correlation between work organization changes and diffusion of ICT (Stanford)

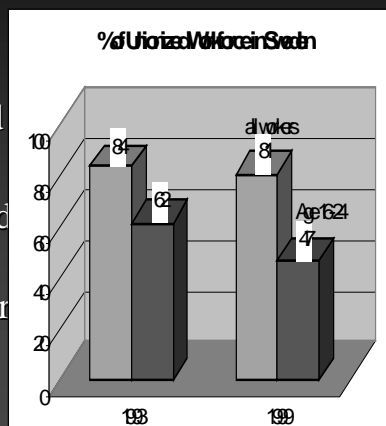


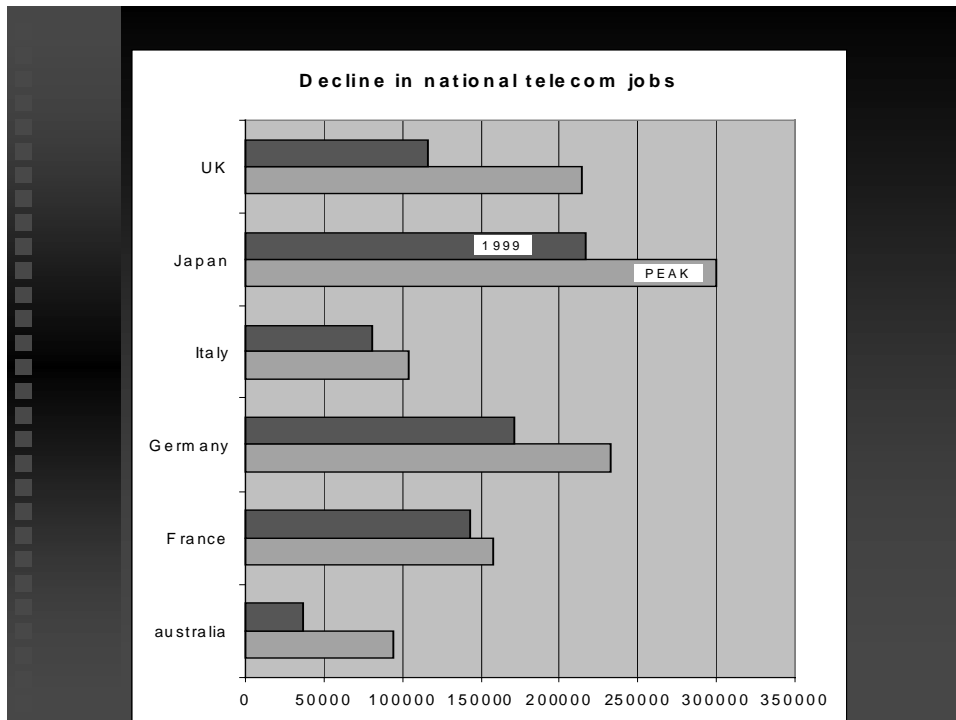
Stable v. Mobile Workforce: Different Needs ...

- Growing margin of a diverse workforce not reliant on tenure with any one firm – most pronounced in local high tech labour markets – e-lancers, temps
- stable « employee tenure » possibly related to time-to-market pressures and is still consistent with « internalized instability »

Emerging period of institutional change

- Low penetration of unionization in emerging sectors and labour markets
- Gap in servicing need of a more diversified segment of the labour market





Three trends:

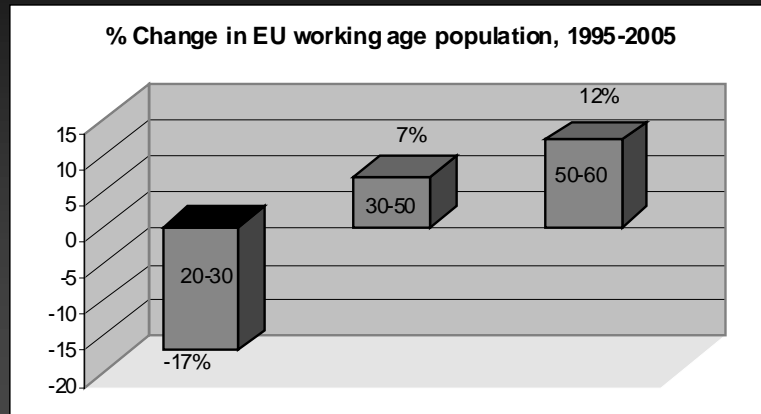
- Continued emphasis on collective worker protection ...for most ?
- Experimentation with greater individualization of employment relations in a collective framework
- Experimentation with delivery of individually tailored services to members

Rising Disparity in the Effects of ICT on the Quality of Working Conditions

Improvements in the Quality of Worklife

- Independence of work from location in intangible product markets = better balance in work & family
- Decline in share of physically arduous work, more homogeneously distributed between the sexes
- Greater autonomy, responsibility and surveys find link between participation and job satisfaction

But Ageing Workforce Can be a Threat to Employability with risk borne by Worker



And ...

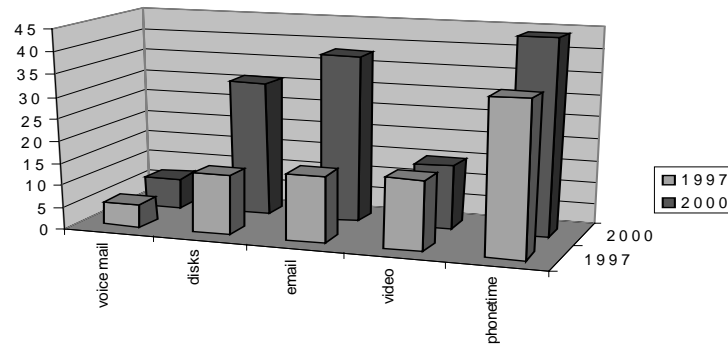
- Blurring of distinction between work and employment – e.g. online contracting
- between independent and dependent employment – e.g. e-lancing
- Blurring of distinction between market and non-market hours for knowledge workers
- Irony of greater information: isolation and gender-based differences

Declining Nasdaq makes blurred distinction between worker and employer back in focus

Evidence of increased stress and related issues of mental health

Evidence of invasions of privacy and performance-screening

US Employer Monitoring of Employees



Experimentation with individualization and partnership

- In collective framework: Dutch « multiple choice model » of working conditions, or Danish agreements on working time
- Cooperation between Communication Workers of America and (non-union) Cisco Systems on retraining

Emerging examples

- Unions as training agencies, e.g. UNISON
- Provision of individualized services by unions (RC Nursing 24-hour call centre, WashTech), rather than collective bargaining
- Organizing e-lancers (UNI) and self-employed (FNV Zelfstandige Bondgenoten, Patrons Indépendants)

Needs:

- ◆ Both the forms of participation and collection protection will become more varied, but will continue to be needed
- ◆ Labour market intermediation will be tailored individually, and competition in service provision will increase

PRESENTATION
BY RAYMOND TORRES, OECD

KNOWLEDGE, WORK ORGANISATION AND GROWTH

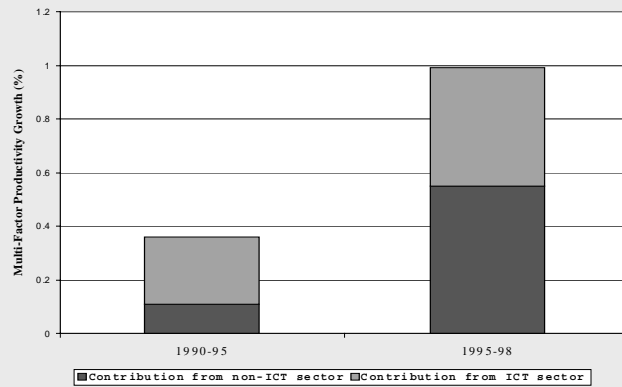


A new growth potential

- **Globalisation**
- **New technology**
- **Policy reform and other factors**

**BUT gains are not automatic:
governments and social partners
have a role.**

ICT-use may be more important than ICT production... (US)

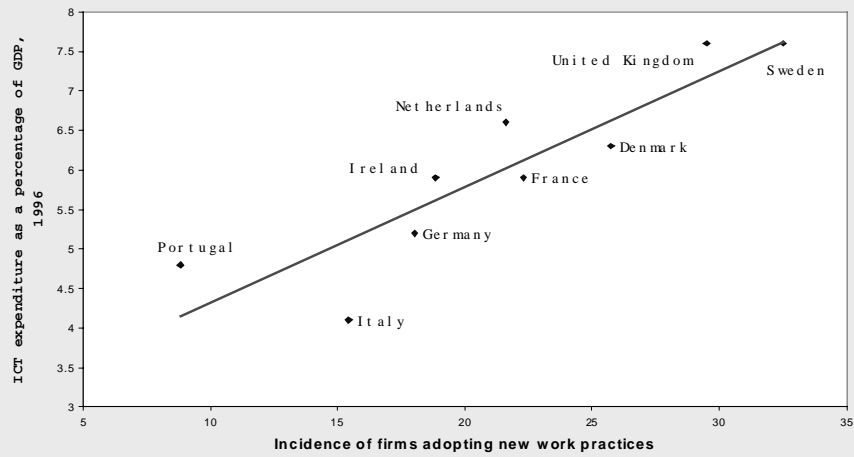


Source: Jorgenson and Stiroh (2000)

What are the findings?

- 1) Work organisation is associated with ICT use

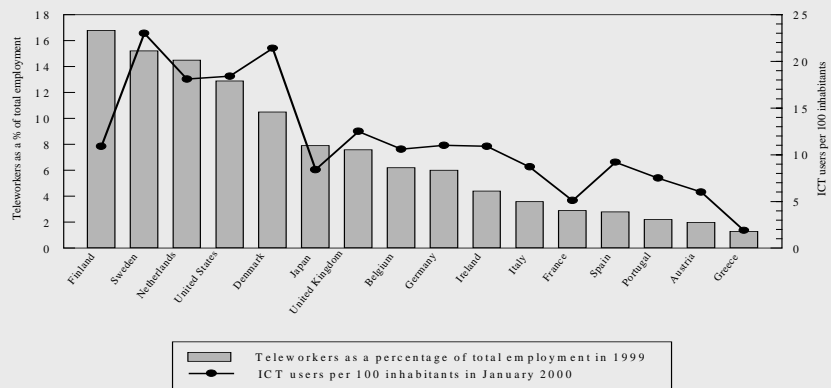
Changes in work organisation go hand-in-hand with ICT use



Source: OECD

ICT facilitates Telework

Chart 2.
Teleworkers and ICT penetration in some OECD countries, 1999-2000

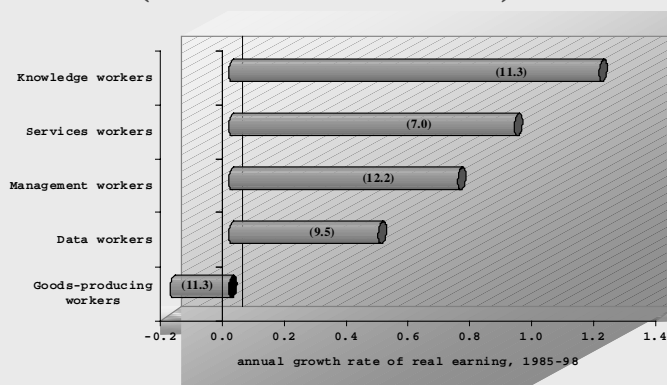


Sources: Secretariat estimates, for ICT users per 100 inhabitants; and *EcaTT Final Report*, "Benchmarking progress on new ways of working and new forms of business across Europe", August 2000, for teleworkers.

What are the findings?

2) "Knowledge-intensive" employment is key to growth

Returns to the "knowledge-intensive" employment are rapidly increasing (Case of the United States)

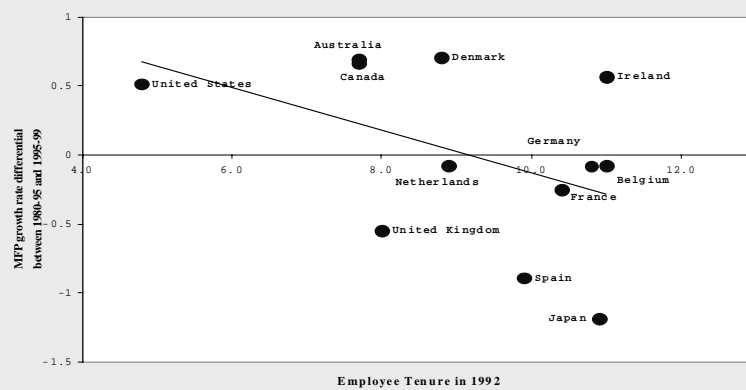


Note: Figures in parentheses refer to real hourly earnings in 1985 in US dollars

What are the findings?

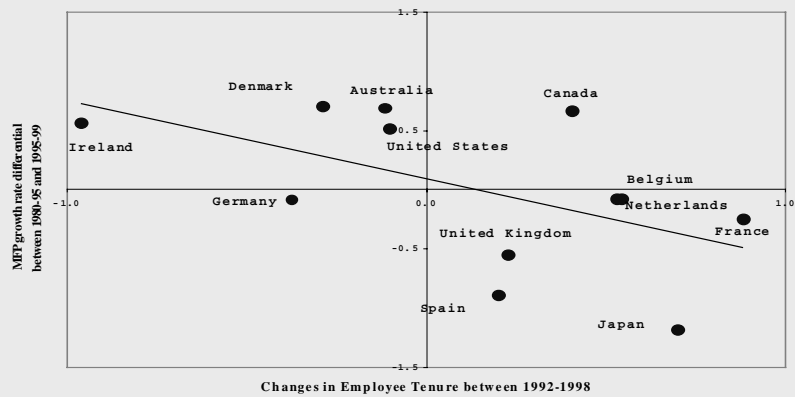
3) Employment mobility is associated with faster productivity growth (but causality is unclear)

Low tenure countries tend to enjoy faster productivity growth



Source: OECD

... and there is an association between changes in tenure and changes in productivity growth



Source: OECD

Policy issues

- **Enhancing firm training (and not just education)**
 - **certification of training**
 - **emphasis on disadvantaged groups and/or on the individual**

Policy issues

- **Labour-management institutions**
 - **there is evidence that these institutions foster firm performance**
 - **but challenges to labour relations are also posed (e.g. job segmentation; sectoral bargaining)**

Policy issues

- **Activate labour market programmes**
 - **high unemployment and labour shortages coexist: this is a problem**

Policy issues

- **Ensure that employment regulations do not inhibit adjustment**
 - **flexible working hours**
 - **portability of pensions**

Policy issues

- **Looking at migration in a new light**
 - **migration can help reduce shortages**
 - **but risk of brain drain and of less emphasis vis-à-vis domestic human capital**

ANNEX -- LIST OF PARTICIPANTS

MANAGEMENT EXPERTS

Mr. Bernd HEINZEMANN	Vice Chairman of the BIAC Committee on Employment, Labour and Social Affairs Deputy Director European and International Affairs Confederation of German Employers' Associations (BDA) Email: b.heinzemann@bda-online.de	GERMANY
Dr. Wolfgang TRITREMMEL	Head of the Industrial Affairs Department Federation of Austrian Industry Email: w.tritremmel@iv-net.at	AUSTRIA
Mr. Jan VAN HOLM	Director, Fédération des Entreprises de Belgique (VBO-FEB) Email: jvh@vbo-feb.be	BELGIUM
Mrs. Helena BRUS	Associate Director, Economic and Health Care Policy Merck & Co., Inc. Email: helena_brus@merck.com	UNITED STATES
Mr. Gary FIELDS	Professor, Department of Labor Economics Chair, Department of International and Comparative Labour School of Industrial and Labor Relations Cornell University Email: gsf2@cornell.edu	UNITED STATES
Mr. Filip HAMRO-DROTZ	Chairman of the BIAC Committee on Employment, Labour and Social Affairs Senior Advisor, International Affairs Confederation of Finnish Industry and Employers Email: filip.hamro-drotz@tt.fi	FINLAND
Mr. Patrick BRUNIER	Coordinateur Régional Mouvement des Entreprises de France (MEDEF) Email: brunier@medef-npc.org	FRANCE
Mr. Alain DUMONT	Directeur de l'Education et de la Formation Mouvement des Entreprises de France (MEDEF) Email: adumont@medef.fr	FRANCE

Mr. Jean-Jacques OECHSLIN	Président d'Honneur, OIE Email: jean-jacques.oechslin@wanadoo.fr	FRANCE
Mr. Claudio GENTILI	Dirigeant du "Secteur Ecole" Confederazione Generale dell'Industria Italiana Email: C.Gentili@confindustria.it	ITALY
Mr. Sergio Maria MACCIO	Manager for Industrial Relations Confederazione Generale dell'Industria Italiana E-mail: s.maccio@confindustria.it	ITALY
Mr. Hiroyuki MATSUI	Manager for Conditions of Work Labor Legislation Division Japan Federation of Employers' Associations (NIKKEIREN) Email: matsuih@nikkeiren.or.jp	JAPAN
Mr. Ton M. HUNTJENS	Director, International Social Affairs Confederation of Netherlands Industry and Employers (VNO-NCW) Email: AMHuntjens@vno-ncw.nl	NETHERLANDS
Mr. Chiel RENIQUE	Chairman of the BIAC Expert Group on Education Policy Senior Adviser Confederation of Netherlands Industry and Employers (VNO-NCW) Email: ajegrenique@vno-ncw.nl	NETHERLANDS
Ms. Karin EKENGER	Director Swedish Employers' Confederation Email: karin.ekenger@saf.se	SWEDEN
Mr. Aysen ISAUGLU	Assistant Specialist, Social Policy Research Department and Rapporteur of the "Employment, Labour and Wage Policies" Working Group Email: aisaoglu@tusiad.org	TURKEY

BUSINESS AND INDUSTRY ADVISORY COMMITTEE TO THE OECD (BIAC)

Mrs. Hanni ROSENBAUM Policy Manager
E-mail: rosenbaum@biac.org

TRADE UNION EXPERTS

Mr. Georg ERBER German Institute of Economic Research (DIW)
E-mail: gerber@diw.de GERMANY

Mr. Winfried HEIDEMANN	Referat Qualifikation Hans-Böckler Stiftung E-mail: winfried-heidemann@boeckler.de	GERMANY
Mr. Klaus WEST	German Confederation of Trade Unions (DGB) E-mail: klaus.west@okay.net	GERMANY
Mr. Gilbert DE SWERT	Chef du Service d'Etudes Confédération des Syndicats Chrétiens de Belgique (CSC) E-mail: gdeswert@acv-csc.be	BELGIUM
Mr. Bob BALDWIN	Director, Social & Economic Department Canadian Labour Congress (CLC) E-mail: bbaldwin@clc-ctc.ca	CANADA
Ms. Evy IVARSSON NIELSEN	Advisor, Danish Confederation of Professional Associations (AC) E-mail: ac@ac.dk	DENMARK
Mr. Jens-Christian STOUGAARD	Economist, The Danish Confederation of Trade Unions (LO-DK) E-mail: jcs@lo.dk	DENMARK
Mr. Benoît ROBIN	Assistant - Secteur économique Force Ouvrière (Cgt-FO) E-mail: rvalladon@force-ouvriere.fr	FRANCE
Ms. Delphine BORGEL	Secteur - Négotiations Collectives Force Ouvrière (Cgt-FO) E-mail: mbiaggi@force-ouvriere.fr	FRANCE
Mr. Angelo GENNARI	Director Studies & Research Department Confédération Italienne des Syndicats des Travailleurs (CISL) E-mail: gennari.studi@cisl.it	ITALY
Mr. Andrea PALLADINO	International Department Union Italienne du Travail (UIL) E-mail: palladino@uil.it	ITALY
Mr. Hideaki NARIKAWA	Director, Department of Economic & Social Policy, Japanese Trade Union Confederation (RENGO) E-mail: hazumi@sv.rengo-net.or.jp	JAPAN

Ms. Cecilie FOSS	Economist Department of Economic & Social Affairs Norwegian Confederation of Trade Unions (LO-N) E-mail: cfooss.lo@loit.no	NORWAY
Ms. Ana Paula BERNARDO	Economist, Union Générale des Travailleurs du Portugal (UGT-P) E-mail: ugt@mail.telepac.pt	PORTUGAL
Mr. Vladimir MATOUSEK	Senior Advisor, Macroeconomic Department Czech-Moravian Confederation of Trade Unions (CMKOS) E-mail: matousek.vladimir@cmkos.cz	CZECH REPUBLIC
Mr. David COATS	Director, Economic & Social Policy Department Trades Union Congress (TUC) E-mail: dcoats@tuc.org.uk	UNITED KINGDOM
Mr. Roland SPANT	Chief Economist The Swedish Confederation of Professional Employees (TCO) E-mail: roland.spant@tco.se	SWEDEN
Mr. David FODEN	Research Officer European Trade Union Institute (ETUI) E-mail: dfoden@etuc.org	
Mr. Neil ANDERSON	Head of Campaigns & Organising Department Union Network International (UNI) E-mail: neil.anderson@union-network.org	

TRADE UNION ADVISORY COMMITTEE TO THE OECD (TUAC)

Mr. John EVANS	General Secretary E-mail: evans@tuac.org
Mr. Roland SCHNEIDER	Senior Policy Adviser E-mail: schneider@tuac.org

DELEGATES

Mr. Frank HEMPEL	Head of Division Federal Ministry of Labour and Social Affairs (BMA) E-mail: fr.hempel@bma.bund.de	GERMANY
------------------	--	---------

Mr. Klaus-Jochen GÜHLCKE	Counsellor Permanent Delegation to the OECD E-mail: klaus.guehlcke@germany-oecd.org	GERMANY
Mr. Paul COWAN	Counsellor (Employment, Education and Training) Permanent Delegation to the OECD E-mail: paul.cowan@dfat.gov.au	AUSTRALIA
Mr. Helmut HÖPFLINGER	Adviser Federal Ministry of Labour, Health and Social Affairs E-mail: helmut.hoepflinger@bmwa.gv.at	AUSTRIA
Mr. Luc RIFFLET	Conseiller Délégation permanente auprès de l'OCDE E-mail: belocde@wanadoo.fr	BELGIUM
Mr. Richard ROY	Senior Advisor Applied Research Branch Human Resources Development Canada E-mail: richard.roy@spg.org	CANADA
Mr. Frank WELDON	Policy Advisor Human Resources Development Canada E-mail: frank.weldon@spg.org	CANADA
Mr. Ki-Kweon LEE	Director, Labour Relations Policy Division Labour Relations Policy Bureau Ministry of Labour	KOREA
Mr. Mu-Song LIM	First Secretary (Employment, Labour, Health, Welfare and Gender) Permanent Delegation to the OECD E-mail: limusong@hanmail.net	KOREA
Mr. Kaj WESTERGAARD	Directorate General The National Labour Market Authority E-mail: kw@ams.dk	DENMARK
Mme Pilar VICENTE	Directeur de Programmes à la Sous-Direction Générale des Relations du Travail Ministère du Travail et des Affaires sociales E-mail: pvicentes@mtas.es	SPAIN
Mme Cristina PENA SOTO	Conseiller pour le Travail et les Affaires sociales Délégation permanente auprès de l'OCDE E-mail: espdeleg002@olis.oecd.org	SPAIN

Mme Isabel COLACIOS	Délégation permanente auprès de l'OCDE E-mail: espdeleg002@olis.oecd.org	SPAIN
Mr. Rolf MYHRMAN	Deputy Director General Ministry of Social Affairs and Health E-mail: rolf.myhrman@stm.vn.fi	FINLAND
Mme Jacqueline VEYRAT	Chef du bureau emploi et environnement social des entreprises à la DIGITIP	FRANCE
Mr. Andreas VAROTSOS	First Secretary Permanent Delegation to the OECD	GREECE
Mrs. Ágnes JÁNSZKY	First Secretary Permanent Delegation to the OECD	HUNGARY
Mrs. Delia LATTANZI	Cabinet du Ministre du Travail Bureau des Affaires internationales	ITALY
Mr. Kazuhisa TAKAHASHI	Deputy Director International Affairs Division Minister's Secretariat Ministry of Health, Labour and Welfare	JAPAN
Ms. Yuki NARITA	First Secretary, Employment and Labour Permanent Delegation to the OECD E-mail: narita@deljp-ocde.fr	JAPAN
Mr. Keiji TAKEBAYASHI	Second Secretary, Social Affairs Permanent Delegation to the OECD E-mail: takebayashi@deljp-ocde.fr	JAPAN
Mr. Jean ZAHLEN	Conseiller du Gouvernement Ministère du Travail et de l'Emploi E-mail: jean.zahlen@mt.etat.lu	LUXEMBOURG
Mr. Rob van der MEULEN	Senior Policy Advisor International Affairs Directorate Ministry of Social Affairs and Employment	NETHERLANDS
Mrs. Monique van WORTEL	Permanent Delegation to the OECD	NETHERLANDS
Mme Maria Henriqueta ALMEIDA	Sous-Directrice Général Département d'Etudes, Perspectives et Planification (DEPP) Ministère du Travail et de la Solidarité (MTS) E-mail: henriqueta.almeida@deppmts.gov.pt	PORTUGAL

Mr. Stanislav BENES	Expert, Ministry of Labour and Social Affairs E-mail: stanislav.benes@mpsv.cz	CZECH REP.
Mr. Bill WELLS	Head of Economy and Labour Market Division, Department of Education and Employment E-mail: bill.wells@dfee.gov.uk	UNITED KINGDOM
Mr. Robert CLOAREC	Counsellor Permanent Delegation to the OECD	SWEDEN
Mme Nazik ISIK	Planning Expert, State Planning Organisation General Directorate of Social Sectors and Coordination Department of Social Policies E-mail: nisik@dpt.gov.tr	TURKEY
Mr. Lars Erik ANDREASEN	Administrateur principal Commission européenne DG Emploi et Affaires sociales Droit du travail et organisation du travail E-mail: lars-erik.andreasen@cec.eu.int	EC

RAPPORTEUR

Mr. Robert TAYLOR	Employment Editor, <i>Financial Times</i> E-mail: robert.taylor@ft.com	UNITED KINGDOM
-------------------	---	----------------

OTHER EXPERTS

Mr. Duncan CAMPBELL	Senior Economist Employment Strategy Department International Labour Office E-mail: campbell@ilo.org	
Professor Peter NOLAN	Head of the Economic and Social Research Council's Future of Work Programme Leeds University Business School E-mail: p.j.nolan@leeds.ac.uk	

OECD SECRETARIAT

General Secretariat

Mr. Herwig SCHLÖGL	Chairman of the meeting Deputy Secretary-General E-mail: herwig.schlogl@oecd.org	
--------------------	--	--

Directorate for Education, Employment, Labour and Social Affairs

Mr. John MARTIN Director
E-mail: john.martin@oecd.org

Ms. Odile SALLARD Deputy Director
E-mail: odile.sallard@oecd.org

Mr. Raymond TORRES Principal Administrator, Employment Analysis and Policy Division
E-mail: raymond.torres@oecd.org

Mme Elena ARNAL Administrator, Employment Analysis and Policy Division
E-mail: elena.arnal@oecd.org

Mr. Wooseok OK Administrator, Employment Analysis and Policy Division
E-mail: wooseok.ok@oecd.org

Economics Department

Mr. Sanghoon AHN Economist, Resource Allocation Division
E-mail: sanghoon.ahn@oecd.org

Directorate for Science, Technology and Industry

Mr. Mario CERVANTES Administrator, Science and Technology Policy Division
E-mail: mario.cervantes@oecd.org

Ms. Marian MURPHY Administrator, Industry Division
E-mail: marian.murphy@oecd.org

Human Resource Management

Mr. Terje HAGEN Human Resource Adviser

Public Affairs and Communications Directorate

Mr. John WEST Head of the Public Affairs Division
E-mail: john.west@oecd.org

Mr. Will DAVIS Principal Administrator
Public Affairs Division
E-mail: will.davis@oecd.org

Mr. Paul PARADIS Administrator
Public Affairs Division
E-mail: paul.paradis@oecd.org

Ms. Gráinne TIFFONNET-
MOONEY Programme Co-ordinator, Public Affairs Division
E-mail: grainne.tiffonnet@oecd.org

Bridging the Digital Divide

Issues and Policies in OECD Countries

by Patrick Xavier

Unclassified

DSTI/ICCP(2001)9/FINAL



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

13-Jul-2001

English - Or. English

**DIRECTORATE FOR SCIENCE, TECHNOLOGY AND INDUSTRY
COMMITTEE FOR INFORMATION, COMPUTER AND COMMUNICATIONS POLICY**

**DSTI/ICCP(2001)9/FINAL
Unclassified**

BRIDGING THE "DIGITAL DIVIDE": ISSUES AND POLICIES IN OECD COUNTRIES

JT00110878

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English - Or. English

FOREWORD

This paper provides a review of the issues and national policies for the digital divide concentrating mainly on those policies relevant to infrastructure. The ICCP Committee agreed to declassify this paper through a written procedure at its meeting of 22-23 February 2001. The paper was prepared by Professor Patrick Xavier, Swinburne University, Australia.

Copyright OECD, 2001

Applications for permission to reproduce or translate all or part of this material should be made to:

Head of Publications Service, OECD, 2, rue André-Pascal, 75775 Paris Cedex 16, France.

TABLE OF CONTENTS

FOREWORD	2
Main Points	4
Measuring and monitoring developments in the digital divide	4
Reliance on a competitive market	5
Updating and streamlining regulation	5
Monitoring and assessing developments in digital inclusion	6
SECTION 1: INTRODUCTION	8
1.1 Digital Divide issues	8
1.2 Some sceptical views of the need for government action	9
1.3 Objective of the paper	10
SECTION 2: RELIANCE ON MARKET FORCES TO CLOSE THE DIGITAL DIVIDE	11
2.1 Narrowband and broadband access to the Internet	11
2.2 Reliance on market provision	12
2.3 Identifying the nature and extent of the digital divide	14
2.4 Changing market characteristics and Internet access	16
2.5 Constraints to market provision	18
2.6 Role of government/regulation	21
2.7 Monitoring and periodic review	22
SECTION 3. OECD GOVERNMENT INITIATIVES TO EXTEND ACCESS TO INTERNET INFRASTRUCTURE	24
3.1 Upgrading the USO to include Internet Access	24
3.2 Country positions on upgrading of USO to include data capability	25
3.3 The cost of upgrading the USO to include a digital capacity	30
3.4 Funding an upgraded USO	32
SECTION 4. GOVERNMENT INITIATIVES TO EXTEND ACCESS TO HIGHER BANDWIDTH SERVICES	36
4.1 Government initiatives to diffuse broadband access	36
SECTION 5. BEYOND ACCESS TO INTERNET INFRASTRUCTURE	51
5.1 Socio-demographic barriers to the take-up of access facilities	51
5.2 Demand side measures	51
(i) Demand stimulation measures	51
(ii) Demand aggregation measures	52
(iii) Strategies to sustain demand and service delivery	54
NOTES	55

BRIDGING THE “DIGITAL DIVIDE”: ISSUES AND POLICIES IN OECD COUNTRIES

Main Points

In OECD countries there is now rising concern over the so-called “digital divide” — a term that refers to the gap that exists in the opportunities to access advanced information and communication technologies between geographic areas or by individuals at different socio-economic levels.

Most OECD countries that have been concerned about the digital divide have instituted policies and programmes aimed at reducing aspects of the divide, particularly pro-competitive regulatory initiatives aimed at increasing network infrastructure competition. In some countries, the strategies being articulated and employed are as yet by way of very general ‘vision’ statements about the pursuit of universal access. But many OECD countries are further advanced and have recognised the need to install a range of specific strategies and programmes.

This paper focuses on the issues concerning the digital divide within a country and not on the divide between countries. Its specific focus is with the OECD countries. Its concern is with identifying issues and policy initiatives rather than with analysis of quantitative data. Since it is designed to complement other OECD work in this area, the paper has a relatively narrow focus in the sense that it is particularly concerned with infrastructure and the degree to which a competitive market can be depended upon to close the digital divide. The paper is structured as follows. Section 1 introduces the paper and discusses various issues relating to concerns over the so-called “digital divide”. Section 2 discusses efforts being made to identify the nature, extent and evolving characteristics of the digital divide. It also examines the extent to which a competitive market is being relied upon to provide narrowband “dial-up” and broadband Internet access in various geographic areas (urban, regional, rural and remote) and socio-demographic groups (income, education, age, gender, race, disability, etc) in OECD countries. Section 3 examines approaches used in OECD countries to address the argument that the Universal Service Obligations (USO) for telecommunications should be upgraded to include access to the Internet. Section 4 examines approaches used in OECD countries to increase the provision of broadband Internet infrastructure. Section 5 looks beyond access to Internet infrastructure to examine approaches to address socio-demographic barriers to Internet access and usage. Finally, section 6 presents the paper’s conclusions.

Measuring and monitoring developments in the digital divide

The OECD has for several years published comparative indicators relevant to Internet access and performance. In addition, recognising that effective strategic policies to address the digital divide depend on good data, many OECD governments have initiated systematic reviews to ascertain the nature and extent of the digital divide in their countries. Agencies have also been established (*e.g.* Ireland’s Information Society Commission, Australia’s National Office for the Information Economy) to raise awareness about the benefits of the digital economy and to assist and catalyse policy development.

But governments are also displaying awareness that the detection of differences in rates of Internet access does not necessarily justify government action. Thus it has been recognised that the problem of “digital divide” should not be confused with “digital delays” in that with the diffusion of any new technology it is only to be expected that some less commercially attractive groups/areas will receive service later than others. Thus appropriate and effective strategic policies to address the digital divide depend crucially on good data, and many OECD governments have initiated systematic reviews to ascertain the nature and extent of the digital divide in their countries.

Reliance on a competitive market

OECD governments are placing primary reliance on competitive market forces underpinned by vigorous pro-competitive regulation to develop advanced Internet access infrastructures and stimulate Internet diffusion. This approach, based on recent experiences in telecommunication service development, is driven by evidence that competition in the supply of Internet access provides consumers with expanded choice, superior technology and quality of service, and lower prices with greater pricing options that serve to enhance ‘affordability’. Governments consider reliance on the market a sensible approach since, to the extent that market forces serve to diffuse Internet access, the burden of any special programmes and subsidies that may be required is reduced.

New technology and market circumstances are developing, but the impact of this on the provision of services to regional, rural and remote areas and other less commercially attractive consumers is uncertain at this stage. Concerns over such potentially underserved areas have led a number of OECD governments to initiate Committees of Inquiry to identify technical, financial, institutional and other barriers and to advise on the development of strategies to address these barriers.

Updating and streamlining regulation

OECD governments are undertaking reforms to significantly update regulatory rules to the digital age. There is now clear recognition that regulation should be streamlined, competitively and technologically neutral, and be the minimum necessary to achieve specified goals since obsolete, inappropriate or disproportionate regulation can result in costly distortions. But some new regulations have been necessary, notably obligations on market dominant incumbent operators to “unbundle” the local loop.

Upgrading Universal Service Obligations

In some countries, a significant digital divide issue is that “narrowband” connection via the PSTN is unavailable and/or that the prices of data services are significantly higher in rural and remote areas than in urban and provincial centres. This has led to arguments from some quarters that the universal service obligations (USO) should be upgraded to include a minimum data speed capability at an affordable price. Indeed a few OECD countries have done so and a few have included ISDN service within the USO. But most countries have decided not to include Internet access within the USO at this stage. Debate has also begun as to whether universal service obligations should be changed to include access to high speed network resources. However, at present most countries view it as advisable to leave this to market forces rather than impose additional obligations on telecommunications operators.

Costing and funding diffusion of broadband access

Recognising that decisions must be made in the context of programme funding and costing, some OECD governments have begun such estimations. In regard to funding, in the United States, operators are required to bear cost of providing subsidised access to schools and libraries. In Australia, some of the proceeds of Telstra's privatisation are being used. In the European Union, programmes to address the digital divide that are outside the specified USO activities are not prohibited but must not be funded through levies on telecommunications operators.

Beyond access to Internet infrastructure

Apart from access to Internet infrastructure, a range of activities is required to increase awareness of the benefits of Internet usage and to enhance usage facilities and skills across communities, including the disabled. The success of such initiatives depends on an effective partnership between the private, public and community/people sectors. The private sector is seen to be responsible for Internet infrastructure and for driving the activities of the digital economy. Certainly, to ensure a viable workforce for the new economy, to broaden markets for e-business and to capture opportunities being spawned by 'convergence' and the new economy, the private sector has a shared interest with government to address the digital divide.

An increasing number of OECD governments are installing policy frameworks and re-inventing themselves to lead by example through numerous Government-to-Business and Government-to-Consumer online applications and services. The public, private and community sectors are beginning to work together on awareness, education and capability building programmes, so that the digital divide can be bridged in sustainable ways that provide digital opportunity for all.

Monitoring and assessing developments in digital inclusion

In the face of a dynamic, rapidly changing situation, regulators in OECD countries are installing systems to regularly and systematically review developments towards digital inclusion, including the state of effective competition in the provision of Internet access and the extent to which competition is delivering promised benefits.

Upgrading Universal Service Obligations

In some countries, a significant digital divide issue is that "narrowband" connection via the PSTN is unavailable and/or that the prices of data services are significantly higher in rural and remote areas than in urban and provincial centres. This has led to arguments from some quarters that the universal service obligations (USO) should be upgraded to include a minimum data speed capability at an affordable price. Indeed a few OECD countries have done so and a few have specifically included ISDN service within the USO. But most countries have decided not to include Internet access within the USO at this stage. Debate has also begun as to whether universal service obligations should be changed to include access to broadband high-speed network resources. However, at present most countries view it as advisable to leave this to market forces rather than impose additional obligations on telecommunications operators.

Costing and funding diffusion of broadband access

Recognising that decisions must be made in the context of programme costing, some OECD governments have begun such cost estimations. In regard to funding, several approaches have been used. In the United States operators are required to bear cost of providing subsidised access to schools and libraries. In Australia, some of the proceeds of Telstra's privatisation are being used. In the European Union, programmes to address the digital divide that are outside the specified USO activities are not prohibited but must not be funded through levies on telecommunications operators.

Beyond access to Internet infrastructure

The private sector is seen to be responsible for Internet infrastructure and for driving the activities of the digital economy. Certainly, to ensure a viable workforce for the new economy, to broaden markets for e-business and to capture opportunities being spawned by 'convergence' and the new economy, the private sector has a shared interest with government to address the digital divide.

But governments are recognising that apart from access to Internet infrastructure, a range of activities is also required to expand demand by increasing awareness of the benefits of Internet usage and enhancing usage facilities and skills across communities, including the disabled. The success of such initiatives is being boosted by partnerships between the private, public and community/people sectors in education and capability building programmes, so that the digital divide can be bridged in sustainable ways that provide digital opportunity for all.

An increasing number of OECD governments are installing policy frameworks and re-inventing themselves through *eGovernment* programmes aimed at leading by example via government-to-business and government-to-consumer online applications and services.

Monitoring and assessing developments in digital inclusion

In the face of a dynamic, rapidly changing situation, regulators in OECD countries are installing systems to regularly and systematically review developments towards digital inclusion, including the state of effective competition in the provision of Internet access and the extent to which competition is delivering promised benefits.

OECD governments are recognising that improved information is crucial for assessing the nature and scope of any problems and for developing well-targeted and cost-effective strategies for overcoming the digital divide. In particular, there is recognition that the barriers causing the digital divide and impeding digital inclusion need to be regularly measured, monitored, assessed and addressed.

SECTION 1: INTRODUCTION

Only a few years ago, in the face of imminent market liberalisation and competitive entry into telecommunications markets, there was considerable concern over the extent to which Universal Service Obligations (USOs) would be maintained. In many OECD countries, this concern had been subsiding since programmes to address the needs of rural, lower income, aged and disabled subscribers were being successfully initiated either voluntarily by telecommunication operators or through regulatory requirement. However, the concerns about universal access to telecommunications have recently been resurrected, in fact, heightened, especially in developing countries with low penetration rates since “dial-up” access to the Internet continues to depend on access to a telecommunications connection. Indeed, as the importance of developing a knowledge-based information economy is recognised, the stakes are seen to be even higher than before. This has resulted in calls for a reconsideration of the nature and scope of USOs so that they are more adequate and relevant to an era of technological acceleration towards a networked information society. Moreover, as more and more elements of the economy, education, health, government services, information and entertainment are linked to electronic networks, there are increasingly concerns that a “digital divide” will develop. The primary concern is that if certain groups are excluded or left behind by being “unconnected” to Internet facilities, a divisive society of information ‘have’ and ‘have nots’ will result.

The concerns of many OECD countries were typically expressed by the Irish Information Society Commission. Pointing to the findings of a survey of 1 408 adults conducted on its behalf during 2000, the Commission concluded¹:

“The greatest issue to be faced over the coming year is the digital divide. It is widely accepted that information and communications technologies can be used to overcome disadvantage in society, yet the results of this survey indicate that the technology itself could be a stimulus to further disadvantage unless issues such as training, education, and access are tackled as a matter of urgency.”(page 91)

The United Kingdom and Canadian governments’ responses to concerns over the digital divide are typical of OECD governments. In the United Kingdom, the Blair Government recently announced the goal of Internet access for all residents by 2005. In October 2000, the Canadian Government announced its commitment to achieving the goal of high-speed broadband access to all communities by 2004 and established a National Broadband Task Force to develop a strategy and advise on how best to make high-speed broadband Internet services available to businesses and residents in all Canadian communities by that year.²

1.1 Digital Divide issues

What is the “digital divide”?

The phrase “Digital Divide” is now in common use. However, the divide itself can have various dimensions. As used here, the term refers to the gap between individuals, households, businesses and geographic areas at different socio-economic levels with regard both to their opportunities to access

information and communication technologies (ICTs) and to their use of the Internet for a wide variety of activities. The digital divide reflects various differences among and within countries. The ability of individuals and businesses to take advantage of the Internet varies significantly across the OECD area as well as between OECD and non-member countries. In essence the term “digital divide” is frequently used to refer to the gap between people who have the opportunity for regular access to the Internet and people who have irregular or no opportunity to access the Internet.

The broadband divide

Another concern is that the current divide between those with Internet access and those without will be exacerbated with the rollout of high-speed access and broadband services.³ The "broadband divide" may be defined by those with rich, interactive audio and video services in the home and those with low-bandwidth, text-driven services. This divide will become increasingly important as the availability of advanced telecommunications⁴ becomes essential to the development of business, industry, shopping and trade, as well as distance learning, telemedicine, and telecommuting.⁵

Urban/rural divide

Those without an enhanced data capability will be unable to access the benefits expected particularly in relation to education,⁶ health⁷ and government services.⁸ This concern is seen to be greatest in relation to those living and working in rural and remote areas since the lower rates for data access for these consumers places them at a disadvantage in comparison to metropolitan consumers.

The international digital divide

The digital divide also exists between different countries, with the ability of individuals to take advantage of the Internet varying significantly across the OECD area and between OECD and other countries. There are concerns that unless access to and use of the information and communication technology (ICT) is broadened, the majority of people, particularly in the developing countries, will not enjoy the benefits of the new knowledge-based economy. Indeed, the digital divide was a key theme of the Group of 8 (comprising Britain, Canada, France, Germany, Italy, Japan, Russia and the United States) summit in Okinawa.⁹

1.2 Some sceptical views of the need for government action

Digital divide or digital delay?

There are those who argue that the digital divide is no different from other technology divides with different rates of diffusion according to household/individual by income, education, location, age, gender. While some accept that to some extent the digital divide is a “digital delay”, they remain concerned that in the digital age, the need to wait a “few years” for technology to trickle down can be a serious disadvantage. Each year of being connected is seen to be critical to economic and educational advancement and to community participation.

Symptomatic of a broader divide?

Some have pointed out that the digital divide is a symptom of much deeper social, economic and educational gaps that have long existed and the Internet has simply made these issues more pronounced. They ask why special programmes should be put in place for telecommunications and Internet access.

Where, for equity concerns, certain socio-demographic groups are deemed to require assistance, why should special telecommunications subsidies for these groups exist as a separate regime outside means-tested, targeted, general welfare programmes. For instance Sawhney argues:¹⁰ “We live in a world fraught with inequalities. We have long accepted disparities between the “haves” and the “have nots” in all (many?) spheres of life. However, for some reason, we find the idea of a society stratified into the “information rich” and “information poor” particularly disturbing. What is special about information?” (p.161).

Why should urban dwellers subsidise rural dwellers (any more than the converse)?

Some have questioned whether urban dwellers should be obliged to subsidise high-cost rural Internet users, any more than rural residents should be forced to subsidise high urban rents? Because there are benefits of diffused Internet access does not necessarily mean that subsidies to meet those needs are necessary. They argue that as far as possible, the telecommunications needs of rural areas can be met through market forces over the course of time, as with the diffusion of other technologies.

These sceptical views/arguments about the need for government action are notable contributions to the debate since they prevail against exaggerated claims in favour of a judicious, systematic approach to determining the nature and extent of policies and programmes necessary to address the digital divide. The sceptical views have also led to strengthened demands that policies be based on sound data-based analysis of any current and prospective "digital divide".

1.3 Objective of the paper

The digital divide raises a number of questions. Where does it occur and why? What are its causes? How is it to be measured? What are the relevant parameters? What is its extent, that is, how wide is the digital divide(s)? Where is it most critical? What are its effects likely to be in the short term? In the longer term? What needs to be done to alleviate it? And what has been done thus far to alleviate it?

OECD work presented in other documents addresses many of these questions.¹¹

In this paper, the focus is on the policies and programmes that have been developing in OECD countries (thus far) to address digital divide issues, particularly in regard to infrastructure issues. The objective is that OECD (and non-OECD) countries setting out to develop their own policies may gain some insights from the discussion of the examples of policies in other countries taking action to address the digital divide. To contain its length, the paper has not tried to describe all the measures initiated in each OECD country. Rather, the paper concentrates on describing the best example(s) of a particular type of initiative relating to the digital divide.

The paper is concerned with issues concerning the digital divide within a country and not on the divide between countries. Its concern is with identifying policy initiatives rather than with analysis of quantitative data.

SECTION 2: RELIANCE ON MARKET FORCES TO CLOSE THE DIGITAL DIVIDE

This section begins with some background information about narrowband and broadband Internet access, then proceeds to examine how countries are placing the primary reliance on the market, including an examination of the barriers impeding digital inclusion through market forces. Developments resulting in changing market conditions that may facilitate market provision in some regional, rural and remote areas are considered.

2.1 Narrowband and broadband access to the Internet

In order to use the Internet, the user must establish an interconnection with the backbone, one of the high speed data pipes that makes up part of the network of networks that is the Internet. A large business might consider having its own dedicated link to the Internet, which would be fast but expensive. Instead, most users have a connection to an ISP, which then consolidates the upstream traffic to the backbone in a single connection for many users.

Narrowband

At the present time, 'dial-up' is the most readily available method for accessing the Internet. That is, most users dial-up to their ISP using a modem over a standard PSTN connection (public switched telephone network). This uses traditional twin copper wires to carry data in analogue form. Because of the limit on the speed at which data that can be sent via this medium, it is known as "narrowband". The users employ a modem to convert the digital data from their own computer to an analogue signal that can be carried over the telephone network. The data is then reconverted to digital by the ISP's modem.

High-speed broadband access

There are a number of alternatives to the narrowband dial-up connection, technologies collectively known as "broadband" defined by the FCC as "having the capability of supporting, in both the provider-to-consumer (downstream) and the consumer-to-provider (upstream) directions, a speed (in technical terms, "bandwidth") in excess of 200 kilobits per second (kbps) in the last mile."¹² The FCC uses the term "advanced telecommunications capability" to refer to "high speed, switched broadband telecommunications capability that enables users to originate and receive high quality voice, data, graphics, and video telecommunications using any technology". Oftel defines broadband as: "... higher speed access (typically faster than 500kbit/s) to the Internet (using a variety of technologies) that enables advanced services ranging from enhanced Web browsing through to true broadband services such as the ability to watch and interact with video over the Internet. Broadband access is usually provided as a permanent 'always-on' connection, allowing more flexibility and allowing users to access the Internet without having to repeatedly dial in to their service provider."¹³

2.2 Reliance on market provision

OECD governments are relying primarily on market provision to expand Internet access, including access to high-speed broadband networks. Many countries have adopted the position that leading the market is inadvisable since selecting particular services or technologies for preferential support would:

- Interfere with market choices among a widening range of options.
- Risk making wrong choices.
- Add barriers to innovation and competitive entry.

United Kingdom

The UK government's policy stance is typical in pronouncing a long-term strategy for developing Internet access that, while placing primary reliance on market competition,¹⁴ maintains a commitment to act where this is considered necessary to:

- Encourage the development of a fully competitive market.
- Encourage a more rapid introduction of competitive forces in regional, rural and remote markets.
- Address fundamental quality of service issues, particularly in areas that do not yet fully enjoy the benefits of competition.
- Help ensure that the particular needs of disadvantaged groups are addressed.

Rapid rollout of high bandwidth communication networks, providing fast 'always-on' connections directly to business premises, homes and public access points in libraries and similar community institutions is a key objective of the Government. However, UK Government action to achieve this, where considered necessary, would be incentive-based and aim at encouraging operators to meet actual customer needs, rather than through rigid service obligations.¹⁵

United States

In the United States, diffusion of access to advanced services (including to those identified as being particularly vulnerable to not having timely, affordable access to high-speed services) is promoted by encouraging competition, promoting infrastructure investment and addressing the affordability of advanced services. Among efforts in pursuit of this goal, the FCC has recommended that:¹⁶

- Rules should be examined to ensure that competitors can access remote terminals.
- The equipment approval process for wireless and customer premise equipment with advanced telecommunications should be streamlined.
- There be consideration of whether and how more can be done to promote high-speed connections in schools, libraries, and the surrounding communities.
- More spectrum be made available for broadband service – both licensed and unlicensed.
- Consideration be given to the need to establish a national policy to mandate access by multiple Internet service providers to a cable company's platform.

Canada

The Canadian government is also placing primary reliance on market forces while committing, “where market forces fail to provide a minimum level of access, to step in to ensure affordable access to essential services for all Canadians, regardless of their income or geographic location”. In October 2000, the Canadian Government established a Task Force¹⁷ to consider how best to achieve this aim by 2004, including an examination of the technical, institutional and financial barriers which could delay provision of such services by the private sector and the role governments might play in overcoming these barriers.

Sweden

In Sweden, the acquisition of IT infrastructure with a high transfer capacity is “primarily to be achieved through market channels”. Competition, low prices and rapid development are to be fostered by a large number of operators and IT companies being given the opportunity to use networks. Central government, however, accepts overall responsibility for ensuring that IT infrastructure with a high transfer capacity is available nation-wide.¹⁸ A new IT Bill was passed by the Parliament in March 2000 to:

- Create an information society for all through universal accessibility, including remote areas.
- Develop IT confidence (through improving security, online government, regulation).
- Increase IT competence through enhanced education and training.

Norway

“A major *eNorway* initiative was announced on 29 June 2000 by the Ministry of Trade and Industry. As part of the follow up on the initiative, an Action Plan on Broadband Communication was launched on 11 October 2000. The Action Plan relies on two pillars: (i) stimulating competition in the broadband market, and (ii) stimulating public demand for broadband networks and services. The government emphasises primary reliance on market forces for broadband development. However, it is recognised that special measures might be required where market players cannot establish access on a commercial basis (e.g. in remote and underpopulated areas).”¹⁹

The government’s objective with *eNorway* is to create a green knowledge economy and an Information Society for all. To achieve these objectives, three basic pre-requisites must be installed: *access - knowledge - confidence*.

The government will endeavour to:

- Help ensure that everyone has access to the new technology.
- Increase people’s knowledge and understanding so that individuals will be capable of using ICT as a tool according to their own needs and desires.
- Implement actions that increase confidence. ICT must be secure and available for all, regardless of the level of expertise.

The government's policy initiatives are aimed at ensuring that everyone has access to information and communications technology irrespective of where they live, their age, economic circumstances or level of education. ICT will be utilised to facilitate access to the knowledge and experience resources administered

by cultural institutions and mass media. A uniform policy for a sustainable knowledge society will be prepared, based on environmental information, an increased use of telecommunications to replace transport, a green product policy and green public-sector procurements.

The Government supports the voluntary organisation “Senior Net Norway”, which makes important contributions in assuring the participation of the elderly in the information society. A working group has also been established to consider co-ordinated efforts to increase the opportunities for handicapped persons in the knowledge society.

2.3 Identifying the nature and extent of the digital divide

In order to help ensure the development of effective policies to address the divide, several OECD countries have embarked on efforts to identify more precisely the nature and extent of the digital divide and the nature of barriers to digital inclusion.

Canada

As noted above, in October 2000 the Canadian Government, when expressing the goal of making high-speed broadband Internet services available to businesses, and residents in every Canadian community by the year 2004, established a Task Force,²⁰ requiring it to conduct an examination of:

- The needs and characteristics of communities which without government involvement will not likely gain access to private sector-delivered high-speed services by 2004.
- The technical, institutional and financial barriers which could delay provision of such services by the private sector.
- The role governments might play in overcoming these barriers.
- The carriers and other organisations that may be receptive to deploying these services in such communities and what the government would need to do to get them to do so.
- The arrangements that governments might use that are neutral with respect to technologies and maximise the role and risk-taking of the private sector.
- Whether or not pilot projects would be useful to provide both the private sector and governments with insights and experience that would usefully inform an approach to a broader effort and if so what aspects the pilots should test.

United States

In the United States, the NTIA has issued several reports analysing the nature of the digital divide and developments in the divide. The first report, *Falling through the Net: A Survey of the “Have Nots” in Rural and Urban America (July 1995)*, surveyed household telephone, computer, and modem ownership. A later report: *Falling Through the Net II: New Data on the Digital Divide (July 1998)*, presented updated data on household access to telephones, computers, and the Internet. A third report: *Falling Through the Net: Defining the Digital Divide (July 1999)* provided new data on household access to communications technologies, and also provided new information on individual Internet access and usage. The most recent NTIA report *Toward Digital Inclusion (September 2000)*, found that in the United States, the number of individuals owning a computer or who have access to the Internet, whether from home or other places, has increased across geographic regions, income, racial and educational levels.²¹

The FCC also has focused on whether the deployment of Internet infrastructure to provide advanced services to all Americans is “reasonable and timely”. This was assessed by looking at three major factors: *i*) subscribership levels, and how they have changed; *ii*) levels of investment and projections of future growth with advanced telecommunications capability; and *iii*) choices available to consumers today and in the near future, looking at both choices among service providers and among technology options.

The FCC reached the conclusion that advanced telecommunications capability is being deployed in a reasonable and timely manner in the United States with significant investment in the facilities needed to provide advanced telecommunications capability, steadily rising subscription rates for advanced services, and a proliferation of providers in the marketplace.²² However (as with any technology, particularly in its early stages), deployment of advanced telecommunications capability has not been uniform across the nation. While economic forces have driven deployment as markets develop, consumers in certain areas of the country may be particularly vulnerable to not receiving timely access to advanced telecommunications capability, if deployment is left to market forces alone, including:

- Rural Americans, particularly those outside of population centres.
- Inner city consumers.
- Low-income consumers.
- Minority consumers.
- Tribal areas.
- Consumers in United States territories.

An NTIA/RUS study²³ also examined the availability and deployment of advanced telecommunications capabilities, particularly to those who live in rural areas, including:

- Investment in telecommunications facilities with advanced capability in rural areas compared with non-rural areas, including an assessment of the various levels of capability being deployed under different technologies and the bandwidth capabilities of such deployment.
- Availability of telecommunications backbone networks and last mile facilities with advanced capability in rural areas compared with advanced telecommunications backbone networks and last mile facilities in non-rural areas.
- The rate of deployment of advanced telecommunications capability in rural areas compared with the deployment of such capabilities in non-rural areas, identifying specific geographic areas where advanced telecommunications capabilities are being deployed at a significantly lower rate than elsewhere.
- The feasibility of various technological alternatives to provide last mile advanced telecommunications capability in rural areas.
- The capability of various technical enhancements to existing wireline and wireless networks to provide last mile advanced telecommunications capability in rural areas.
- The effectiveness of competition and universal service support mechanisms to promote the deployment of advanced telecommunications capability and the availability of advanced telecommunications services in rural areas.

The study concluded that in the United States, a major problem with regard to broadband access in rural areas lies primarily with last mile connections rather than access to the backbone network. DSL and cable modems are the most widely available last mile broadband technologies. However, their deployment in rural areas lags that in urban areas. New technologies hold promise for broadband access in rural areas but may be years away from widespread availability. While a number of last mile facilities that connect the user to the network (cable modems and digital subscriber lines) are being deployed rapidly, others (such as fibre to the home and terrestrial and satellite wireless) are in the relatively early stages of deployment or are being tested with the expectation of deployment in the next few years.

United Kingdom

In the United Kingdom, Oftel monitors and publishes market data on narrowband Internet services, as well as higher bandwidth services in order to increase transparency in the market and assist policy making.²⁴ Specifically, Oftel's aim is to:

- Monitor and publish data on consumers' access to higher bandwidth including breakdowns by region and social class.
- Monitor and publish United Kingdom prices and how they compare with international competitors.
- Conduct and publish research into consumer preferences and demand.

France

In France, the Bourdier Report,²⁵ issued in March 2000, by the Ministry of Economy, Finance and Industry, outlined France's current broadband environment, provides strategic analysis of current activities, identifies obstacles, and makes specific proposals towards the goal of extending broadband access throughout France (including government support for extending regional networks).

Korea

In Korea, work to identify the nature and extent of the digital divide included issuance of a White Paper on Internet Policy.²⁶

2.4 Changing market characteristics and Internet access

Access to basic telecommunications infrastructure is fundamental to any consideration of the digital divide since a telecommunications connection is required for access to the Internet. The telecommunications market has undergone far-reaching structural change in recent years, with major transformations both on the demand and supply sides of the industry that are expected to further enhance the potential of the market to expand access.²⁷

On the demand side, the growth of demand for new services, most notably for mobile communications and for data transmission, has significantly expanded the industry's revenue base. This has allowed the fixed costs involved in market entry to be spread over a wider base thereby lowering a barrier to entry into the market. Moreover, with demand growing quickly, any excess capacity is more rapidly absorbed, so that financial break-even occurs sooner. Also, with demand becoming more differentiated, the scope for new entrants to differentiate the services they supply from those provided by incumbent suppliers has increased, again facilitating the competitive entry process.

On the supply side, the rapid development of new technologies has lowered the capital costs involved in market entry, not only in the inter-exchange network but also in the customer access network. The range of technologies that can be used to compete has also expanded, including a wide range of wireline and wireless alternatives. Some of these technologies differ significantly in their cost characteristics (such as the proportion of fixed to variable costs) allowing entry to occur on scales that can be more finely adapted to various market segments, including those in regional, rural and remote areas.

In short, recent technological developments are reinforcing new market entry possibilities by:

- Lowering the costs of establishing alternative network infrastructure.
- Offering a wider range of infrastructure possibilities, thereby enabling new entrant competitors to more effectively target particular markets than existing providers (who may be reluctant to scrap or upgrade outmoded infrastructure).
- Providing new entrants with opportunities to make use of wireless technologies that are more easily scaleable thereby allowing the initial costs of entry to be lowered while retaining a capacity to expand with market growth.
- Increasing the options for bypassing existing networks, thereby reducing the dependence of new entrants on access to existing infrastructure.

Despite the emergence of new technologies in dealing with the delivery of broadband services to regional areas, particularly with the “last mile” issues, the potential impact of some of the technologies on the digital divide is still uncertain. Service supply in rural and remote areas continues to present difficulties. The distinctive features of these areas, such as low population and revenue base, and physical isolation from capital cities, are a significant disadvantage for service supply industry based on economies of scale. The cost per customer of supplying terrestrial services in these areas will remain significantly higher than in more densely populated areas. Also, the current major fixed line infrastructure-based telecommunications service providers see these areas as markets of marginal significance, far less commercially attractive than securing a market share in metropolitan and regional centres. Servicing rural and remote areas may be seen in social rather than commercial terms. Indeed, the past reliance on the universal service obligation as a means of ensuring supply to such areas probably reinforces this view.

However, the emerging satellite services may have the potential to address disadvantages of isolation and low population density. Although some of the most appropriate satellite services have been experiencing some start-up problems, satellite systems that can offer cost-effective service to rural and remote users could develop in the medium- to long-term relative to terrestrial wireless solutions.

Prospective new technologies

Changes in technology are happening quickly although the PC remains the most traditional means of using e-mail and accessing the Internet. The speed of technological development and technology-convergence could allow such services to be accessed through other devices such as the TV. The development of digital TV is particularly significant in this respect. Digital TV can be used for the delivery of Internet based services such as email, Web-browsing and on-line shopping which will allow for integration of content and relevant services. Web TV is already available to a limited extent through the cable companies, and more services are being launched onto the market. The ideal scenario would be where every individual has access to electronic services in their own home through a device such as their television set that is familiar and easy to use.

Digital, interactive television services will enable widespread, low-cost solutions to consumers' needs for data communications, since many homes already have a television set and it is a 'user-friendly' medium. The introduction of digital television and the auction of national/regional datacasting licences could enable broadcasting services to be a dominant broadband gateway into the home – particularly in regional areas where other delivery mechanisms are hampered. However, the widespread availability of digital television is still some years away.

Using power lines for high-speed Internet access

There are a number of other access possibilities, among which is access via power lines. The potential use of powerlines to provide high-speed broadband access is of considerable interest to this paper since if the technical difficulties are overcome, powerlines offers the capability of having, if not broadband access, then still widespread access at a significantly higher speed than by traditional methods, and at reasonable prices.

Power companies are recognising the opportunity to provide broadband carriage infrastructure along and through their easements and rights of way. Experiments with the use of power lines for data transmission have been conducted in the United States, Germany, the Netherlands and Sweden. Germany, for instance, actively encourages the development of electricity grid and other new transmission media.

A problem with high-speed data transmission via power lines is evidently that "noise problems" may arise in the form of disturbances to other radio-communication because there is a high emission of signals from power lines. However, new second-generation transmission equipment is expected to reduce the noise problems significantly. If the technical aspects can be clarified, a significant commercial interest in developing high-speed access via power lines can be expected. As power lines extend to nearly all households, including regional, rural and remote ones, such lines may supplement and be an alternative to ADSL and cable TV modems for fixed network access.

Box 2.1 summarises technology options for the supply of Internet access.

2.5 Constraints to market provision

The relevance of developments in technology and new market conditions pertaining to service provision seems greatest in regional centres, and notably in those areas where economic prospects are reasonably good. In sparsely populated areas and in smaller rural centres, especially those suffering from shifts in population to larger towns, demand is less likely to be sufficient to absorb new infrastructure, especially if it is mainly intended to provide specialised or niche services. As a result, while the new market conditions might result in improvements in particular regions, they are unlikely to resolve concerns about nation-wide equity. Rather, they might even accentuate the disparities between regions. This is not to disparage the importance of the new market conditions. Certainly, intermediate volume users – who might have been less well served by traditional operators whose focus is more naturally on the largest customers in regional areas – could well benefit. Nonetheless, the needs of customers in less favoured parts of the country are unlikely to be adequately addressed by the developments in technology and new market conditions.

Box 2.1: Summary of Technology Options

Access Technology	Infrastructure	Range (from local exchange or base station to customer premises)	Indicative Digital Transmission Rates	Comments
ADSL, HDSL, VDSL	Copper wire	5km	Upstream: 256kbit/s Downstream: 6Mbit/s	Requires Copper wire local loop Cost effective for urban areas only
DAMA	Geostationary satellite	No limit	9.6kbit/s, 16kbit/s, 19.2kbit/s	Radio spectrum required
DRCS	Fixed radio	50km Up to 9 repeaters 50km apart	2.4kbit/s	Not suitable for digital transmission Radio spectrum required
HCRCs	Fixed radio	50km Up to 9 repeaters 50km apart	14.4kbit/s, 19.2kbit/s	Radio spectrum required 28.8kbit/s planned(c)
HFC	Optical fibre & co-axial cable	Local (a)	Up to 10Mbit/s	Cost effective for urban areas only
ISDN	Copper wire	Up to 5km from exchange	64kbit/s, 128kbit/s, 2Mbit/s	
LEO	Orbiting Satellite	No limit	9.6kbit/s	Radio spectrum required
Microwave Radio	Fixed radio	Multiples of 40km-no limit	Up to 155Mbit/s	Radio spectrum and line of sight required
MEO	Orbiting satellite	No limit	(b)	Radio spectrum required
Powerline	Electric power lines	Limited to existing electricity network	Up to 1Mbit/s	Commercial viability yet to be proven
PSTA via modem	Copper wire	Up to 5-10km from exchange	From 2.4kbit/s to 56kbit/s depending on condition of the local loop	
VSAT	Geostationary satellite	No limit	Upstream: up to 512kbit/s Downstream: up to 30Mbit/s	PSTN & ISDN can be used for upstream links Radio spectrum required
Wireless Local Loop (WWL) (narrowband)	Fixed Radio	70-90km	Wireless IP 19.2kbit/s	Radio spectrum required
Proprietary CDMA			Asynch. 28.8kbit/s 64kbit/s	
Wireless Local Loop (broadband)	Fixed radio	Limited	Up to 6Mbit/s	Radio spectrum required
LMDS	Fixed radio	Limited	Up to 155Mbit/s	Radio spectrum required

- a) Range determined by number of people using the service rather than the characteristics of the cable.
b) No indicative transmission rates available as no service yet in operation.
c) HCRCs is now capable of 14.4kbit/s and 19.2kbit/s. Over time it is expected to be capable of 28.8kbit/s.
Source: The Allen Consulting Group and Telstra.

Pricing obstacles to access and take-up of access

Affordability is a significant barrier to households going online and accessing data capability benefits. Concerns relate not only to the level of actual prices but to the structure of prices for accessing the Internet. However, it is open to question if the appropriate response to the challenges of the digital divide in regard to price is to mandate particular tariff structures (*e.g.* unmetered access). Some governments are recognising that this would be a retrograde step that would return policy makers to setting telecommunications tariffs, and that instead other policy options are available, including:

- A greater range of tariff options, in particular, pricing favourable to “always-on” capabilities necessary to support electronic commerce.
- Infrastructure competition.
- Unbundling the local loops.

The competitive development of high-speed options for Internet access. Because of the long history of legal monopolies, incumbent operators provide almost all the local telecommunications lines used for Internet access. These operators have shown a marked reluctance to offer a variety of pricing options largely because the absence of competition in the local loop enables dominant operators to disregard or delay meeting the changing needs of business and users.²⁸ Nevertheless direct intervention by governments to impose tariff options that appear to be more favourable runs counter to allowing telecommunication carriers to manage tariff structures.

Rural customers can be significantly disadvantaged compared with urban customers in regard to prices. In some countries usage rates in regional areas are calculated on timed/distance tariffs, rural customers pay more than the local call connection rates enjoyed by urban customers and those who can access points-of-presence. This can apply to customer equipment expenditure as well. To access faster data rates, rural customers may require more expensive customer equipment to overcome quality of service problems inherent in existing infrastructure.

Regional, rural and remote centres are not seen as commercially viable ventures and, as a result, market forces are less likely to operate adequately. There is frequently only a sole provider of telecommunications infrastructure in these regions and government intervention may be required to enable lower connection and data access prices and improved quality/reliability of service. Certainly, quality of service/reliability can be a significant barrier preventing customers from benefiting from technological improvements in telecommunications and Internet access, particularly in rural areas.

Unbundling and pricing the local loop

The key element in addressing the digital divide within a country (as well as the international digital divide) is support for infrastructure competition since this is fundamental to providing a framework that encourages tariff innovation and responsiveness to user demands. Notwithstanding this, the drawback of solely relying on this policy is the significant time it takes to roll out competitive infrastructure in local access networks.

Support for unbundling local loops has the advantage of accelerating the competitive provision of local access service.²⁹ At the same time, policies that mandate favourable interconnection rates, and that

encourage innovation in retail tariffs, can also be important. Some countries view as a potential drawback of such action the fact that it may discourage investment in alternative infrastructure. For this reason a number of OECD governments are tackling this issue by offering phased withdrawal of incentives to enter the market while new entrants build their own infrastructure. Other countries believe there will not be any drawback as long as unbundled elements of networks or interconnection are correctly priced.

In regard to local loop unbundling, policy frameworks are now in place for the majority of OECD countries to implement unbundling so as to allow operators to install their own equipment enabling them to provide services in direct competition to the incumbent's ADSL products. In some countries, the declaration of unconditioned local loop services into regional markets has been a major factor in the rapid overall growth in numbers of new carrier licences issued.

In May 2000, Oftel made a decision requiring BT to make available an unmetered wholesale Internet access product called "FRIACO",³⁰ to enable other operators to offer their own unmetered Internet access products in competition with BT, by collecting traffic from BT's local exchanges. Oftel is currently undertaking a review of price controls that will include consideration of the treatment of FRIACO as part of the Network Charge Controls. The telecommunications regulator in Germany, RegTP, also concluded that the incumbent was required to offer wholesale flat-rate access to Internet Service Providers by 1 February 2001.

Recent work by the OECD found that the level, and structure, of pricing for Internet access is one of the major constraints facing users and potential users. This analysis concluded that the key to greater tariff innovation to support electronic commerce is to increase competition. Where competition is most advanced, at the local level, the benefits of pricing innovation are increasingly evident.³¹ Whereas at the beginning of 2000 users in only five OECD countries had the option of unmetered dial-up Internet access from the incumbent telecommunication carrier, by the beginning of 2001 this number had been extended to 12 countries.

2.6 Role of government/regulation

The changes in demand and supply have been accompanied by significant changes in the policy and regulatory environment designed to:

- Enhance competition/market provision as far as possible.
- Reduce cost.
- Provide incentives to use appropriate technology.
- Increase pricing options.
- Foster market conditions conducive to the provision of affordable communications services.

Restrictions on entry are being eliminated and a regulatory framework strongly supportive of competition is being put in place, with stringent controls being exercised to ensure that entrants can access the networks and facilities of the incumbent carrier. There is broad recognition that any intervention should be competitively neutral and should not lead to inefficient, competition-distorting outcomes. Governments are re-examining telecommunications policies to ensure that they are not artificially limiting the development of new modes of service provision, or in other ways limiting competition and efficiency.

2.7 Monitoring and periodic review

A dependence on a competitive market and the dynamic circumstances of today's unparalleled technological developments demands considerable effort to monitor and assess market effectiveness and a preparedness to periodically revisit policies and programmes. This highlights the need for good data. Indeed, improved information is crucial for assessing the nature and scope of any problems and for developing well-targeted and cost-effective strategies for overcoming them. Monitoring the extent to which competition is delivering its promised benefits is a critical task. In this context, the set of indicators Oftel uses as a framework for monitoring the degree of effective competition in telecommunications markets set out in Box 2.2 is of interest since it is applicable to Internet service markets.

Policy makers are monitoring progress to determine whether there are disparities in access, quality of services, or pricing that need to be addressed. Performance indicators and measurements to track progress toward reaching targets are being established. In particular, it is being recognised that the barriers causing and sustaining the digital divide need to be regularly measured, monitored, assessed and addressed.

Box 2.2: Indicators of Effective Competition

Consumer outcome	<ul style="list-style-type: none"> Whether the market conditions consumers face compare well against consumers in similar economies Whether a wide range of services is available to consumers Degree of consumer satisfaction with the quality of service received Extent to which prices broadly reflect underlying costs (<i>i.e.</i> absence of persistent excessive profits)
Consumer behaviour	<ul style="list-style-type: none"> Extent consumers can access information to help make effective choices Whether consumers are confident/knowledgeable in using information and in taking advantage of market opportunities Absence of barriers to consumers switching suppliers
Supplier behaviour	<ul style="list-style-type: none"> Active competition in price, quality and innovation Absence of anti-competitive behaviour Absence of collusion Extent to which consumer needs are being met Efficient provision of services Recent entry
Structural	<ul style="list-style-type: none"> Limited entry barriers that would make the threat of entry a competitive discipline Absence of inefficient suppliers Limited ability of operators with market power in related markets (through vertical or horizontal integration) to lever this market power into the market segment being reviewed Changes in market structure over time, especially a tendency to reduce concentration

Source: Oftel, Implementing Oftel's Strategy: Effective Competition Review Guidelines, August 2000.

In some countries regulators are requiring regulatory reporting on carrier performance including carrier response times to customer requests for higher bandwidth data services, particularly in regional, rural and remote areas. In addition, measures of carrier responsiveness in the provision of broadband services and market data on narrowband Internet services and on higher bandwidth Internet services are being monitored in order to increase transparency in the market and assist policy making.

There is also increasing awareness of the need for vigilance that traditional government monitoring and control processes do not become sluggish and indeed, ineffective or, worse, counter-productive and that accordingly, monitoring processes need to be re-engineered to fit the new environment.

SECTION 3. OECD GOVERNMENT INITIATIVES TO EXTEND ACCESS TO INTERNET INFRASTRUCTURE

3.1 Upgrading the USO to include Internet Access

Provisions relating to the supply of “Universal Service Obligations” (USOs) for telecommunications are now widespread in OECD (and other) countries. In essence, USOs constitute a requirement that telecommunications operators provide basic voice telephone service to all who request it at a uniform and affordable price even though there may be significant differences in the costs of supply.³² A major issue relating to the digital divide is whether provision of broadband service into regional, rural and remote areas should be mandated, and if so, whether they should be offered at a subsidised price as part of a universal service offering, to ensure affordability for all.³³ Applying such a traditional USO approach to higher bandwidth services would mean giving all consumers the right to a telecommunications connection above a stated (higher) data capability speed³⁴ on reasonable demand at affordable prices.

Arguments against extending the USO to broadband

Incorporating a minimum data requirement into the USO is likely to require a significant investment in upgrading the operator’s customer access network. This can impact adversely on the development of competition in the industry, both by any imposition of higher USO levies on an incumbent’s competitors, and by further entrenching subsidisation of the incumbent’s services in USO net cost areas. Such a development may well have the perverse effect of dissuading innovative alternative providers from entering regional markets (since high-speed data services can be delivered through a number of different platforms, many of which are offered by new competitors).

The delivery of new services on a highly cross-subsidised, uniform price basis reduces or eliminates the prospect of competitive entry and discourages the incumbent from further investment and service improvement in non-profitable or less profitable areas of the market. At the same time, the maintenance of a cross-subsidy based regime results in prices in more profitable areas of the market being higher than would otherwise be necessary. Such an approach runs the real risk that the supply of new services to meet the real needs of regional, rural and remote areas is either further delayed or simply does not materialise.³⁵

Communications access is taking an ever-wider variety of forms, and there is a broad range of information transmitting and processing capabilities. An expanded USO overlooks the most promising feature of the new competitive marketplace: the enhanced ability to tailor the price and capability of service to specific user needs and socio-economic constraints. An expanded USO will simply waste a vast amount of resources on sub-optimal solutions. Further, it may discourage the market from discovering and supplying the solutions that are optimal for various groups. The USO mechanism, which assumes a common set of needs and can limit competition, would be ineffective in promoting equity of choice.

3.2 Country positions on upgrading of USO to include data capability

European Community

Within the framework of current EU law, Member States shall ensure that a defined minimum set of services of specified quality is available to all users in their territory, regardless of geographic location, and, in light of specific national conditions, at an affordable price.

The minimum data speed set by current EU Directives is 2.4 kbit/s. As a result of the 1999 Review³⁶, the European Commission proposed in July 2000 that this harmonised minimum be removed and that Member States should be able to set data rates that permit Internet access. The Commission was not convinced that extending the scope of universal service to broadband services at this stage would be advisable.

However, in considering whether a review of the scope of universal service obligations is necessary, the Commission proposal refers to the following options which the Commission may consider:

- Propose a change or re-definition of the scope of universal service obligations but require that any net costs are financed only via general government budgets, or
- Propose a change or re-definition of the scope of universal service obligations and permit any net costs to be financed by a mechanism to compensate undertakings for these net costs from the general government budget, or to share the net cost of universal service obligations which may be based on a Universal Service Fund.

Alternatively, the Commission may propose that specific services should become mandatory services to be provided under cost oriented obligations and not be included in the scope of universal service obligations.

In considering whether the scope of universal service obligations be changed or re-defined, the EC takes into consideration the following elements:

- Are specific services available to and used by a majority of consumers and does the lack of availability or non-use by a minority of consumers result in social exclusion?
- Does the availability and use of specific services convey a general net benefit to all consumers such that public intervention is warranted in circumstances where the specific services are not provided to the public under normal commercial circumstances?

The position proposed by the Commission is that any review of the scope of the universal service obligations must be determined principally by user demand. An assessment of the scope of universal service will be based on a market-based analysis of the demand for, and widespread availability of, that service, and a political assessment of its social and economic desirability.

The Commission proposal not to upgrade the definition of universal service does not prohibit a Member State from taking its own initiative to make broadband services publicly available in its own territory. But in doing so, no compensation mechanism involving specific undertakings, operators or service providers may be imposed.³⁷

Currently, the EU definition of universal service does not extend to the Integrated Services Digital Network (ISDN) since it considers that there should be no constraints on the technical means by which the connection is provided, allowing for wired or wireless technologies, nor any constraints on which operators provide part or all of universal service obligations.³⁸

According to a proposed EU directive, connections to the public telephone network at a fixed location should be capable of supporting speech and data communications at rates sufficient for access to online services such as those provided via the public Internet. The data rate that can be supported by a single connection to the public telephone network depends on the capabilities of the subscriber's terminal equipment as well as the connection. For this reason it is not considered appropriate to mandate a specific data or bit rate at Community level. Currently available voice band modems typically offer a data rate of 56 kbit/s and employ automatic data rate adaptation to cater for variable line quality, with the result that the achieved data rate may be lower than 56 kbit/s. In specific cases where the connection to the public telephony network at a fixed location is clearly insufficient to support satisfactory Internet access, Member States should be able to require the connection to be brought up to the level enjoyed by the majority of subscribers so that it supports data rates sufficient for access to the Internet. Where such specific measures produce a net cost burden for those consumers concerned, the net effect may be included in any net cost calculation of universal service obligations.

The Commission's proposal involves removing the minimum data speed requirement from legislation allowing Member States to set levels appropriate to their own circumstances.³⁹ One reason for this is that the minimum data speed needs to reflect technical limitations of networks. For instance, where there are long connections between the exchange and the customer's premises, speeds in excess of 14.4 kbit/s may be difficult to achieve without significant network upgrades. The minimum would need to reflect such circumstances and be based on what is practicably achievable across the network. In addition to a minimum standard, the Commission considers that it may be appropriate to ensure that an operator responds to all reasonable requests for non-voice services including data communication services.

United Kingdom

In the United Kingdom, BT and Kingston Telecommunications are subject to an obligation to provide a minimum data speed of 2.4 kbits/s in accord with EC directives. However, since in practice most users (*e.g.* over 90% in the United Kingdom) experience much faster speeds of 28kbits/s from the end user to the Internet service provider such rates provide adequate speeds for reliable access to e-mail services and many current uses of the Internet.

While recognising that the user's modem speed and the capability of the service provider will affect the data speeds experienced by the Internet user, Oftel's position is that appropriate data speeds for networks should be set within the USO in line with the Government's goals of universal Internet access by 2005. The United Kingdom's submission to the European Commission's 1999 review of European legislation proposed that Member States should be given greater flexibility in setting minimum data speeds.

The United Kingdom government has resisted pressures to extend universal service beyond telephony-based services, which are currently seen as the only services which are "essential for full social and economic inclusion in society". Oftel, the United Kingdom regulator, has argued that the universal service regime is an inappropriate tool for preventing social exclusion from the Information Age:

"..historically universal service has been founded on the basic principle that the majority of consumers who use a telephone service can afford to cross-subsidise the limited, basic needs of a small minority that might otherwise miss out. That principle does not translate easily to the provision of expensive new technology at affordable prices, at least in the early stages of market development".⁴⁰

Oftel examined whether the level of universal service should be revised to include mobile and narrowband ISDN services, to enhance the ability to access Internet services and to cover higher bandwidth services (services provided at speeds greater than 384kbits/s) and concluded that, at this stage, it should not. However, Oftel believes that this does not exclude the possibility of universal service being extended to encompass high-speed broadband services in the future should they become essential for such social participation. Circumstances relevant to the future of the USO, including the emerging EC framework, impacts on investment, funding, cross-subsidies, consumer demand and means of supply are changing very rapidly. Accordingly, Oftel concluded that the issue of an extension of the USO to include higher bandwidth services should be kept under review. Oftel proposed that the basic definition of universal service be reviewed periodically to ensure that services be categorised as a USO if the level of penetration reaches a point at which “unacceptable social and economic disadvantage is placed on customers lacking access to those services”.⁴¹

Germany

In Germany there is now considerable focus on expanding broadband infrastructure, with broadband defined as an ADSL having a level of up to 8Mbps. But no policies to upgrade universal service exist.

Italy

Even though the diffusion of Internet access is an important concern for the Italian government, no policy directed toward the extension or upgrading of existing universal service obligations has been formally proposed in Italy. At the moment Italian USOs conform to EC directives and ITU-T recommendations in the matter of basic telephony services. In particular, a minimum data speed of 2 400 bit/s is guaranteed over the Italian PSTN network.

In February 2001, the Prime Minister’s Office – Information Society Forum published a report containing proposals for broadband in deprived areas.⁴² The report maintains that within a few years, the concept of universal services must include access to the following infrastructures: ADSL for residential users; connections between 640 Kbit/s and 8 Mbit/s for schools, SMEs and offices; and industries and universities with connections between 8Mbit/s and 155 Mbit/s. Such objectives require further analysis regarding the possibility and limits of public intervention for the support of investment in infrastructure.

The report also outlines the role of various actors (such as the central government) in promoting the birth of a national forum for discussion, exchange of experiences, the co-ordination and promotion of policies to stimulate investment and remove administrative barriers that block initiatives. Territorial bodies have the role of preparing strategic plans for the cabling of deprived areas, where necessary creating mixed capital cabling firms. The Telecommunications Authority must enforce the rules for the promotion of competition and investment. Businesses should attempt to invest also in areas which seem to be less profitable. The report also focuses on the necessity of studying in depth the role of public demand for network access as an instrument for promoting the cabling of various areas.

Australia

In Australia, the universal service obligation (USO) includes:

- Access to a 64 kbps ISDN service on demand for 96% of the population.
- For the 4% living in rural areas not able to access ISDN on demand, the provision of an on-demand Internet-based asymmetric satellite service that delivers a satellite downlink service

comparable to the 64 kbps ISDN service; and reimbursement of 50% of the price of purchasing the necessary satellite receiving equipment.

This means that high speed Internet access is to be made available to all Australians on demand. For 96% of Australians, this will be via ISDN over the ordinary telephone line. For the remainder – mostly in regional and remote parts of Australia – it will be via satellite services. Telstra and other telephone companies will have an obligation to provide these services. Those in this last 4% will get a special benefit: they will receive a rebate of 50% of the cost of equipment necessary to receive the special digital data service.

Digital data service providers will also be required to prepare digital data service plans. These plans will include commitments on quality of service and connection times. There is a requirement for carriers to consult with the public on these plans before submitting them to the Minister for Communications for approval.

New USO arrangements were passed by the Australian Parliament in June 2000 providing for the government to conduct a tender in so-called “Extended Zones” in remote Australia for the provision of untime local calls (already available to urban Australia). The winning tenderer will receive up to AUD 150 million for the provision of untime local calls and, in addition, will become the universal service provider for those areas attracting a USO-related subsidy.

The losses that result from supplying loss-making services and from facilitating the satellite subsidy in the course of fulfilling the USO and digital data service obligation are required to be shared among all carriers. The Telecommunications Act 1997 provided that a universal service provider's net universal service cost as assessed by the Australian Communications Authority was to be shared amongst the universal service provider and other participating carriers on a basis proportional to the eligible revenue of each carrier.

In July 2000, further USO amendments were introduced to Parliament that provided for contestability in the supply of the USO, with multiple service providers (subsequent to authorisation by the ACA) able to compete for customers in defined geographic areas and to receive a per-customer subsidy. Importantly, carriage service providers (non-infrastructure owners) will be able to provide USO services in addition to carriers (infrastructure owners). Also, carriage service providers earning eligible revenue above a particular level (AUD 130 million) may be required by Ministerial determination to contribute towards funding the USO cost.

United States

In the United States, through mechanisms such as the high cost fund and access charges, the FCC has supported basic telephone service in high cost (primarily rural) areas. Other universal service mechanisms similarly target ordinary telephone service. For example, among the FCC's low-income assistance programmes, *Link-up America* provides support for up-front installation charges, and *Lifeline Assistance* helps defray monthly telephone bills for local service.

Section 254 of the 1996 Telecommunications Act requires (inter alia) that:

- Access to “advanced” telecommunications services be provided “in all regions of the Nation”.
- “Low-income consumers” and those in “rural, insular and high-cost areas,” have access to telecommunications services, including “interexchange and advanced services that are

reasonably comparable” to those provided in urban areas, at rates “reasonably comparable” to rates in urban areas.

- Schools, health care institutions, and libraries be eligible for special rates and other concessions to ensure that they have affordable access to advanced telecommunications and information services.

In response, the United States Congress adopted an expanded universal service policy.⁴³ Two primary components of the universal service mechanism include support for high cost areas and support for schools, libraries, and rural health care.

E-Rate

Section 254 of the 1996 US Telecommunications Act encourages access to advanced telecommunications and information services for all public and non-profit elementary school classrooms, libraries, and rural health care providers. Schools and libraries are provided with discounted telecommunications services, Internet access, and classroom connections known as the education or “E-Rate”. Under the implementation method adopted by the FCC, this can include discounts on broadband applications if provided as part of a school or library’s authorised technology implementation plan. Rural health care providers are provided rates comparable to urban rates for similar services.

The E-Rate programme provides discounts of 20% to 90% with the largest discounts given to schools and libraries operating in poor communities. Currently, over 90% of the nation’s public schools and libraries have Internet access, in some cases broadband, and over 63% of US classrooms are now connected. Table 3.1 indicates the break-down of overall E-Rate funding.

Table 3. 1. Overall E-Rate Funding by Eligible Service Type

Service Type	Total Dollars	Per cent of total
Telecommunications	USD 1 260 390 355	34%
Internal Connections	USD 2 138 274 551	58%
Internet Access	USD 278 265 275	8%
Total	USD 3 679 743 130	100%

Source: U.S. Department of Education, Planning and Evaluation Service, *The E-Rate and the “Digital Divide”, A Preliminary Analysis*, September 2000.

Funding is derived from mandatory contributions to the federal Universal Service Fund by all telecommunications companies (local and long-distance carriers, resellers, cellular, paging, other wireless, and any other companies that interconnect with the switched network), but not Internet, on-line service, and cable companies.

Under the *Rural Utilities Service Telecommunications Program* (RUS), loans are provided to certain operators to provide local/last-mile access to rural areas. Under this programme, loans or grants are also provided for distance learning and telemedicine in rural areas.

Under the Department of Education's *Community Technology Centres (CTC) Program*, three-year grants are awarded to state or local agencies, institutions of higher education, or non-profit agencies to develop model programmes to demonstrate the educational effectiveness of technology in economically-distressed communities, inner cities and other low-income and rural/remote locations. The focus is on access and training programmes. The programme is seen as central to the development of "anchor tenants" for broadband infrastructure, services, and new applications.

Canada

In Canada, the Canadian Radio-Television and Telecommunications Commission (CRTC) requires local exchange carriers to provide individual line local service with touch-tone dialling, provided by a digital switch with capability to connect to the Internet via low speed data transmission at local rates. The basic service objective is independent of the technology used to provide service, and may change over time as service expectations evolve.

In 1999, the CRTC decided against upgrading the Canadian basic universal service obligation, pointing to the technical difficulties that would be faced by carriers in guaranteeing a data transmission speed, the cost associated with an upgrade to 28.8 kbps or higher, and the impact that cost would have on the operation of both profitable and unprofitable markets.⁴⁴

The CRTC believes that, over time, competitive pressures and improvements in network technology will enable basic service to include faster transmission speeds.

As noted earlier, in October 2000 the Canadian Government announced its commitment to achieving the goal of high-speed broadband access to all Canadians by 2004 and established a National Broadband Task Force to advise on strategies to achieve this target. The work of the Task Force effects an expansion of the government's existing *Connecting Canadians* programme,⁴⁵ which has so far focused on funding connectivity – of any speed – for schools and libraries.

Sweden

Under the *Small Community Broadband Infrastructure Initiative* announced in March 2000, broadband access is extended to communities with a population of less than 3 000 (comprising some 30% of the national population).⁴⁶ The national government would subsidize local networks, private ones or in the absence of a market, community owned.

New Zealand

In December 2000, the government accepted selected recommendations of an inquiry into New Zealand's telecommunications regulation and policy. The government rejected direct subsidies for broadband development but will have Telecom NZ upgrade the network for universal low speed access. A private-public Information Society Initiative may provide direct subsidies in rural/remote locations in order to ensure access to broadband services that the market would otherwise not make available.⁴⁷

3.3 The cost of upgrading the USO to include a digital capacity

Decisions about policies and programmes to address the digital divide must of course be made in the context of programme funding and costing. However, the protracted debates over the appropriate cost of providing USOs relating to basic telecommunications services warn of significant difficulties in ascertaining the costs of digital divide programmes.

For instance, there is the problem of costing methodology and its practical application. Acknowledging that basing rural subsidies on historical costs rewards carriers whose high costs result from operational inefficiencies, United States regulators opted for subsidy calculations based on “forward-looking costs” that approximate the costs a hypothetical efficient carrier would incur in constructing and operating its network. Those costs, minus a “revenue benchmark” taking account of all of a carrier's revenues, determine the subsidy amount. But in practice, forward-looking costs have proven to be notoriously difficult to determine varying from place to place and time to time.

Some governments (*e.g.* Australia's) consider that the difficulties of using cost models to determine the level of subsidies for telecommunications in high-cost areas might be avoided by using a competitive tendering approach. An auction could be held to decide who will provide universal service, with the lowest bidder getting the universal service subsidy.

Another issue is whether the benefits of serving underserved areas should also be recognised so that the cost estimate should be of *net* costs? For instance, Oftel estimated in 1997 that the benefits to BT as the universal service provider amounted to between GBP 102 and 151 million per annum (later revised to GBP 61 million per annum)⁴⁸ leading to the conclusion that *net* costs of delivering USOs were insignificant and could be borne by BT without the need to establish a universal service fund.

It would be arguable that there are similar intangible potential benefits to being the provider of programmes to bridge the digital divide and that these benefits should be recognised in costing digital divide programmes.

Australia

The Australian Communications Authority (ACA) in its 1998 Digital Data Inquiry report estimated that the cost of upgrading Telstra's customer access network to a minimum data speed of 28.8 kbps would be in the order of AUS 4 billion (about USD 2.1 billion). The ACA also found that an upgrade to a data speed lower than 28.8 kbps would incur very similar costs.

Telstra estimates the capital cost of upgrading its network to provide a minimum data speed of 33.6 kbps would total AUD 4.486 billion. Telstra did not provide an estimate of the operating and maintenance costs, although these could be expected to be small since it already incurs such costs with its existing network.

Drawing on the analysis by the ACA (in its Digital Data Inquiry report)⁴⁹ and information provided by Telstra, the *Australian Broadband Inquiry* estimated that the following costs would be incurred in providing all customers with 64 kbps using ISDN:

- The capital cost of network upgrades to Telstra's access lines which cannot currently access ISDN, is approximately AUD 2.5 billion.
- The cost of upgrading customer equipment to enable the supply of ISDN is AUD 1 240 per customer.

The Inquiry estimated the cost of upgraded customer equipment at about AUD 11.5 billion. The total cost of the upgrade was estimated at approximately AUD 14 billion.

The Communications Research Unit (CRU) of the Australian Department of Communications, Information Technology and the Arts (DoCITA), were also asked to provide an estimate of the likely cost of upgrading the USO to at least 64 kbps. The CRU advised that the likely cost would be in the order of AUD 20 – 30 billion⁵⁰ based on costs arising from three areas:

- Capital costs for customer equipment in the order of AUD 10 billion (the CRU assumed the use of a number of technologies, including ADSL).
- Network upgrade costs for both CAN and backbone in the order of AUD 10 billion.
- Operating costs in the order of AUD 6 billion.

Despite the variation between the cost estimates for an upgrade to 64 kbps, it is clear from these estimates that the total cost is large.

United States

In the United States, in compliance with Congressional intent that support be explicit, the FCC has adopted a mechanism for the high cost areas served by non-rural local exchange carriers based on forward-looking cost, *i.e.* what it would cost to build a telephone system today. The US Telecommunications Act 1996 permits tendering but evidently for the present, the FCC is concentrating on the forward looking economic cost model.

France

The French regulator, *Autorité de régulation des télécommunications* (ART), currently uses an historic cost model to estimate the cost of the USO. ART estimated about FRF 200 million per annum of benefits accruing to the universal service provider.⁵¹ However, there has been heated debate about the actual cost and the basic costing model that the regulator should use and the universal service costing and funding arrangements have been reviewed.

Sweden

Sweden, a country with a small geographical area, has budgeted to spend a significant amount to bring broadband access nation-wide. SEK 5.25 billion has been earmarked for regional network development and remote/rural broadband access. Substantial (30 to 40%) subsidies are to be paid to carriers for regional/remote broadband access development. The government will also fund SEK 3.2 billion, including SEK 1.2 billion for tax credits to end users, and SEK 1.2 billion for municipal broadband expansion.

3.4 Funding an upgraded USO

Australia

In Australia, the *Networking the Nation* (NTN) programme receives a portion of the revenue generated from the partial sale of Telstra to provide a mechanism for meeting the needs of telecommunications consumers, particularly in regional, rural and remote areas. The government has primarily used NTN funding as a catalyst for promoting investment by the commercial sector in marginal or uneconomic markets. Commercial organisations are ineligible to apply for NTN funding. Projects funded through NTN have an identifiable community need. Where infrastructure has been funded directly, *e.g.* the provision of Internet points of presence, additional funding is usually provided for services and facilities to encourage use of the infrastructure.

The NTN programme is not only about infrastructure but about bridging the gap between having infrastructure and being able to utilise it, including training and awareness *e.g.* the opportunities that teleworking provides for people who live remotely.

The ‘Extended Zones’ tender

In Australia, approximately 40 000 telecommunications consumers who live in generally sparsely populated areas known as “Extended Zones” (covering about 80% of the Australian landmass) have no (or limited) access to untimed local calls (unlike consumers who live outside these Extended Zones who do have a legislated right to untimed local calling).

In passing legislation to extend the right of untimed local calls to the Extended Zones, funding of up to AUD 150 million over three years was provided for an infrastructure upgrade commencing in 1999-2000 through a tender process. The successful tenderer is declared the universal service provider and is eligible for exclusive USO subsidies for three years. But other service providers may provide services in the Extended Zones during the contract term.

The AUD 150 million allocation is used to leverage a better communications outcome for rural and remote Australia. The “beauty contest” style tender for provision of the standard telephone service in the Extended Zones provides the opportunity to test the competing claims of Telstra and other service providers regarding their capacity to serve rural and remote Australia. The enhanced contestability reduces barriers to entry, particularly in regional areas, and leads to increased competition and service improvement.

The Australian Department of Communications, Information Technology and the Arts (DoCita) has announced that a number of tenderers (amongst which were AAPT, CWO, Datafast Telecommunications, Heartland, Pacific Telco, Telstra and Vodafone) had offered a range of high speed data and other services that would significantly improve the quality of telecommunications services in the Extended Zones. For instance, Cable and Wireless Optus (CWO) indicated that it would provide a wide range of services in the Extended Zones if successful in the tender and will bring down the costs of satellite customer equipment substantially. CWO indicated that a data capability of 28.8 kbps would form part of its standard service offering under the tender, with higher data speeds and other additional services, such as pay TV, access to free to air TV and radio and multiple lines to one customer comprising optional service offers.

Another tenderer, Heartland Communications, announced it would offer a range of enhanced services to regional, rural and remote Australia regardless of the tender outcome. Heartland’s goal is to provide regional Australia, particularly regional businesses, with broadband telecommunications solutions encompassing two-way satellite technology and wireless local loop solutions.

Pilot schemes for competitive delivery

Two trial pilot schemes for competitive delivery of the USO in regional areas will be conducted. Both trials will enable carriers to compete with Telstra for subsidies to provide standard telephone services that would otherwise be commercially unattractive.

The so-called *Greater Green Triangle* (GGT) received funding support under the Government’s AUD 70 million *Building Additional Rural Networks* (BARN) programme, which supports the development of innovative market models for the delivery of regional communications services, including new kinds of community-owned or regionally-based carriers.⁵² This pilot programme is designed to help test the importance of supplementary funding in facilitating contestable USO arrangements.

All universal service providers (USPs) will be able to offer alternative telephone service, such as mobile services or a service providing enhanced Internet access that would be eligible for the subsidy. Consumers

are able to choose either the standard Telstra offering, or an alternative offering from Telstra or a new service provider. Measures have been put in place to prevent “cherry picking” (servicing high but not low value customers) in contestable areas.

USPs supplying the standard telephone service will be required to meet standard regulatory requirements in relation to the service. These include an untimed local call option, pre-selection and emergency facilities, and disability equipment where relevant.

Telstra will be required to remain in the pilot areas as the primary USP, and must continue to offer its existing standard service, thus ensuring all consumers continue to be served. Telstra will be able to exit the market only when another carrier agrees to take its place.

Canada

Canada has a “contribution” system, which includes universal service subsidies. Long-distance carriers pay contributions in proportion to each carrier’s share of traffic minutes. These contributions currently include both the cost of serving high-cost areas at controlled prices and the cost of meeting price controls on access in the rest of Canada (in some other countries, *e.g.* the United Kingdom and Australia, this impost is called the access deficit contribution). However, in 1997 the Canadian regulator (CRTC) unbundled the local loop, opened up all markets to competition and froze existing contribution levels until 2001. Any local exchange carrier serving a high-cost area is entitled to receive subsidy on a per-customer basis (calculated depending on which “band” their high-cost customers are in), in effect making the universal service subsidy “contestable”.

The CRTC considered a bidding process but concluded that it would make administration more complex, and would unduly slow the implementation of basic service in certain high-cost areas. The CRTC was of the view that – in view of the small number of Canadians without access to telephone services – establishing a new bidding mechanism to provide basic service is not warranted. In any case, the CRTC concluded that incumbent local carriers, with their widespread infrastructures, are likely to be the only providers of service to these areas in the foreseeable future.

United States

The 1996 Telecommunications Act conferred authority on the FCC to mandate access to telecommunications services for schools and libraries. To pay for this, telecommunications companies (and hence their customers) were required to raise USD 2.25 billion per year. Mandates to benefit rural health care providers led the FCC to ask for an additional USD 400 million. The 1996 Act also requires explicit subsidies for local, residential, and rural telephony, the traditional beneficiaries of universal service obligation.

The fund for high-cost rural areas has been growing. The Office of Management and Budget and Congressional Budget Office estimates project the total fund growing (from about USD 3.3 billion) to USD 13.4 billion. To pay for subsidies, carriers are required to make contributions to a Federal government central high-cost fund in proportion to their share of revenue. Most States also propose to move towards a State central high-cost fund to cover subsidy requirements.

As part of reforms initiated by the 1996 Telecommunications Act, funding was made contestable, or “portable”, to any carrier that provides service to a customer in a high-cost area. This recognises that otherwise, rural areas would not benefit from competition and choice, since a new carrier would find it very difficult to compete for customers in rural areas against a subsidised incumbent.

SECTION 4. GOVERNMENT INITIATIVES TO EXTEND ACCESS TO HIGHER BANDWIDTH SERVICES

4.1 Government initiatives to diffuse broadband access

There have been a number of OECD government initiatives to promote broadband access.⁵³

European Community

Within Europe, the European Commission continues to be a driver of E-economy strategies. The EU launched the *eEurope*⁵⁴ initiative in December 1999 to accelerate the uptake of digital technologies across Europe and to ensure that all Europeans have the necessary skills to use them. An Action Plan and set of targets to measure progress towards the objective of “bringing Europe on-line” was established.⁵⁵

The broad range of measures included in the initiative includes the following key objectives:

- Bringing all Europeans into the digital age and online.
- Creating a digitally literate Europe, supported by an entrepreneurial culture.
- Ensuring that the process is socially inclusive⁵⁶ and builds consumer trust.

Austria

Austria has undertaken a number of measures to stimulate the take up of Internet⁵⁷. A major initiative of the *Go on!* project⁵⁸ included:

- Raising awareness of the Internet and the need for further training.
- To demonstrate concrete individual use and benefits of the Internet.
- To raise Austria’s competitiveness by lowering online-access costs and removing access barriers.

State (*land*) initiatives have also started. For instance the Salzburg *Land* provides a so-called Internet cheque of ATS 1 000 for 10 000 citizens to facilitate on line access.

Germany

The government is to shape the migration to the information society by a comprehensive programme that targets all citizens,⁵⁹ including groups such as SMEs, libraries, women, youth, seniors, etc. Core strategy elements include:

- Increasing the speed of broadband technology with the aim of being world-leading by 2005.
- Meeting the goal of access to underserved groups.
- Expanding and improve IT education and training.
- Expanding R&D.
- Expanding the diffusion of broadband infrastructure.
- Migrating all government services on-line.

Italy

Since 1996, the Italian Government has launched numerous projects for the development of the Information Society, with particular attention paid to schools. In 1997, the legislation that liberalised telecommunications created a single regulator for all sectors involved in technological convergence (www.agcom). This authority is divided into two commissions: one for infrastructures and another for services and content, with the authority's council dealing with matters of a more general nature.

In 1999, the Government instituted the Committee of Ministers for the Information Society and also the Information Society Forum at the Prime Minister's Office. The Forum has been given the task of promoting a culture of innovation, co-ordinating various public activities to promote and broaden social inclusion to include various individual areas. A bilingual Website (www.governo.it/fsi) was immediately created by the forum along with a bi-monthly newsletter (available in both Italian and English), which may well be the first electronic newsletter published by a public institution, and which now reaches thousands of readers throughout the world.

Numerous individuals and bodies (firms, trade unions, universities, the non-profit and financial sectors) have been actively encouraged to get involved in the Forum's activities. In other words, a "bottom up" process of participation and preparation of public decisions has been created.

Italy has contributed to the preparation of proceedings for the eEurope 2002 action plan and is currently dedicated to achieving the objectives laid out in the plan. Also to be noted is that in June 2000, the Committee of Ministers approved an Action Plan for human capital development and one for e-government. In 2001, the Government decided to earmark 10% of proceeds from the UMTS licence fund for the development of the Information Society, paying particular attention to deprived areas.

The allocation of these funds was as follows:

- ITL 267.5 billion (USD 138.2 million) towards the prevention and reduction of electromagnetic pollution.
- ITL 50 billion (USD 25.8 million) towards the creation of a training credit card for Italians who are 18 in 2001.
- ITL 800 billion (USD 413.2 million) towards the e-Government action plan, approved by the Committee of Ministers for the Information Society on 23 June 2000.
- ITL 900 billion (USD 468.8 million) towards scientific and technological research as well as 200 billion (USD 103.3 million) towards the "CampusOne" project.
- ITL 200 billion (USD 103.3 million) towards helping new innovative businesses with training and the equipment of IT instruments according to the Action Plan for the Information Society.
- ITL 50 billion (USD 25.8 million) for co-financing with regional authorities and universities as outlined in the *Programma straordinario contro la disoccupazione intellettuale* (Special Programme Against Intellectual Unemployment).
- ITL 57.5 billion (USD 29.7 million) towards libraries and multimedia centres outlined in the Action Plan for the Information Society.
- ITL 150 billion (USD 77.5 million) towards the training needed to equip teachers with the IT skills necessary.

In addition to this, the Government and individual regions are to allocate a significant chunk of the European Union's Structural Funds to the development of the Information Society along with innovation in deprived areas.

Finally, the book "e-Italia. A project for Italy and Europe, a Contribution to the International Community. Report by the Information Society Forum" was published in October 2000.⁶⁰ Emphasised in the report is the necessity to reduce the digital divide that exists between developed and developing countries. The book proposes a comprehensive overview of a modern society capable of offering the same opportunities to everyone.

Australia

In Australia, key initiatives have included:⁶¹

- Establishing a National Office for the Information Economy (NOIE).
- The creation of an Australian Online Council (set up 1997) to develop a strategic "national policy framework" to maximise and evolve the e-economy.
- A National Bandwidth Inquiry in 1999 to determine: the demand for bandwidth; bandwidth availability; and competitive pricing and an appropriate regulatory framework.

- Making the market more competitive in order to ensure that broadband access is affordable. There is a strong emphasis on the need to maintain a competitively priced bandwidth network, in order to enable broadband access to mass information provision and maximising e-commerce in business. Broadband access is considered to be especially important to those living in rural areas as well as in metropolitan areas.

A government report, *The Commonwealth Government's vision for Australia in the Information Age*, 1999, recommended a number of key policies to improve access to a cost effective broadband network to enhance and develop an accessible information network access for all Australians, for example, the Health Online programme. In 1999, the National Office for the Information Economy was charged with the responsibility for creating a database detailing groups most in need of Internet exposure. This is used to target training initiatives and projects to integrate the Internet into the daily lives of various socio-economic groups, including older and indigenous Australians. The NOIE has placed a strong emphasis on improving Internet access for the consumer, including commissioning research to determine the benefits of Internet access to households. AUD 3 million of public money has been allocated by the government for a national campaign to increase public awareness of the benefits of being online, with over 30 "Online Australia" summits to allow regional communities to explore the opportunities and benefits to be gained from the Internet and e-commerce. Government funding for community projects such as *telecentres* and *cybercafes* to improve access and stimulate interest in the Internet.

Networking the Nation

The Networking the Nation programme⁶² was launched by the Australian Government in June 1997 to assist the economic and social development of rural Australia by funding projects that:

- Enhance telecommunications infrastructure and services.
- Increase access to, and promote use of, services available through telecommunications networks.
- Reduce disparities in access to such services and facilities.

The Government originally set aside AUD 250 million for the programme (the General Fund) adding a further AUD 214 million in June 1999, funded from the proceeds of the sale of a further 16.6% of Telstra, to establish a number of additional elements:

- Building Additional Rural Networks (BARN) (AUD 70 million).
- Local Government Fund (AUD 45 million).
- Internet access (at least equivalent to untimed local call access) for regional and rural Australia (AUD 36 million).
- Meeting the telecommunications needs of remote and isolated island communities (AUD 20 million).
- Mobile phone coverage on key major national highways (AUD 25 million).
- Additional mobile phone coverage in South Australia, Tasmania, and Western Australia (AUD 3 million).
- Networking schools in the State of Tasmania (AUD 15 million).

Building Additional Rural Networks (BARN)

BARN is providing AUD 70 million over five years (1999/2000 to 2003/4) to support the development of new networks and new network services and products, with an emphasis on the adoption of innovative solutions and leading edge technologies, and strong participation of new telecommunications carriers and service providers in project implementation. Of the AUD 70 million, AUD 10 million is being provided to each State, with a further AUD 10 million to be provided for the territories, including the Pacific and Indian Ocean Territories.

The funds provided for the territories will not be further sub-divided between the territories, but will be allocated by the Networking the Nation Board based on the merit of project proposals against the Selection Criteria and Project Priorities and on the demonstrated needs addressed by proposals.

Examples of infrastructure and services that could be supported under BARN include:

- Backbone data carriage services.
- Wireless local loop systems.
- Network management systems.
- Innovative satellite services.
- Network hardware components.
- Technical support services.
- Training and skills development services.
- E-business and e-commerce systems.
- Online service delivery.
- Video-conferencing.
- Internet service delivery.
- Mobile telephony.

BARN projects are implemented in close consultation with state and territory governments, to ensure that funded projects reinforce state strategies, including in such areas as demand aggregation.

Selection criteria

The *Networking the Nation* General Guidelines set out the framework under which BARN operates, including the selection criteria to be applied. In brief, these are:

- Meeting needs: That the project promises to meet an identified need within the targeted area.
- Support for the proposed project: That the proposal is well supported by all relevant parties.

- Providing value for money: That the project promises to provide good value for money.
- Ensuring project management skills: That the project would be well managed.
- Ensuring sustainable services: That the project service outcomes are sustainable, or are aimed at supporting the development of sustainable services.
- Competitive neutrality: That the project approach is competitively neutral.

Guidelines have been established to ensure that projects seeking to develop innovative products and services compete fairly with existing services of a similar nature, and that rigorous, transparent processes will be applied to ensure that private sector partners in projects are selected on an open basis.

Project priorities

BARN supports the development and implementation of innovative telecommunications and IT infrastructure and services in regional Australia. Funded projects are aimed at:

- The development, trialing and implementation of new services and products capable of leapfrogging present price and service quality parameters.
- Enhancing competition in the supply of such products and services to regional users.
- The development of new market models for delivery of regional communications services.
- Providing broad and lasting benefits for rural telecommunications users.
- Promoting the economic development of regional areas.
- Complementing commercial opportunities arising from possible tendering of USO obligations by encouraging delivery of USO service through cost-effective, leading edge technologies.

Key priorities for projects funded under BARN include innovative infrastructure and services; and private sector commitment to ongoing involvement and support. Priority is also given to:

- Projects which are consistent with State and local governments' strategies.
- Projects which aggregate existing and new demand in regional areas, and therefore improve the business case for enhanced services (a number of projects of this type are currently being funded through Networking the Nation); and projects with a regional, state or national scope, and which are supported by regional bodies or by state governments.

To be eligible for funding under BARN and other Networking the Nation programmes, a project must be located outside the capital city of a state or territory. (Projects located in remote and isolated island communities are also eligible for funding, under the Networking the Nation Remote Islands Fund).

Private sector involvement

The Australian Government uses BARN funding to encourage the entry of new telecommunications providers into regional telecommunications markets. At the same time, projects are used to promote new models for service delivery across a range of regional markets. Projects funded under BARN also have a strong focus on meeting community needs and need to be supported by target communities. BARN funded projects are likely to have significant private sector involvement, consistent with the Government's objective of encouraging competition in telecommunications. New infrastructure resulting from projects may be owned either by the project organisation or by the private sector participant. In most cases, new products and services supported through projects are vested in the private sector, either at the outset, or through a planned ownership transfer, during or after the completion of the project.

The Networking the Nation programme is explicitly demand driven, depending on community-based development of funding proposals. The Government is also funding programmes to provide different incentives to the market. Programme measures too can be more clearly aimed at encouraging competition.

The government recognises that as a significant purchaser of telecommunications services it can help implement demand aggregation strategies with substantial benefits, particularly in regional areas, through:

- Improving the quality and reach of communications services to regional users.
- Requiring contracted carriers/service providers to provide additional benefits to the regions – either as wholesale services to regional service providers, or as retail services to the general public.

To avoid any tensions between these strategies and regional initiatives, there is significant effort to consult and co-ordinate the various telecommunications-related funding programmes to ensure activities are not inconsistent with regional service improvement strategies. The government considers that appropriately structured and targeted funding programmes can play a positive role in assisting communities to meet their communications needs.

Canada

In Canada, the CRTC directs all incumbent local carriers to file service improvement plans for Commission approval, or to demonstrate that the basic service objective has been and will continue to be achieved in their territory. Plans filed are required to indicate how incumbent local carriers will reinforce their existing networks where necessary to improve service or extend service to unserved areas. Subject to network design and cost limitations, these plans are designed to:

- Incorporate least-cost technology.
- Target larger communities or areas first.
- Serve unserved areas prior to providing upgrades.
- Serve permanent dwellings before seasonal ones.

Multi-year plans to improve service, developed by incumbent local carriers and filed for approval with the CRTC, aim to be administratively simple to implement and allow for comment by the public. It is considered that such programmes can also allow communities or regions to participate in proposed service upgrades. For instance, if a telephone company begins construction in an area, it may be able to offer inexpensive service improvements beyond the basic service objective to other nearby homes or communities. Knowing in advance the timetable for construction projects near their area, individuals, communities or regions may choose to take advantage of any cost-saving opportunities. They may be able to budget their own resources or obtain government grants to enhance services.

Denmark

In 1998, the Minister of Research and Information Technology established a committee to prepare a new Information Society programme to replace the IS 2000 programme initiated in 1994. During 1999-2000, a new agreement on telecommunications policy was reached between the Minister of Research and Information Technology and a majority of the political parties in Denmark.⁶³ High-speed access is seen to be a key aspect of: "...the Danes admission ticket to the networked society". The agreement outlined a number of goals, including:

- All Danes being ensured access to modern communication technologies.
- Reliance on the market to meet the increasing demand for larger bandwidth.
- Stimulating competition in the telecommunications market leading to innovation and growth.

Norway

The Norwegian Action Plan on broadband communication states two goals: Through increased competition and demand, help provide a) favourable market offerings that enable broadband connections to all primary and secondary schools, public libraries, hospitals and local authority administrations by the end of 2002; and b) favourable market offerings that provide broadband connections to all Norwegian households by the end of 2004.

A broadband development programme (HØYKOM), aiming at making local government services more efficient, is in its third year of operation. The programme is supplemented by developmental programmes targeting each of the four prioritised sectors (schools, libraries, hospitals and local municipal administrations). Several examples of municipalities setting up collaborative broadband projects can be shown. In Finmark, the northernmost county in Norway, and among the most sparsely populated areas, a private company is collaborating with several energy suppliers in broadband development in the area. The consortium plans for 35% of the population to have broadband connection by 1 June 2001.

Sweden

During 2000, the Swedish Government introduced IT legislation containing measures for encouraging the establishment of and access to broadband networks. The legislation has the expressed overall policy objective of making Sweden the first country to create "an information society for all". The objective is that households and businesses in all parts of Sweden have access to IT infrastructure with a high transmission capacity over the next few years. This would be achieved primarily through market channels, but the government accepts overall responsibility for ensuring that a high transmission capacity infrastructure is available in all parts of the country.⁶⁴ The measures and regulations are designed to achieve competitive neutrality and diversity in the networks without major regional differences in accessibility,

prices and capacity. To achieve this goal, the legislation proposes investments in broadband networks amounting to SEK 8.3 billion, of which SEK 3.2 billion would be set aside for tax relief to stimulate such investments. The support includes a government funding of SEK 2.6 billion that would be available for the establishment of regional networks and to facilitate access to broadband networks in sparsely populated areas. The Swedish National Electricity Grid was directed to undertake a project of SEK 2.5 billion for the construction of a backbone network to be extended to all municipal centres in Sweden.

Finland

In Finland, the government is keenly supportive of initiatives to close the digital divide⁶⁵ but assistance for Internet access is indirect in the form of income support to eligible households to help pay for basic needs such as food, electricity, television licenses – and telecommunications.

Hungary

During 2000, Hungary established a state subsidy programme to help boost the penetration of computers and Internet usage by families. Under the scheme, 1 400 families will get computers and 20 hours Internet access a month for two years at cheap rates. Only 9% of Hungarian families have Internet access. High prices for Internet services and a low PC penetration have been the bottleneck development, but improvements are expected due to increasing competition between service providers, falling prices, improving living standards and government subsidies and customs concessions.

Established in 2000, the Office of the Government Commissioner for IT in the Prime Minister's Office has elaborated a number of projects to address the digital divide problem to be implemented in 2001-2002. These projects were designed to cover the main risk groups, including young (underprivileged) men through the introduction of IT training into the military drill; the handicapped through the setting up of instruction laboratories in their training facilities; institutionalised young people through the setting up of instruction laboratories in their training facilities; young mothers through the provision of infrastructure and training material to the Family Care Service.

Ireland

In Ireland, survey research conducted on behalf of the Information Society Commission found that in 1999, 41% of the general public had access to a PC with 33% having access to the Internet.

There are no specific programmes to subsidise Internet access. Full liberalisation of the telecommunications market is being depended upon to effect access and lower prices.

Japan

In Japan, 49.4% of those with an annual income of JPY 10 million or more are Internet users (up 9.9 points from the previous survey conducted during the end of March 2000), while only 11% of the JPY 3.5 million or less income group are Internet users (up only 0.5 points). The higher the annual income, the higher the Internet penetration ratio. Internet penetration rates and growth rates remain low, especially in the JPY 3.5 million or less annual income segment, with the gap between high and low income earners widening.

Furthermore, more than 20% of those earning JPY 3.5 million or more own i-mode or other Internet accessible mobile phones, while only about 10% of the under JPY 3.5 million annual income earners do. This indicates that lower income groups in Japan may be being left behind in regard to Internet use.

The spatial disparity in Internet use is also significant: 34.6% of the residents living in the cities designated by ordinance, 33.4% of the residents in the prefectural capitals, and 32.7% of the residents in the other local big cities have Internet access. In towns and villages, however, only 18.5% of the inhabitants use the Internet. This is almost one year behind the Internet use rate of 17.3% in the designated cities and prefectural capitals attained at the end of September 1999.

MITI and MPT are responsible for most activities to develop the Information Society. As in other OECD countries, there are regulatory efforts designed to lower interconnect charges and to introduce local loop unbundling as part of efforts to create greater competition in the local loop.

The Japanese government has engaged in a broad range of activities to help bridge the digital divide. For instance the Ministry for Posts and Telecommunications (MPT) has launched several initiatives, including:

- Plans to establish a new subsidiary programme for the provision of telecommunications and broadcasting services for people with disabilities in fiscal year 2001.
- Development of an assistant system to ensure Web accessibility and plans to conduct a verification experiment of the system in fiscal years 2001 and 2002.
- Establishment of a set of guidelines for accessibility to telecommunications equipment for the elderly and people with disabilities in October 1998. These guidelines address functions required of telecommunications equipment in order for the elderly and people with disabilities to be able to use telecommunications services smoothly.
- Conduct of demonstration projects for an info-communications system that enables Website-development assistant services for the elderly and people with disabilities in Kanazawa City, Ishikawa Prefecture, from December 1999 to March 2000. This system is now available via the Internet, providing such functions as automatic design, on-screen character enlargement and voice recognition.
- Subsidisation of local governments in the construction of information barrier-free telework centres since fiscal year 1998, in which the elderly and people with disabilities can telework with info-communications systems designed especially for them. This project supports R&D on IT equipment (hardware and peripherals) and IT-related software which is user-friendly for the elderly and physically handicapped, not only assisting them in overcoming their handicaps, but also opening the way for their active participation in the IT socio-economy.

To provide financial and personnel support for SMEs in responding to the IT revolution, MITI will conduct IT training and seminars for SME management and supply information, as well as laying the necessary foundations by bolstering policy finance for management innovation using IT (establishment of a special lending system) and developing a more objective approach to the skills of skilled workers, creating manuals on these.⁶⁶

The Japanese government has attached importance to international co-operation and aid in the communications sector. A notable example is Japan's Comprehensive Co-operation Package to address the international digital divide which aims to:

- Provide flexible co-operation systematically combining all forms of policy instrument in a manner which complements the active efforts of the private sector.
- Ensure that efforts in target areas are coherent, encompassing the whole realm of IT-related policy in developing countries.
- Give special consideration in implementing action to the importance of co-operative relations with the Asia-Pacific region, while basing co-operation at a global level. Furthermore, duly acknowledging that "networking" is a vital key in disseminating IT world wide, to endeavour to enhance inter-regional co-operative alliances.
- Focus due attention on collaboration with relevant international organisations and other donors with a view to global co-operation and the promotion of network development.

Examples of other specific initiatives include:

1. R&D on networks to connect schools to the Internet with multi-type of access lines (November 1999). MPT and the Ministry of Education are promoting collaborative R&D on school access to the Internet. Approximately 1 000 elementary schools, junior-high schools and high schools in 30 areas in Japan will be connected to the Internet via multiple access lines such as optical fibre, xDSL, satellite communications, cable TV line, Wireless Local Loop (WLL), etc. A backbone network is being utilised for the research that consists of the central network centre and 30 local area network centres.
2. Towards widespread use and promotion of xDSL services (July 2000). The Japanese Government has, through MPT, the telecommunications regulator, taken various policy measures to promote xDSL services nation-wide to lower communications charges.
3. Next-generation Info-Communications Infrastructure initiative toward 2005 - A Report of the Executive Meeting on the next generation Info-Communications Infrastructure Initiative (19 July 1999). With the rapid growth in Internet use and the development of new services using the telecommunications networks, the expanding Japanese info-communications market is regarded as a key factor in the recovery of the Japanese economy. MPT is promoting next-generation info-communications network society, incorporating broadband access. The next-generation info-communications infrastructure in 2005 is expected to be mainly composed of high-quality routers. A variety of technologies for high-speed access will be introduced into the local loop in order to create a free and fair competitive environment for assurance of good-quality services to meet a variety of user needs.
4. MPT of the Regional Multimedia Highway Conference-21 (November 1999). One example of the conference activity is to demonstrate and experiment on wide-area networks with xDSL, FWA, etc. for easy use of the Internet. This conference is aimed at creating easy use of Internet environment in local areas.
5. R&D (June 2000). The project entitled "Desirable R&D on Info-communications in the 21st century", is led by MPT and will include broadband access technology as one of the categories of fundamental research.

Korea

Korea has a high penetration of Internet access and is promoting competition as a means of stimulating telecommunications and Internet penetration. To achieve the aim of having 75% of homes using high speed Internet access by 2005, the government has earmarked 1.9 trillion won for network upgrades while companies from the private sector will put in 38 trillion won.

The Korean Government's 1999 White Paper *Cyber Korea 21* highlights the importance attributed by the country's leaders to information infrastructure and sets out a number of policy goals.

The universal service obligation for basic telephone services is regarded as a first step toward universal access to information infrastructure. It is considered that, at least in the short term, the incumbent is able to shoulder the responsibility of providing universal service. In the longer term, the universal service compensation fund should be competitively and technologically neutral. However, the government considers that beyond basic services, universal access to more advanced equipment is likely to be better funded directly through general government revenue rather than by imposing requirements on telecommunications operators.

Improving equity of access to the Internet will involve the widespread training and access policies outlined in the *Cyber Korea 21* White Paper – initiatives such as connecting 10 400 schools, teaching civil servants, housewives, students and military personnel to use computers; building Internet Plazas; and facilitating Internet PC purchases.

The Korean government has also encouraged working from home resulting in a sharp increase in the home usage of networked PCs. This has resulted in a significant growth in cable-based or ADSL broadband services in recent months. What has contributed to the popularity of working from home has been the availability of cheaper PCs resulting from a government-initiated Internet PC project that boosted the sales of PCs and notebook computers. The government's role in this has been one of promotion and not funding.

France

The French Government has declared a high priority Information Society action programme and believes that the public sector has a major role to play in implementing this programme. There is considerable emphasis on the benefits of the *E*-conomy being available to all French citizens. The focus of government action is on developing various types of broadband access, particularly broadband wireless, xDSL and cable modems simultaneously lower communications charges.

Aside from pro-competitive regulatory action, high profile speeches and some examples of public/private sector consultation, however, so far only limited examples of initiatives directly promoting broadband access are identifiable.

United Kingdom

To address the issue of broadband access to small and medium enterprises (SMEs) and consumers, in 1997 the British government developed a strategic plan to achieve growth in broadband networks. The strong emphasis was on encouraging successful business start ups, and maximising business opportunities for SMEs, and on a lesser scale improving access for consumers. To increase e-commerce opportunities the British government's specific goals and initiatives include:

- Roll out of broader-band networks on a national basis to make information networks more accessible.

- Appointment of an e-Minister and e-Envoy.
- Partnerships with major United Kingdom businesses to ensure that by 2001, GBP 75 million worth of funding is secured from the 5th Framework European Program for the promotion of an information society.
- A strong partnership with the United Kingdom regulator (OFTEL), to ensure a fair, competitive market and value for consumers and SMEs.
- Free narrowband Internet connections within the public sector (*e.g.* schools, colleges, hospitals) but no steps have yet been taken to extend this to broadband.
- Access through information and communications technology (ICT) to all groups.
- Target figures of 1.5 million SMEs linked to the digital marketplace and 1 million SMEs trading on-line (by 2002).
- Direct marketing – advertising and Direct Mail campaign targeted at SMEs – to increase awareness of e-commerce and the annual e-commerce award scheme to encourage commercial awareness and competition.
- Make advice more accessible, including the creation of an ISI Centre to give advice to SMEs on the use of ITC in business.
- Establishment of E-commerce Resource Centres to assist new start ups.

In addition to central government initiatives, the agencies are also active in trying to ensure that their regions do not miss out on broadband access. For instance, the Welsh Development Agency has allocated some EU funding to projects which will provide xDSL in parts of Wales faster than would have been possible by market forces alone. In addition to the market rollout, it is expected that local initiatives will support rollout of higher bandwidth facilities into areas where operators may not currently plan to offer such services because sparse population levels make a reasonable commercial return unlikely. For example, in Wales the Pathway Project, run jointly by Powys County Council and the Welsh Development Agency, and supported by EU Structural Funds, aims to upgrade the telecommunications infrastructure in rural areas to allow access to advanced telecommunications services by the end of 2001. Other Assisted Areas may be in a position, within European investment rules, to assist in the provision of higher bandwidth services to rural and remote communities, *e.g.* to public access points, schools and businesses. In very remote rural areas, initiatives would need to work within technical constraints associated with the delivery of higher bandwidth services.

In Scotland, Highlands & Islands Enterprise, an agency responsible for economic development in one of the more sparsely populated regions of the EU, has in the last few years been successful in ensuring that modern fixed and mobile networks are available across the region. It has done this through the use of EU funding and a partnership with BT and other telecommunications operators. It has also provided “anchor” customers, mainly educational establishments such as the University of the Highlands & Islands (a virtual academic institute) that provide enough network traffic to satisfy the on-going running costs of the network operators.

United States

The 1996 Telecommunications Act (section 706) directs the FCC and State Public Utilities Commissions to monitor the roll-out of advanced telecommunications capability and, if necessary, to take steps to ensure that all Americans have access to such capability on a reasonable and timely basis.

In 1999 the FCC announced the goal of achieving open broadband access. Later that year, the FCC disclosed that broadband deployment is increasingly becoming a top priority as it seeks to ensure that the benefits of the communications and information revolution extend throughout the United States. The National Telecommunications and Information Authority (NTIA) also plays a leading role in the government's Information Society activities.

In essence, the United States pursues a policy of relying on a competitive market and pro-competition regulation to achieve its goal of low cost telecommunications services for all, for broadband as well as narrowband service. The FCC's policy position is that the most important government action is to create the environment necessary for the further development of broadband access. The FCC considers that market dynamics and incentives will go a long way in ensuring that an open broadband platform develops.

Specific FCC initiatives include:

1. Annual reviews of the development of access to "advanced communications services", focusing particularly on consumers, SMEs and disparities between urban and rural access. As part of the first review in 1999, the FCC established a series of "on going broadband monitoring sessions" on the subject. Participants included local government representatives, public interest groups, investment analysts, cable and phone companies, ISPs, academics and others.
2. In 1999, the FCC established a Federal-State Joint Conference to promote advancement of broadband services. The Joint Conference provided a forum for an ongoing dialogue between the Commission, state regulators, and local and regional entities regarding the deployment of advanced telecommunications capabilities, *e.g.* Broadband. Its aim was to identify a set of "best practices from across the nation so that one community (in Vermont, for example), could learn how another county (*e.g.* in Nevada) collected and quantified aggregate demand sufficient to make the case for a local provider to invest in broadband technology.
3. In June 2000, the FCC and State regulators announced the development of a nationwide database of broadband deployment activities, including an interactive Web site to serve as a national clearing house for local communities to share news and information about their broadband deployment projects.
4. In November 1999, the FCC adopted rules to promote competition for advanced services, by directing local telephone companies to share their telephone lines with providers of high speed Internet access and other data services.⁶⁷ This Order is intended to ensure that as many companies as possible will be able to deploy new technologies on a faster, more cost-effective basis and designed to accelerate the ability of residential and small business customers to access competitive broadband services from their choice of providers.
5. In December 1999 the FCC launched a 12 day programme on the FCC Web site to raise awareness of broadband opportunities. Each day was devoted to a specific aspect of broadband use, including its potential use in areas such as education, telemedicine, news and information gathering, and shopping.

6. A variety of funding initiatives to promote Internet access in rural and some urban areas have also been developed by a number of government departments. Both narrowband and broadband access are considered. Examples include:
 - NTIA's Technical Opportunities Programme (TOP) which gives grants to public and non-profit making organisations for model projects in poor urban and rural areas. The recipient organisations in these areas have to contribute part of the cost of the projects themselves. The programme supports projects that demonstrate the value of broadband networks in rural areas.
 - The Economic Development Administration, an agency of the Department of Commerce, provides grants to support technology-driven projects facilitating economic development. It is currently supporting a project involving fibre deployment to create a distance learning network.
 - The Department of Agriculture Rural Utilities Service Telecommunications Programs has long supported the development of telecommunications in rural areas with fibre deployment eligible for funding support.

Tax credits

In the United States, Bills before Congress, such as S.2698 (The Broadband Internet Access Act of 2000), aim to bridge the digital divide by giving tax breaks to corporations for building infrastructure.

Switzerland

The Information Society Project Switzerland (ISPS) established in 1998 targets all citizens but contains government action aimed at education and training, creating on-line government services and fostering an open regulatory framework. The government has explicitly refused to fund infrastructure development.⁶⁸ However, in certain instances, cantonal/local government may subsidise access (*e.g.* for schools).

SECTION 5. BEYOND ACCESS TO INTERNET INFRASTRUCTURE

5.1 Socio-demographic barriers to the take-up of access facilities

Evidence from many countries indicates that socio-demographic factors such as income, education levels, gender, age and disabilities are major determinants of Internet access and usage patterns.⁶⁹ Thus, as well as “supply side factors” such as access to hardware and software and an Internet connection, “demand-side” factors such as the skills to use the facilities are necessary. Importantly, as access to the infrastructure aspects of Internet connectivity is increasingly achieved, these socio-demographic barriers to the take-up of telecommunications and online services will become the more problematic aspects of the digital divide.

Government initiatives demonstrate an awareness of the importance of the socio-demographic barriers. The private sector too is demonstrating through its activities that it is increasingly aware that to ensure a viable workforce for the new economy, to broaden markets for e-business and to capture opportunities being spawned by “convergence” and the new economy, it has a shared interest with government to address the digital divide.

This section provides some information on initiatives to increase the take-up of access facilities taken by government, the private sector, and community organisations, including combined government/private sector/community partnerships that are not dealt with elsewhere.

5.2 Demand side measures

Demand-side measures are often overlapping and interlinking, but it may nevertheless be useful to organise issues into three streams:

- Demand stimulation measures.
- Demand aggregation measures.
- Sustainability concerns.

5.2 (i) Demand stimulation measures

Demand for services is a main driver of the deployment of advanced telecommunications capability. Thus programmes designed to increase consumers' interest in and use of advanced technologies and services can spur further deployment.

In designing demand stimulation measures, governments are being guided by the recognition that:

- Relevant local content, applications and services are critical for stimulating demand for online services.

- Demand generation strategies need to focus on identifying the real service needs of regional, rural and remote communities, and must recognise that the needs and priorities of different communities can vary widely.

In some OECD countries, government bodies as well as the larger private businesses with a commercial presence in regional centres, are playing an important role in establishing and maintaining demand for data services in regional centres. This core demand is a crucial factor inducing carriers to enter the market, thereupon also making their services available to small businesses and domestic users in the region.

Community networks

Community networking can and has provided the catalyst and the means for communities to collaborate amongst and within themselves at the regional level to effectively bring together the interests of government, business and volunteer-based organisations. A number of municipalities, school systems, and other institutions, with their own needs for advanced network services, are exploring options that leverage their infrastructure development plans, to extend broadband services to other organisations as well as individuals. Community partnerships that focus on the development of locally-based and focused content, are playing a vital role in stimulating demand for enhanced services.

5.2 (ii) Demand aggregation measures

The presence of a group of customers who can be served collectively can substantially reduce providers' customer acquisition costs. Thus the ability to aggregate customer demand for advanced services in order to demonstrate demand sufficient to warrant infrastructure investment can be valuable. This can be particularly important when seeking a provider in regional, rural and remote areas.

In the United States, Berkshire Connect⁷⁰ is an example of a successful demand aggregation effort. In rural Berkshire County, Massachusetts, a consortium of business, cultural, academic and local economic development leaders formed Berkshire Connect and created an attractive market by aggregating demand from all sectors and all levels of users. The consortium was able to attract several million dollars for the construction of new facilities. As a result, they are now able to purchase advanced services at rates comparable to those paid in Boston. The Massachusetts Community Network has taken a similar approach using the combined demand of local government traffic. The state government requested bids for T1 services to all of its municipal governments and schools. To win the contract, the bidder was required to offer the same price for T1 service to any customer, regardless of location. According to the project's management, the winning contract cut T1 costs in Massachusetts nearly in half, and guaranteed access to T1 services for all towns, villages and schools in the state.

In Australia some important considerations in constructing demand aggregation strategies are being put forward.⁷¹ These include:

- Regions themselves must be the primary drivers of demand aggregation strategies, with government partners playing a supporting role.
- Demand aggregation strategies need to explore innovative service developments that have the potential to leapfrog existing technologies and services, and provide regions with cost-effective access to new services at urban price and service quality levels.
- Whole-of-government aggregation strategies can provide more cost-effective access to bandwidth for regional communities, particularly for remote areas. However such strategies

need to ensure benefits flow through to non-government communications users; and that whole-of-government arrangements do not impede the capacity of regions to aggregate demand at the regional level.

- In the more remote regions where there is a minimal level of infrastructure, USO tendering has a potential to provide a substantial base for demand aggregation.
- Demand aggregation strategies should explore all opportunities for infrastructure sharing, particularly using “anchor tenants”, such as government service providers.

Anchor tenants

The reference to “anchor tenants” above warrants some elaboration. Essentially, a public entity, or other large customer, can use its demand to attract investment in infrastructure with advanced telecommunications capability. The infrastructure used to provide service to this anchor tenant can then be used by other business and residential consumers, or it can be the springboard for deployment of additional facilities. In some instances, public entities acting as the anchor tenant have put conditions on their purchase agreements, such as requiring providers to serve rural areas in a certain time frame.

In Colorado, the state government has acted as an anchor tenant. Colorado requested bids for high-speed service at each of its 64 county seats to carry the State's data traffic, such as data related to driver's license and registration and that related to public assistance benefits. A multi-year contract was awarded to the winning bidder in April 2000 on the basis of price and how quickly remote counties would be served. By 2003, all counties will be served with advanced telecommunications capability.

The state of Montana has undertaken similar initiatives, the most recent is called SUMMITNET II. This project connects nine Montana communities and carries the traffic of public and educational entities. In addition to providing direct benefits to the public customers involved, the project sponsors believe it will bring investment in advanced services capability to these communities.

There are examples of government initiatives being used to leverage market developments. For instance, in Australia, the Queensland Government disclosed that it had leveraged its own requirements to improve accessibility to digital data service and reduce tariffs for rural and remote communities. This network initiative influenced Telstra to invest in an additional 29 Dial Connect Points of Presence throughout Queensland that are available for use by all government agencies and communities.

Commercially negotiated programmes between governments and carriers have been used to increase the opportunity for regional and rural inhabitants to access data services – and additionally, these programmes have influenced carrier infrastructure roll out plans. The opportunity to aggregate content can also be useful since this can also lead to increased economies of scale, as well as a better marketing focus for regions.

5.2 (iii) Strategies to sustain demand and service delivery

Governments and regulatory authorities are recognising the need to ensure that not only short term solutions are sought from the opportunities provided by changing technologies, potential entry and new models of provision. However, ways must be found to provide incentives, or to ensure that there are suppliers practically focussed upon supplying the needs of local communities in the long term.

Tactical solutions are inadequate since solutions need to be sustainable over the long term. Policy focusing on the gap between those with Internet access and those without will assist. However, to improve the socio-economic status for disadvantaged groups, public policy should focus on bringing access to people in the home, in school and at work.

Governments are exploring various approaches, including a willingness to enter new strategic partnerships, and to encourage “social entrepreneurs” to “broker” such partnerships. It is also being recognised that careful management will be required to sustain the partnerships between the private sector and the community since there is likely to be an inherent tension between the objectives of the private sector and those of the community.

NOTES

1. Irish Information Society Commission, Ireland's Progress as an Information Society: 1999 Research into General Public Attitudes towards Information and Communications Technology, www.isc.ie
2. This news release as well as all others issued by Industry Canada may be accessed online at: <http://www.ic.gc.ca>
3. The FCC defined broadband "as having the capability of supporting, in both the provider-to-customer (downstream) and the customer-to-provider (upstream) directions, a speed (in technical terms, 'bandwidth') in excess of 200 kilobits per second (kbps) in the last mile".

In a later report, the FCC defines advanced telecommunications capability as infrastructure capable of delivering a speed in excess of 200kbps in each direction. The FCC denominates as 'high speed' those services capable of delivering transmission speeds in excess of 200kbps in at least one direction. Advanced telecommunication capability and advanced services thus are a subset of the larger 'high-speed' category. A service may have asymmetrical upstream and downstream transmission paths and still be advanced telecommunications capability as long as both paths are capable of speeds in excess of 200kbps to the network demarcation point at the subscriber's premises.

4. The term advanced (telecommunications) capability, the term advanced services, and the term broadband are used interchangeably/synonymously to mean the same thing. Advanced services are generally understood to mean digital information transmission rates (bit rates) that are significantly higher than the nominal 56 kilobits/second that can be transmitted through an ordinary, high quality telephone voice circuit. The FCC's definition of broadband is the capability of supporting at least 200 kilobits/second in the consumer's connection to the network ("last mile"), both from the provider to the consumer (downstream) and from the consumer to the provider (upstream). Because most consumers use the Internet to receive data, broadband service offerings are generally asymmetrical (*i.e.* the downstream link operates at a higher rate than the upstream link). The US NTIA and RUS believe that two-way capability is an essential element of broadband service because it enables an end-user to be a content originator or service provider.
5. This level of service is necessary for effective use of real-time video. There is increasing bandwidth intensity in the provision of many online services as demand is generated from more advanced levels of broadband access in countries such as the US. High-bandwidth services are expected to be increasingly important in:
 - Electronic commerce such as in the presentation of products using real-time video interaction.
 - Education such as in interaction between teachers and students.
 - Health such as for consultation and diagnostic purposes.
 - Service delivery such as "virtual call centres" using video as well as voice interaction.
 - Teleworking, permitting, for example, video as well as audio- and text-based interaction with work colleagues and others regardless of geographical location.

- Communications such as the development of “video phones”.

6. Education. The importance of an enhanced data capability in the delivery of education are said to include:

- An improvement in the quality of education service delivery particularly to rural and remote areas thus promoting equity between country and city students and increasing participation rates of rural and remote students in secondary and tertiary education.
- Enabling the effective delivery of an improved quality of professional development to education staff in remote areas through video linked training, in services and information dissemination.
- Providing a more direct means of communication for schools. This was seen as having the potential to improve the quality of school administration and to promote the flexible delivery of distance based education.

An enhanced data capability would enable cost-effective provision of distance based education. In addition, the fact that the data capability can complement traditional education delivery platforms was noted by a number of state governments and education-specific organisations.

7. Health. Health was identified as another area that has much to gain from an enhanced data capability. Telehealth and video conferencing are said to be able to be efficient and effective modes of health service delivery. Telehealth networks would promote equity in health service delivery by improving access to health services and information, particularly in rural and remote areas. The ability of video conferencing to encourage the relocation of medical practitioners and other professionals thus increasing the number and availability of services to small regional centres. Improved client health outcomes through decreasing patient travel time and improved speed of access to health services is cited. An enhanced data capability can supplement existing health programmes in rural areas and capitalise on the expertise of health care providers.

8. e-Government. E-government presents a tremendous opportunity for the use of information and communications technology in the provision of government services. It can significantly improve efficiency in service delivery and reduce costs and can also serve to educate people in the use of information and communications technology. Government must drive initiatives to ensure that information and communications technology offer opportunities for electronic citizenship.

Delivering public services electronically will be critical to making information and communications technology more relevant to the life of every individual.

In addition, if consumers are not educated and equipped to do business electronically then this could represent a serious impediment to the growth of e-commerce.

9. Okinawa Charter on Global information Society at <http://www.g8kyushu-okinawa.go.jp/e/documents/itl.html>

10. Sawhney H, “Universal Service: Separating the Grain of Truth from the Proverbial Chaff”, *The Information Society*, 16, 161-164, 2000.

11. OECD, Understanding the Digital Divide, OECD/DSTI, Paris 2001; Local Access Pricing and E-Commerce, DSTI/ICCP/TISP(2000)1/FINAL; Internet Infrastructure Indicators, DSTI/ICCP/TISP(98)7/FINAL; Building Infrastructure for Electronic Commerce – Leased Line Developments and Pricing, DSTI/ICCP/TISP(99)4/FINAL; Webcasting and Convergence: Policy Implications, OCDE/GD(97)221; The Role of Telecommunications and Information Infrastructures in Advancing Electronic Commerce, DSTI/ICCP/TISP(98)8/FINAL; *Universal Service and Rate Restructuring in Telecommunications, Information Computer Communications Policy, Number 23*, Paris

- 1991; *Universal Service Obligations in a competitive telecommunications environment*, Paris 1995; *Universal Service and Public Access in the Networked Society*, Paris 1997. OECD.
12. "Inquiry Concerning the Deployment of Advanced Telecommunications Capabilities", CC Docket No. 98-146, Report, 14FCCRcd2398,2406(1999).
 13. Oftel, "Access to Bandwidth: Delivering Competition for the Information Age", A statement issued by the Director General of Telecommunications, November 1999.
 14. United Kingdom online report at <http://www.ukonline.gov.uk>
 15. Oftel, "Access to Bandwidth: Delivering Competition for the Information Age", A statement issued by the Director General of Telecommunications, November 1999.
 16. Federal Communications Commission, "Deployment of Advanced Telecommunications Capability: Second Report", August 2000.
 17. This news release as well as all others issued by Industry Canada may be accessed online at: <http://www.ic.gc.ca>
 18. Swedish Ministry of Industry, Employment and Communications, "An Information Society for All", N.2000.018, March 2000.
 19. Also see, Ministry of Trade and Industry, Action Plan, Broadband Communication 1.0, Oslo, 11 October 2000.
 20. This news release as well as all others issued by Industry Canada may be accessed online at: <http://www.ic.gc.ca>
 21. "Falling Through the Net, Toward Digital Inclusion", available at (<http://www.ntia.doc.gov/ntiahome/digitaldivide/execsumfttn00.htm>)
 22. Federal Communications Commission, "Deployment of Advanced Telecommunications Capability": Second Report, August 2000.
 23. NTIA & Rural Utilities Service (Department of Agriculture), *Advanced Telecommunications in Rural America: The Challenge of bringing Broadband Service to all Americans*, Washington D.C. April 2000.
 24. Oftel, "Review of the dial-up Internet access market", October 2000.
 25. Ministry of Economy, Finance and Industry, "Report on High-Speed/Capacity Networks: New Content, Applications, and Services", March 2000.
 26. 2000 Korea Internet White Paper.
 27. Network Economics Consulting Group, "New Market Models for the Delivery of Telecommunications and Online Services in Regional Australia", August 2000.
 28. OECD, "Local Access Pricing and E-Commerce", DSTI/ICCP/TISP(2000)1/FINAL, Paris 2000.
 29. Unbundling the 'unconditioned local loop' enables competitors to use copper cable between exchange facilities and each customer. Competitors can connect their own electronic components and switching equipment to the cable in order to supply telephony and high speed services for carrying data direct to end users. Declaration of this service provides new competitors with greater flexibility in developing and supplying new services to consumers.

30. FRIACO is short for Flat Rate Internet Access Call Origination. See Oftel, "Review of the dial-up Internet access market", available at <http://www.oftel.gov.uk/competition/iamr11000.htm>
31. See, OECD, "Local Access Pricing and E-Commerce", DSTI/ICCP/TISP(2000)1/FINAL.
32. The support for universal service for basic telecommunications is certainly not unanimous. See for example, Lawrence Gasman, "Universal Service: The New Telecommunications Entitlements and Taxes" Cato Policy Analysis, No. 310 June 25, 1998.
33. Arguments for an expansion of the USO to include Internet access into regional, rural and remote areas draw on support from the rationale of so-called 'network externalities'. The externality occurs because all customers receive benefits when others join the network. Because these benefits cannot be reflected directly in individual transactions or met on strict commercial terms, there is a role for government in ensuring that the network is as extensive as is feasible at appropriate prices.
34. A 'data capability' refers to the ability of a carriage service to carry data expressed in terms of a data transmission rate which is what determines both the type of applications that a service can support and the responsiveness at which they operate. Hence, a higher data rate enables a data service to support a wider range of applications and to run those applications more quickly. Groups representing customer interests have suggested that the definition of a basic service should include a telephone line capable of local and inter-exchange data transmission at a modem speed of 28.8kb/s or higher. For instance, in Australia, the average data rate in rural and remote areas was estimated at somewhere between 2.4kbit/s and 9.6kbit/s, whereas urban rates averaged 14.4kbit/s to 28.8kbit/s. Many rural consumers made submissions to a government initiated inquiry stating that a data rate of 2.4kbit/s is inadequate for accessing online and other Internet applications. Rural customers perceive that they are doubly disadvantaged as it takes longer and costs more to complete identical tasks.
35. Australian Information Economy Advisory Council (AIEAC), "National Bandwidth Inquiry: Report of the Australian Information Economy Advisory Council", Canberra, 1999, p. xi.
36. European Commission, "Towards a new framework for Electronic Communications infrastructure and associated services, The 1999 Communications Review", Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, COM(1999)539.
37. Commission of the European Communities, "Proposal for a Directive of the European Parliament and of the Council on universal service and users' rights relating to electronic communications networks and services", Brussels, 12 July 2000 COM(2000)392.
38. The Commission, however, adopted a Council Recommendation (92/383/EEC of 5 June 1992) on the provision of harmonised integrated services digital network (ISDN) access arrangements and a minimum set of ISDN offerings in accordance with open network provision (ONP) principles.
39. One question that has been raised is whether there is a need for an upper ceiling for national minimum data speeds to ensure that regulators do not impose undue burdens on industry.
40. Oftel, "Review of the dial-up Internet access market", October 2000.
41. OFTEL, "Review of Universal Telecommunication Services." A consultative document issued by the Director General of Telecommunications, September 2000. Available at <http://www.oftel.gov.uk/consumer/uso0900.htm>
42. Available at www.governo.it/fsi
43. Federal-State Joint Board on Universal Service, Recommended Decision, Before the Federal Communications Commission, Adopted 7 November 1996.

44. Canadian Radio-Television and Telecommunications Commission, Telecom Decision CRTC 99-16 Telephone Service to High-cost Serving Areas, paragraphs 26 and 27.
45. More information on the Connecting Canadians programme can be found online at: <http://connect.gc.ca/>
46. Towards a Swedish Information Society for All, Report prepared for the conference “Stepping Stones into the Digital World” in Bremen, Germany, on 21-22 September 2000.
47. Savage, J, “International Public Programs to provide Broadband Access to the Internet”, prepared for Industry Canada, 5 January 2001.
48. Ovum, “Calculation of the Intangible Potential Benefits of being the Universal Service Provider”, Discussion Paper November 1999.
49. Australian Communications Authority (ACA), Digital Data Inquiry, Public Inquiry under section 486(1) of the Telecommunications Act 1997, Australian Communications Authority, 1998.
50. (Australian) Department of Communications, Information Technology and the Arts, Telecommunications Universal Service Obligation Review Of Funding Arrangements, August 1999.
51. ART, (Autorité de régulation des télécommunications), *L’Autorité détermine les conditions du financement du service universel des télécommunications, Decision 98-907*, November 13, 1998, Paris.
52. Department of Communications, Information Technology and the Arts, Regional USO Contestability Pilots, See factsheet available at <www.dcita.gov.au>
53. A detailed review of the availability of broadband access in various countries is available in, “The Status of Broadband Access Services for Consumers and SMEs”, a report to Telestryrelsen, prepared by Ovum.
54. European Commission, *eEurope: An Information Society for All*, (1999), www.ispo.cec.be/eeurope-initiative.htm
55. Details of progress on each action line are available on the eEurope Web site at http://europa.eu.int/information_society/e-europe/
56. Ensuring that less-favoured regions can fully participate in the Information Society is a priority for the European Union. Projects encouraging up-take of new technologies must therefore become a key element in regional development agendas. Public investment in Information Society infrastructure in less favoured regions may be justified in cases of market failures, where private investment alone cannot be profitable. These investments must be made in a way that does not distort competition and is technologically neutral. Investments must be determined by each region and on the basis of their particular economic and social structure. The Commission has undertaken to increase priority of information society related projects within the structural funds. A similar revision of priorities has been announced by the European Investment Bank (EIB).
57. See “The Digital Divide in Austria”, Report by the Institute of Technology Assessment and the Austrian Academy of Sciences, Vienna July 2000.
58. The full title is “*Go on! Österreich ans Internet. Eine Initiative des Bundeskanzlers*”. See <http://www.austria.gv.at/go on>
59. Government of Germany, “Innovation and Jobs in the Information Society in the 21st century – The Internet for Everyone”.
60. The English version is available at www.governo.it/fsi

61. More details are available at <<http://www.dcita.gov.au>>
62. More detailed information about the administration of Networking the Nation is available from the programme Website at <http://www.dcita.gov.au/rtif.html>.
63. Danish Ministry of Research and Information Technology (1999). "Digital Denmark – conversion to the network society". Copenhagen: Ministry of Research and Information Technology; Danish Ministry of Research and Information Technology (2000). Realigning to the network society. Copenhagen: Ministry of Research and Information Technology.
64. Towards a Swedish Information Society for All, Report prepared for the conference "Stepping Stones into the Digital World" in Bremen, Germany, on 21-22 September 2000.
65. "Finland as an Information Society", The report of the Information Society Advisory Board to the Finnish Government, 2000.
66. Further information is available at <http://www.miti.go.jp/english/whatsnew/data/c2001polie.html>
67. FCC, "Line Sharing" to Lower Cost and Increase Availability of Broadband Services Used for High Speed Access to the Internet, November 18, 1999.
68. Savage, J, *International Public Programs to provide Broadband Access to the Internet*, prepared for Industry Canada, 5 January 2001.
69. Booz Allen & Hamilton, *Achieving Universal Access*, London 7 March 2000.
70. <http://www.bconnect.org>
71. Australian Information Economy Advisory Council (AIEAC), National Bandwidth Inquiry: Report of the Australian Information Economy Advisory Council, Canberra, 1999.

Improving the Environmental Performance of Agriculture

Policy Options and Market Approaches

**IMPROVING THE ENVIRONMENTAL PERFORMANCE OF AGRICULTURE:
POLICY OPTIONS AND MARKET APPROACHES**

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development, and
- to contribute to the expansion of world trade on a multilateral, on-discriminatory basis in accordance with international obligations.

The original Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became Members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973) Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996), Korea (12th December 1996) and the Slovak Republic (14th December 2000). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

Publié en français sous le titre :
Améliorer les performances environnementales
de l'agriculture : choix de mesures et approches par le marche

© OECD 2001

Permission to reproduce a portion of this work for non-commercial purposes or classroom use should be obtained through the Centre français d'exploitation du droit de copie (CFC), 20, rue des Grands-Augustins, 75006 Paris, France, Tel. (33 1) 44 07 47 70, Fax (33 1) 46 34 67 19, for every country except the United States. In the United States permission should be obtained through the Copyright Clearance Center, Customer Service, (508) 750-8400, 222 Rosewood Drive, Danvers, MA 01923 USA, or CCC Online: www.copyright.com. All other applications for permission to reproduce or translate all or part of this book should be made to OECD Publications, 2, rue André-Pascal, 75775 Paris Cedex 16, France.

Foreword

Agriculture has a major impact on the environment, especially on land use, soil, water, biodiversity and landscapes. There is a general recognition of the need to enhance the beneficial, and reduce the harmful, environmental impacts of agriculture and to ensure the sustainability of resource use. Agricultural policies in many OECD countries provide substantial production-linked support affecting resource use, farming practices and environmental quality. Reconciling the need for sufficient and safe food and environmental quality is a challenge, and the reform of agricultural policies is starting to give signals to farmers that will contribute to these aims. Many OECD countries have been introducing a variety of policy measures to address environmental concerns and developing indicators to track the state and trends of environmental conditions in agriculture.

Given the heightened concern in OECD countries about the effects of agricultural activities and policies on the environment, and the linkages with environmental policies, OECD has undertaken significant work in this field through the activities carried out by the Joint Working Party of the Committee for Agriculture and the Environment Policy Committee (JWP). A first synthesis of the main conceptual issues and analytical results of the work carried out by the JWP was published in 1998 under the title *Agriculture and the Environment: Issues and Policies*. The present report is a synthesis of the work undertaken since then. The two parent Committees approved the report in March 2001 and agreed to publish it as an OECD document. It is addressed to policy makers, farmers' organisations, non-government organisations, as well as the wider public in both OECD and non-OECD countries.

TABLE OF CONTENTS

Executive Summary.....	6
Introduction.....	7
Background	7
Policy context	7
Environmental impacts	10
What are the main environmental impacts of agricultural activities?	10
What is the current environmental performance of agriculture?	14
What have been the environmental impacts of agricultural policies?	18
What have been the environmental impacts of trade liberalisation?	24
Improving environmental performance: policies and markets.....	25
How can the environmental impacts of agricultural activities be taken into account?.....	25
What is the role of markets and policies?.....	26
What is the role of technology and information?	27
How could market forces be harnessed to improve the environmental performance of agriculture?.....	30
What is the role of agri-environmental policies?.....	34
Guidelines for policies	36
How to determine the need for policy action?.....	36
How to choose the appropriate agri-environmental policy measure?	37
How to design and implement agri-environmental measures?.....	39
Concluding comments.....	40
<i>Annex 1</i> Recent OECD Publications.....	42
<i>Annex 2</i> Main Domestic and International Events Shaping Agricultural Sectors and Policies	43
<i>Annex 3</i> The Polluter-Pays-Principle.....	45
<i>Annex 4</i> Joint Provision of Environmental Impacts (Outputs) of Agricultural Production	47
<i>Annex 5</i> Environmental Reference Levels: Allocation of Costs and Benefits Associated with Environmental Quality	49
 Boxes	
Box 1. Agriculture and sustainable development	8
Box 2. Key concepts	9
Box 3. Main environmental impacts of agriculture in OECD countries	11
Box 4. The use of farm inputs and the environmental impacts of agriculture	12
Box 5. Improving sector environmental performance: the industrial sector experience.....	25
Box 6. Conservation easements	31
Box 7. General policy principles.....	34
Box 8. General criteria for policy action.....	37

Executive Summary

Agriculture has a major impact on the environment, especially on land, water and biodiversity. Over the last 10-15 years, the environmental performance of agriculture has been mixed. Nitrogen and pesticide loading in water remain relatively high and risks of soil erosion and water resource depletion persist in many regions and countries. In recent years there has been improvement in wildlife habitats, landscapes, and sinks for greenhouse gases provided by agriculture, but the most significant progress has occurred where environmental pressures have been greatest.

Agricultural policies in many OECD countries provide substantial farm support, often linked to commodity production affecting resource use, farming practices, and environmental performance. Reconciling food production and environmental goals is a challenge. Sometimes it can be achieved through the adoption of appropriate technologies and practices or simply changing the level, type and location of agricultural production. But reconciling those goals also means that the rights and responsibilities of farmers regarding farm practices need to be clearly defined and applied, and thus the situations under which they are entitled to remuneration or obliged to pay (polluter-pays-principle). Defining who pays and who is paid for the desired level of environmental performance has important implications for the distribution of income and wealth.

The *reform of agricultural policies* to allow for greater influence of market signals in agricultural production and to reduce barriers to international trade, underpinned by the Uruguay Round agreement, is starting to provide signals to farmers that will contribute to a better use of resources and improve environmental performance. Agricultural trade liberalisation has the potential to improve environmental performance although in some cases complementary environmental measures may be needed. Some OECD countries are shifting to policies less linked to production and implementing agri-environmental measures, which have the potential to reduce pressure on the environment. But the payments for improving environmental performance are higher than would otherwise be the case where they counteract the damaging environmental effects of agricultural support. While a more efficient use of resources is necessary to improve the environmental performance of agriculture, this may not stimulate sufficient environmental public goods demanded by society or sufficiently reduce environmental harm, where markets are lacking or incomplete. As many of the positive and negative environmental effects of agriculture are spillovers to the rest of the economy or public goods, the achievement of the desired level of environmental quality will depend on mechanisms and policies so that farmers take these spillovers or public goods into account in their decisions.

This report highlights a number of *general principles, criteria and guidelines for policy action*, which can contribute to improving the environmental performance of agriculture in a sustainable way. It contributes to the debate on where there is a case for any policy action to take account of environmental costs and benefits. It also assists the choice and evaluation of the alternative options and approaches for achieving environmental objectives. The aim is to enhance policy transparency and define “good policies and approaches” to address the main environmental issues in agriculture in the context of agricultural and trade policy reform. The combination of agricultural and environmental policy measures needs to be carefully designed and implemented to ensure coherence so that they improve environmental quality in the most cost-effective and transparent way, with least distortion to production and trade. Bringing together information and data on environmental trends (agri-environmental indicators) and on policies and approaches (policy indicators), and tools and methods of evaluation of actual experience in OECD countries can contribute to achieving this objective.

IMPROVING THE ENVIRONMENTAL PERFORMANCE OF AGRICULTURE: POLICY OPTIONS AND MARKET APPROACHES

Introduction

Background

The effects of agricultural activities on the environment are of growing concern in OECD countries. There is a general recognition of the need to improve environmental performance in agriculture, through enhancing the beneficial, and reducing the harmful environmental effects, and to ensure the sustainability of resource use. As a contribution towards identifying ways of improving the environmental performance in agriculture, the OECD published a report in 1998 entitled *Agriculture and the Environment: Issues and Policies*.

The report highlighted the key issues for policy makers, described and analysed the linkages between policies and the environment in agriculture, and started to provide quantitative measures of the effects of agriculture on the environment. The report concluded that the overall objective of future work should be “to identify ways and offer guidelines to help governments to promote appropriate and cost-effective solutions to achieve environmentally, economically and socially sustainable agriculture, with least trade distortions”, and outlined the main areas for further work:

- Developing agri-environmental indicators, including their use in policy analysis;
- Monitoring and evaluating agricultural, agri-environmental, and environmental policies;
- Understanding conceptual issues relating to reference levels, property rights and the polluter- pays-principle;
- Providing a longer-term perspective on sustainable agriculture, by identifying criteria of “good policy practice”, the possible adjustment to the agricultural sector, and policy implications; and
- Analysing the linkages between agriculture, trade and environment, and examining issues in climate change and agriculture, and eco-labelling in the agri-food sector.

The main purpose of the present study is to present a synthesis of the work undertaken during the period 1998-2000 in the Joint Working Party of the Committee for Agriculture and the Environment Policy Committee. The work has been undertaken to help OECD countries identify appropriate policy options and market approaches to improve environmental performance in agriculture. For reference, a list of recent OECD publications on agriculture and the environment is presented in Annex 1.

Policy context

During the last 10-15 years greater attention has been paid to addressing environmental issues in agriculture in all OECD countries. Increasing public awareness and prosperity, together with the availability of more information, have led to a heightened demand to improve the environmental performance of agriculture and to provide a wider range of food and environmental outputs. At the

same time, technological changes, structural adjustments and closer integration of agriculture into the agri-food sector have raised productivity and output but with mixed results on environmental quality.

In the next half-century world-wide the agri-food industry will need to double its output to meet the expected increased demand for food. So the challenge is whether agricultural activities can efficiently and profitably produce food to meet that growing world demand over time without degrading natural resources — productive soils, clean air, and clean and sufficient supplies of water — habitats, biodiversity and landscapes, and do so in socially acceptable ways.

Box 1. Agriculture and sustainable development*

Farmers and policy makers face significant global challenges, with increasing populations and incomes raising the demand for agriculture's primary output — food and fibre. Such demands need to be met through applying appropriate technologies and farming practices to available land and water resources, which will be under increased competition for housing, industry and transport infrastructure. Within the overall context of contributing to the achievement of sustainable development in the economy, environmentally sustainable systems of agricultural production mean reducing environmental damage from farming activities, conserving natural resources, especially land and water, and contributing to the provision of environmental benefits, such as landscapes, bio-diversity, flood control, and land conservation.

An environmentally sustainable agriculture, however, has to be viewed in the context of using scarce resources in the best possible ways. That means that the demand for sufficient, safe and secure supplies of food and fibre is met in economically efficient and least trade distorting ways while societal values and issues are taken into account, with respect to the distribution of wealth and income.

As with other sectors — although the agricultural sector may display specific characteristics — agriculture makes a contribution to sustainable development in so far as it does not take more from the earth's resources than what is put in over time. Sustainable development has variously been described as “development that lasts”, or “maintaining the stock of capital over time”, or “sustaining maximum welfare from available resources”. Combinations of scarce resources have to be allocated across a wide spectrum of competing demands in a context of uncertainty as to the future availability of resources and demands on them, and of often-imperfect mechanisms to register the value of resources to determine their best allocation.

Sustainable development is a dynamic process, which focuses on the ability of the economy to improve human welfare in cost-efficient ways through developing, combining and substituting resources in the production process — provided that there are appropriate signals to producers and consumers on which they can make their decisions. It is also a global concept, which recognises that allowing flows of resources between sectors and economies through international trade can maximise production while reducing pressure on fragile resources. And it is a multidimensional phenomenon, encompassing economic, environmental, and social aspects. The concept of sustainable development goes beyond the economic growth that is conventionally measured in Gross Domestic Product, taking account of the state of resources and environmental performance of the economy, and social and distribution aspects, in a future-oriented perspective.

Attempts have been made to measure or provide indicators of ‘sustainability’. Measures of ‘resource productivity’, ‘eco-efficiency’, and ‘green accounting’ are ways to try to incorporate non-market values of the ‘environmental dimension’ into the overall measurement of economic efficiency, welfare and sustainability. These measures attempt to take into account the value of depletion of natural resources and non-marketed outputs. They are at an early stage, but highlight the fact that these are non-marketed goods and services that command a value to society.

**See Analytic Report on Sustainable Development, OECD, 2001.*

The environmental performance of agriculture has evolved within the context of a long history of agricultural policies in most OECD countries and, more recently, policy reform and trade liberalisation, and the increasing influence of environmental measures and economy-wide policies (Annex 2), in particular within the broad framework of sustainable agriculture (Box 1). In all OECD countries environmental concerns in agriculture have been addressed through agricultural policies that

include environmental conditions, the application of economy-wide environmental policies to the agricultural sector, and market approaches including the adoption of new technologies.

The public interest issue is the extent to which the various policy measures over recent years have facilitated the improvement or impeded the deterioration of the environmental performance of agriculture, the economic and budgetary costs, the effects on farm structures and trade, and the necessary balance between the role for market approaches and different forms of policy intervention. To achieve sustainable forms of agricultural production, farmers need to have clearly defined property rights, the right knowledge and motivation, access to available technologies, adequate financial resources, and receive appropriate signals (incentives and disincentives) for taking into account the externalities and public goods associated with their production activities (Box 2 gives a summary of the definitions of the key concepts used in this report).

Box 2. Key concepts

In this report, a number of key concepts are used, which are defined below, with examples to illustrate their meaning as used in the analysis, in the context of the overall policy objective to maintain or improve the environmental performance of agriculture to contribute to sustainability.

Sustainability in agriculture is the process by which the demands for its outputs — food, fibre and other outputs — are met from farming practices that are economically efficient, respect the environment, and are socially acceptable.

Agri-environmental standards are current legally enforceable and measurable levels of environmental quality defined, for example, in terms of the levels of environmental loading (*e.g.* maximum level of nitrates in water), farming practices (*e.g.* adherence to specific crop rotations, or integrated pest management), or maintenance of habitats (*e.g.* minimum areas of semi-natural grassland, or density of specific plant species).

Agri-environmental performance targets are measurable levels of environmental quality intended to be achieved in the future and defined, for example, in terms of the levels of environmental loading (*e.g.* x% reduction from the current levels of nitrates in water), farming practices (*e.g.* increase of x% of farmers implementing specific crop rotations or integrated pest management), or maintenance of habitats (*e.g.* an increase of x% in the area under semi-natural grassland, or the density of specific plant species).

Agri-environmental reference levels are measurable levels of environmental quality that should be achieved at the farmer's own expense. Reference levels can be expressed as environmental outcomes, farming practices, or emission levels. The reference level therefore distinguishes between the cases where the polluter pays principle requires that farmers bear the costs of avoiding environmental damage, and those where delivering environmental services by means of privately owned resources or factors of production may require an incentive.

Property rights are the rights concerning the use and disposal of property, explicitly defined and enforced by law or implicitly based on tradition ("presumptive property rights"). In principle, any surrender of such rights is effected only with the individual's full consent, as when an individual offers exchange of one good for another. Therefore, they are the precondition for voluntary exchange in markets. The failure to clearly define, assign and enforce property rights is closely related to the existence of many externalities.

Externalities are spillovers that occur in the production and consumption of goods and services and increase or decrease other people's welfare. They are not themselves the object of market transactions for the gains or losses generated. Although externalities do not appear in the revenue and cost accounts of the producer or industry that is the source of the externality, they represent changes in welfare (costs and benefits) to those affected.

(continued)

Public goods are products or services for which consumption and provision cannot be limited to one individual or group of individuals. Two features make public goods different from private traded goods: *non-rivalry* — the benefit from consuming a product or service does not reduce its beneficial consumption by others; and *non-excludability* — users or potential consumers cannot be prevented from benefiting from the public good in question once it has been supplied. Also, it is impossible to require an individual to pay for the good according to the benefit derived, which would be necessary to avoid *free rider behaviour*. There can also be *local public goods*.

Polluter-pays-principle states that the polluter should be held responsible for environmental damage caused and bear the expenses of carrying out pollution prevention measures or paying for damaging the state of the environment where the consumptive or productive activities causing the environmental damage are not covered by property rights. This is the principle used for allocating costs of pollution prevention and control measures aiming to ensure a rational use of scarce environmental resources and to avoid distortions in international trade and investment (Annex 3).

The environmental performance of agriculture will be enhanced through a better understanding, measuring, and analysis of the environmental effects of agricultural activities and policies. The assessment of the environmental effects of policies requires a sound analytical and classification framework, appropriate analytical tools, and good information on the modalities of policies and on environmental performance. This report focuses on the agriculture and environment policy linkages in OECD countries, and summarises the work on providing analysis and data on these issues.

Environmental impacts

What are the main environmental impacts of agricultural activities?

Agricultural activities make use of natural resources — soil, water and air — and in many countries have shaped the natural environment and landscapes. Agricultural activities have both beneficial and harmful impacts on the environment through changing the quality or the quantity of locally available natural resources, which are also the foundations of natural habitats, biodiversity and landscapes (Box 3). Across OECD countries the relative importance accorded to the beneficial and harmful environmental effects of agriculture is often related to the density of population and the pressure of population on agricultural land use and water supplies.

To meet increasing food demands the sector has been evolving through an industrialisation process characterised by farming practices using more agricultural chemicals, machinery inputs and knowledge. Technological and economic developments have given rise to a marked intensification of agriculture (more output per unit of land or labour). Moreover, for many decades agricultural policies in most OECD countries have encouraged the expansion of commodity production, which has also been an important cause of the environmental impacts of agriculture.

Box 3. Main environmental impacts of agriculture in OECD countries

The main environmental impacts of agriculture may be characterised through the beneficial or harmful contribution of agricultural activities to:

- Soil quality (erosion, nutrient supply, moisture balance, salinity).
- Land quantity (area of ecological management of agricultural land).
- Water quality (nutrient, pesticide and sediment runoff and leaching, salinity).
- Water quantity (irrigation consumption, use efficiency, water retention capacity, flood prevention).
- Air quality (emissions of dust, odours, ammonia and greenhouse gas, absorption of carbon dioxide).
- Bio-diversity (farm and indigenous animal and plant diversity).
- Wildlife and semi-natural habitats (diversity of animal and plant habitats associated with farming).
- Rural landscape (environmental features of areas shaped by farming, including those associated with historic buildings and landmarks).

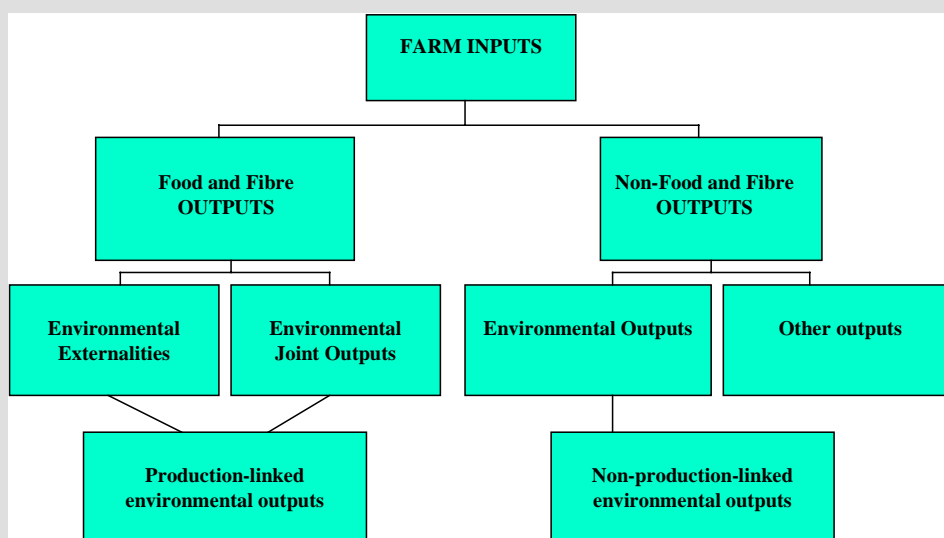
The environmental impacts of agriculture (both beneficial and harmful) result from the use of farm inputs and may or may not be linked to the production of agricultural commodities (Box 4). To produce food and fibre agriculture uses natural resources, labour and capital under different farming practices that determine the potential environmental impacts. In the case of production-linked environmental impacts, any change in farming practices will simultaneously affect agricultural production and contribute to improving or deteriorating ecological, habitat and amenity impacts.

Changes in farming practices result from farmers' production decisions taken in the light of changes in revenues and costs. Where these latter changes do not take environmental harms or benefits into account, they do not encourage farmers to reduce environmental harm and enhance environmental benefits associated with commodity production. On the other hand farmers (or other economic agents) can provide non-production-linked environmental outputs through, for example, using unproductive land to manage wilderness areas or semi-natural habitats, or preserving historic buildings and landmarks (*e.g.* fences and hedges), provided it is profitable to do so. In this case, these environmental outputs are provided by farmers through the use of factors of production at their disposal, and may affect the overall production capacity of the sector.

All economic sectors generate environmental impacts. While detrimental ecological impacts on soil, water and air quality are a feature of many economic activities, ecological impacts and landscape amenities associated with land use are significant in the agricultural (and forestry) sector because of the importance of land in production (Charts 1 and 2). To preserve or improve specific habitats or amenities it is necessary not only to protect the quality of soil and water, but also to preserve biodiversity and habitats in specific areas through different forms of land conservation and water management. In many areas, specific types of agriculture over the centuries have played an important role in creating the site-specific biodiversity, soil properties and landscape amenities. Historically, features such as hedges, walls, buffer zones and trees were created as an integral part of the management of agricultural production.

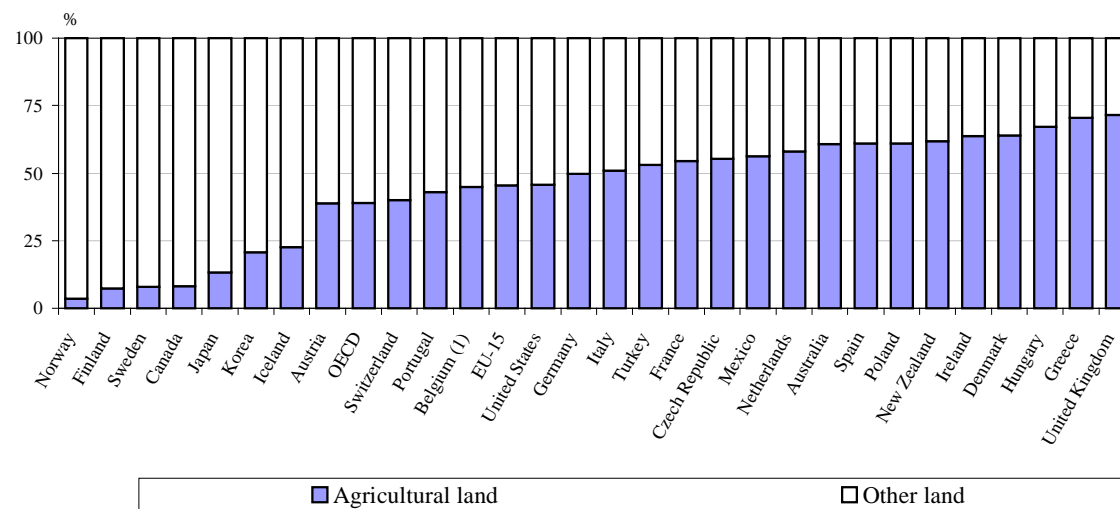
Box 4. The use of farm inputs and the environmental impacts of agriculture

Many of the environmental impacts in Box 3 of food and fibre production are off-farm externalities or spillovers. If farmers are specifically remunerated or charged for an environmental externality, this alters incentives with consequences for the allocation of the farm inputs associated with agricultural production. In this case, the environmental impact is no longer an externality but becomes a joint output with the decision on the level of production by farmers similar to those of any other joint outputs (for example, sheep meat and wool). While environmental externalities result from agricultural production, the production or preservation of some environmental services (outputs) may depend on farmers being encouraged to specifically allocate some of their own farm inputs to the provision of such services (Annex 4).



Therefore, as shown in the above diagram, the environmental impacts (beneficial and harmful) of agriculture can be either externalities or joint outputs resulting from the use of farm inputs (land, labour and capital) for producing food and fibre (agricultural commodities) — *production-linked environmental impacts (outputs)*; or goods and services resulting from the use of farm inputs to specifically produce environmental outputs — *non-production-linked environmental outputs* (e.g. management of wilderness areas, green land set-aside, hedges, walls or buffer zones and trees). While the former result from the farmer’s decision to produce food and fibre, the latter are produced from a decision by farmers or somebody else to produce the environmental output. Farmers also use their own farm input to produce *other outputs* (other than food and fibre, and environmental), for example, machinery rental services for off-farm works and farm tourism.

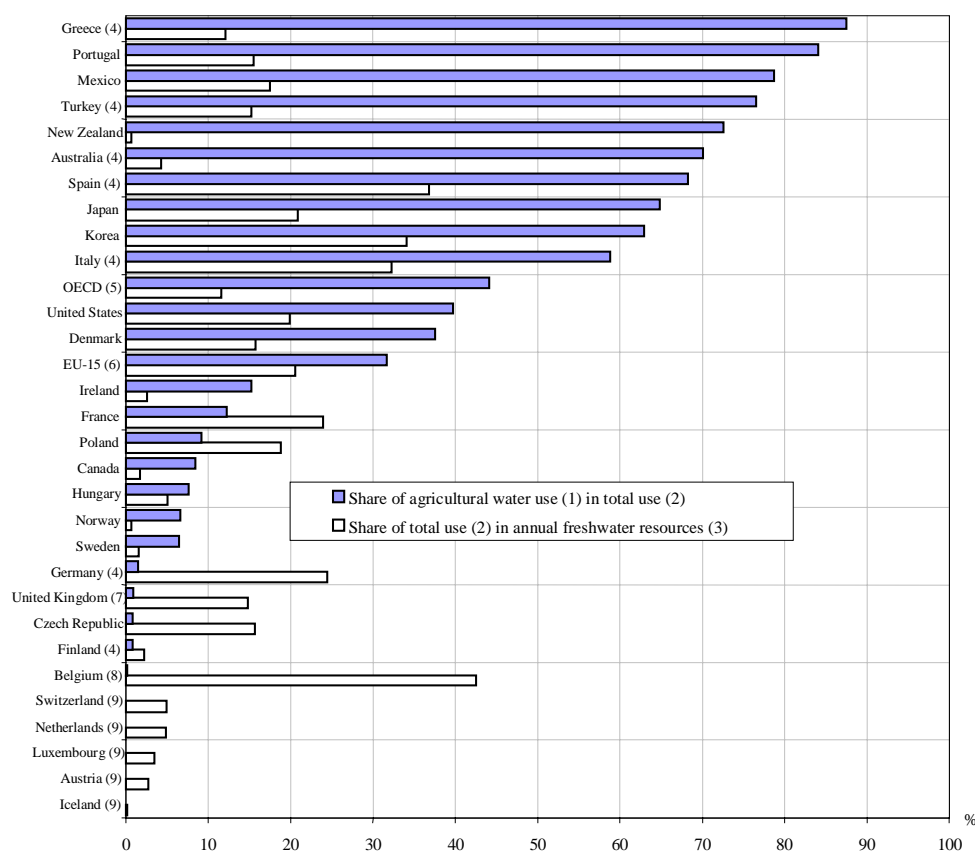
**Chart 1. Share of agricultural land use in the total national land area
1995-97**



1. Including Luxembourg.

Source: FAO Database, 1999.

**Chart 2. Agricultural water utilisation
mid/late 1990s**



Notes:

1. Agricultural water use includes water abstracted from surface and groundwater, and return flows (withdrawals) from irrigation for some countries, but excludes precipitation directly onto agricultural land.
2. Total use (abstractions) of water by all users, including public water supply, agriculture, industry, and for power station cooling.
3. Annual freshwater resources include: Mean annual precipitation + transborder water flows - mean annual evapotranspiration (overexploitation of groundwater resources was not included in the calculation).
4. Data for irrigation water use were used as data for agricultural water use are not available.
5. Austria, Iceland, the Netherlands and Switzerland are excluded from the calculation of the share of agricultural water use but included for the calculation of the share of total use.
6. Austria, Netherlands and Portugal are excluded for the calculation of the share of agricultural water use but included for the calculation of the share of total use.
7. England and Wales only.
8. The share of agricultural water use is less than 1% of total utilisation and includes Luxembourg.
9. Data for agricultural water use are not available, except Luxembourg for which data are included in the share of Belgium.

Source: OECD, *Environmental Indicators for Agriculture, Volume 3: Methods and Results*, Paris, 2001.

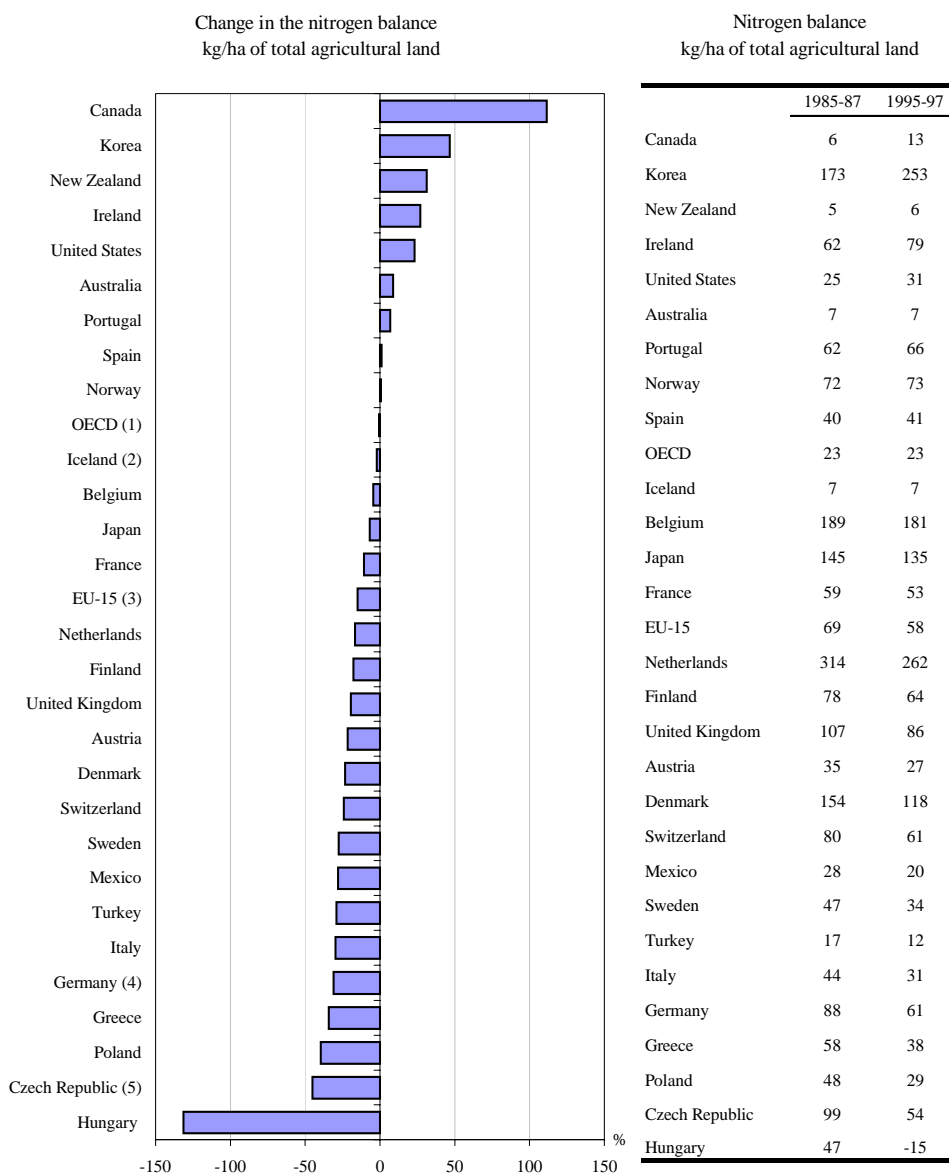
What is the current environmental performance of agriculture?

While some progress in reducing harmful environmental impacts of agriculture has occurred over the last 10-15 years, the environmental performance of agriculture has deteriorated in other cases.¹ In many regions within OECD countries, pollution levels are relatively high (e.g. nitrogen and pesticide loading in water) and various environmental risks persist (e.g. soil erosion, water resource depletion). However, agriculture has also provided environmental benefits and services (e.g. providing wildlife habitat, landscapes, and acting as a sink for greenhouse gases).

The most significant progress in improving the environmental performance of agriculture, according to OECD data, has occurred where environmental pressures have been greatest. There has been a decrease of over 10% in both nitrogen and pesticide use in many European countries and Japan, and associated improvements in water quality and lowering of greenhouse gas emissions, since the

mid-1980s. (Charts 3 and 4). Soil erosion rates have declined in Australia, Canada, and the United States, and progress has been made in adopting farming practices that enhance environmental performance, such as the shift to using nitrogen management plans, integrated pest management and conservation soil tillage.

**Chart 3. Soil surface nitrogen balance estimates
1985-87 to 1995-97**



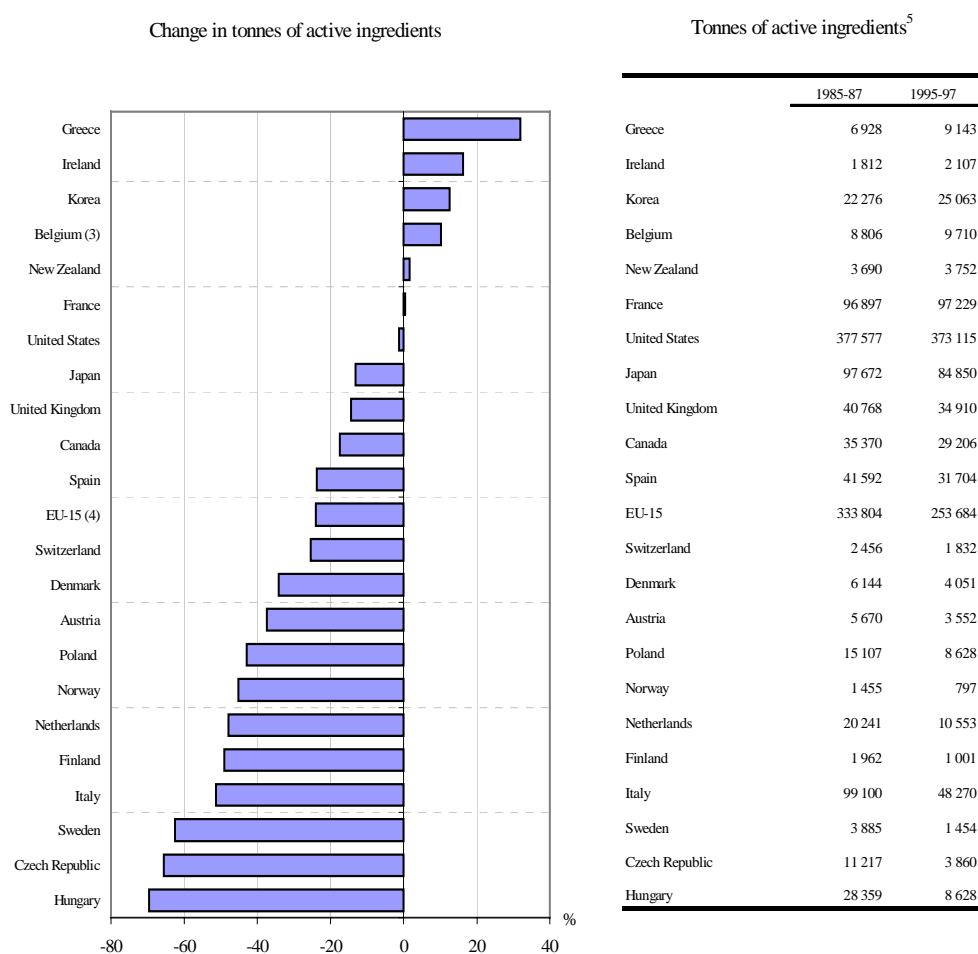
Notes: While these calculations have been derived from using an internationally harmonised methodology, nitrogen conversion coefficients can differ between countries, which may be due to a variety of reasons. For example, differing agro-ecological conditions, varying livestock weights/yield, and differences in the methods used to estimate these coefficients. Also one part of the calculation is the atmospheric deposition of nitrogen which is mostly independent from agricultural activities.

1. OECD averages, excluding Luxembourg.
2. The 1995-97 average refer to 1995.
3. EU-15 averages, excluding Luxembourg.
4. Including eastern and western Germany for the whole period 1985-97.
5. Data for the period 1985-92 refer to the Czech part of the former Czechoslovakia.

Source: OECD.org/agr/env/indicators.htm.

Even where there has been progress, levels of pollution remain high in some countries and areas. The environmental performance of agriculture has also deteriorated with the expansion of farm production on a smaller area of land and the regional concentration of activities, such as livestock farming. In turn, this has resulted in higher levels of nutrient surpluses, ammonia and greenhouse gas emissions, with consequent increases in water and air pollution in some regions of Canada, Europe, New Zealand and the United States. There is also growing competition for scarce water resources both between agriculture and other users and also for meeting the water needs of aquatic ecosystems for recreational and environmental purposes, particularly in the drier regions of Australia, the United States and Southern Europe.

**Chart 4. Pesticide use in agriculture
1985-87¹ to 1995-97²**



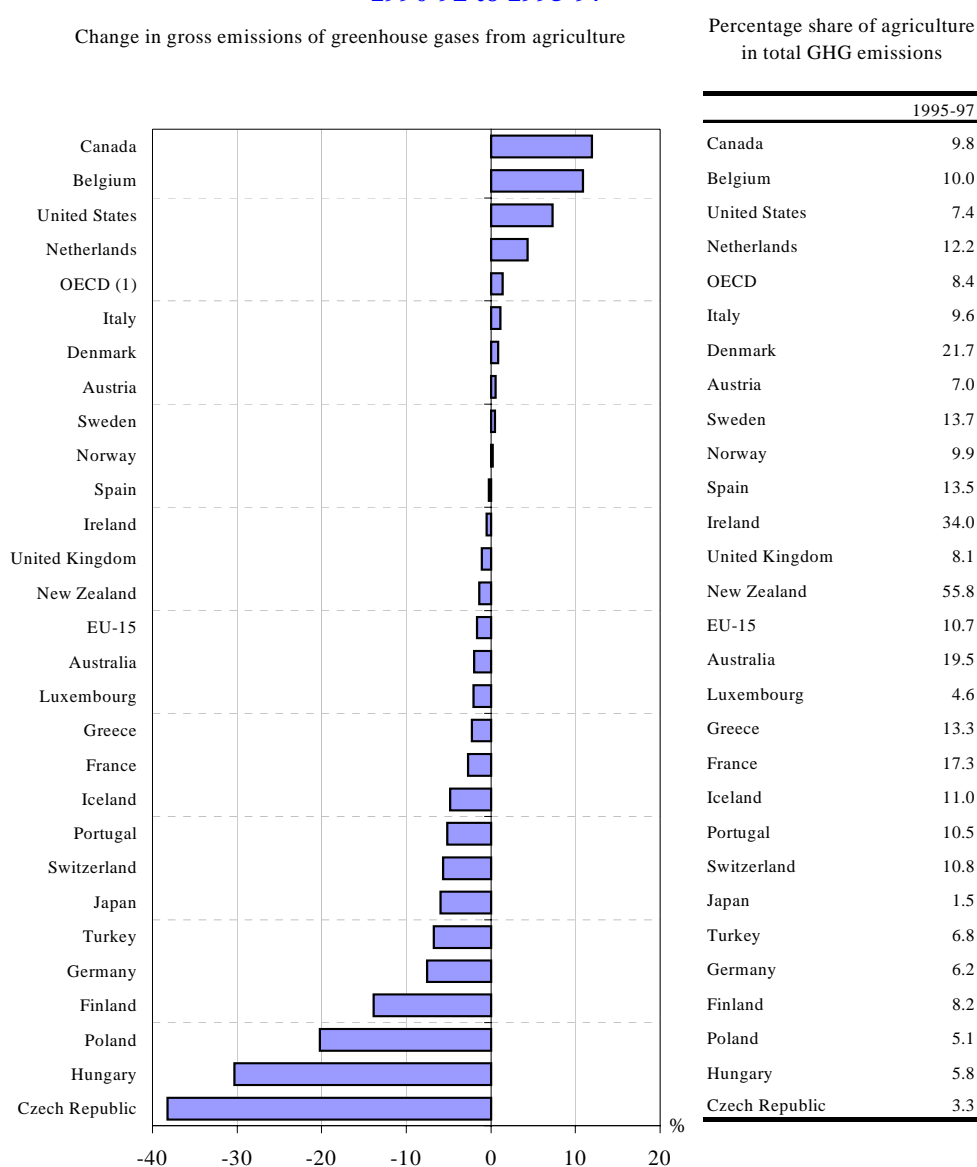
Notes: Some caution is required in comparing trends across countries because of differences in data definitions and coverage.

1. Data for 1985-87 average cover: 1986-87 average for Greece, Korea, and Spain; 1985 for New Zealand; 1985-86 average for Austria; 1987 for Italy; 1988 for Ireland and Switzerland; and 1989 for the Czech Republic.
2. Data for 1995-97 average cover: 1994-95 average for Hungary; 1994-96 average for Switzerland; 1995-96 average for Italy; 1991-93 average for the United States; 1994 for Canada; and 1997 for New Zealand.
3. Includes Luxembourg.
4. Excludes Germany and Portugal.
5. The following countries are not included in the figure: Australia, Germany, Iceland and Mexico (time series are not available); Portugal (data are only available from 1991); and Turkey (data are only available from 1993).

Source: OECD, *Environmental Indicators for Agriculture, Volume 3: Methods and Results*, Paris, 2001.

All OECD countries recognised the need to limit greenhouse gas emissions under the Kyoto Protocol. While agriculture currently contributes only about 8% of the total radiative-forcing of anthropogenic greenhouse gas emissions, it is a major contributor of nitrous oxide (N₂O) and methane (CH₄) emissions. Moreover, the Inter-Governmental Panel on Climate Change has estimated that agriculture alone will account for 20% of the projected increase in anthropogenic radiative-forcing between 1999 and 2020-2050 if no change from the current trend occurs. There is therefore significant potential to use changes in agriculture practices to help meet commitments to the Kyoto Protocol (Chart 5).

**Chart 5. Gross emissions of greenhouse gases from agriculture
1990-92 to 1995-97**



Note:

1. Korea and Mexico are not included.

Source: OECD, *Environmental Indicators for Agriculture, Volume 3: Methods and Results*, Paris, 2001.

The interpretation of the trends of agri-environmental indicators needs to be done with care. The increase in agricultural production and environmental emission levels has been offset, to some extent, by improvements in farm input and natural resource use efficiency. This is the case with the use of fertilisers, pesticides, and water in some countries, where improvements in technology and farming practices have led to a reduction in the use of these inputs per unit volume of production. Because the environmental effects of, for example, nitrogen balances or pesticide use are dependent on the local agro-ecological conditions and farm management practices, there is no unique technical relationship between nitrogen or pesticide use and water quality across countries or regions.

Moreover, for some environmental effects there is incomplete knowledge and data to establish trends. Information is incomplete, for example, concerning the degree of groundwater pollution or rate of depletion resulting from agricultural activities, and the human health and environmental risks associated with the use of pesticides. In other cases the linkages between different indicators are understood but are difficult to measure, such as between changes in farming practices and environmental outcomes, or attributing the relative impact of agriculture and other activities, for example, on water pollution. Also, for biodiversity, habitats and landscapes in particular, the knowledge and measurement of these impacts is still at a preliminary stage of research. The future challenge to developing agri-environmental indicators is to provide information on the current state and changes in the conditions of the environment in agriculture, and use them for policy monitoring, evaluation and forecasting.

What have been the environmental impacts of agricultural policies?

The OECD has been monitoring and evaluating agricultural policy developments, measuring support, and analysing its effects since the mid-1980s. By the early 1990s, most Member countries had begun reforming their agricultural policies with the long-run aim of reducing support and trade distortions, and in general making producers more responsive to market signals. Some progress towards these goals has been made, although this progress stalled or was even reversed when market pressures in 1998 and 1999 led to an increase in support. As measured by the Producer Support Estimate (PSE), support to farmers as a share of total farm receipts fell from 40% on average in 1986-88 to 36% on average in 1997-99 (but reached 40% in 1999). Support to commodity market prices has decreased but still represents 68% of support to farmers, with payments based on output and on area (or headage) of specific commodities, and payments based on input use representing, respectively, 16 and 8% of support to farmers in 1999 (Chart 6).

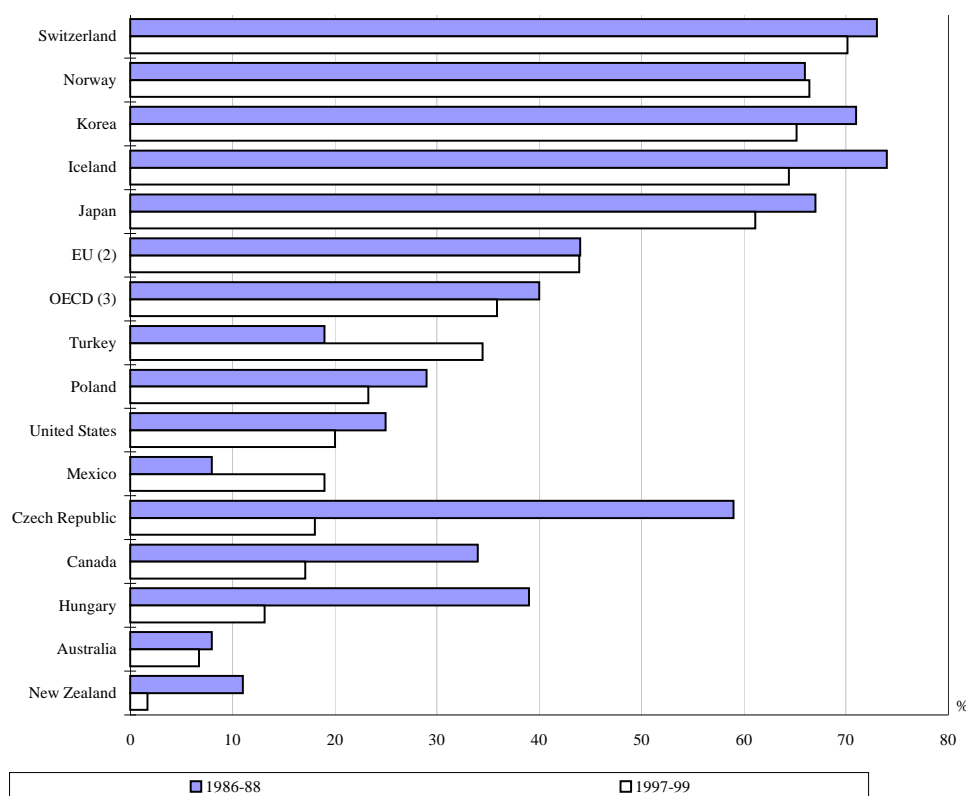
Over the longer term, reforms in a number of countries have led to a small, gradual reduction in overall support to the sector and some shift from support based on output to other forms of support. Support levels vary considerably across countries, however, and in many countries support remains high and based on output (in particular for milk, sugar and rice). Concerning policy measures addressing environmental issues, it appears that payments to remunerate environmental benefits or compensate farmers for adopting practices to improve their environmental performance account for only a small share of total transfers to producers. In many countries policies oblige farmers themselves to meet the cost of meeting environmental goals, but there are cases where farmers are paid to reduce environmental damage, and in some countries agricultural policy measures require farmers to undertake practices related to the environment as a condition for the farmer's eligibility. For a large number of OECD countries there has been a very rapid increase in public agri-environmental expenditure during the 1990s, but this expenditure varies widely across countries, reflecting differences in agri-environmental concerns and priorities (Chart 7).

OECD work has outlined some of the trends in the *environmental effects of agricultural policy reform*. By lowering output price support and input subsidies, shifting to policies that are less

linked to production, and implementing agri-environmental measures, policy reforms have in many cases generated a double benefit: they have resulted in a more efficient allocation of resources, and they have reduced pressure on the environment. They have also increased transparency as to the remaining environmental pressures, which has the potential to be addressed through targeted environmental measures. The economic gains resulting from a better resource allocation could be used to support such targeted measures.

In particular, reductions in *output price support and input subsidies* have in many cases lowered the demand for chemical and mechanical inputs, and have led to an extensification of crop production. Yet, some land may have been shifted into the production of fruits and vegetables, which are sometimes produced in input-intensive ways, or into other input-intensive crops. In some cases, the use of farm chemicals has again increased after an initial decline, largely linked to increases in world commodity prices. The effects on the environment are not only driven by policies but depend also on the developments of markets and technical progress. Improved environmental performance may, for instance, result from a switch to environmentally friendly production methods induced by producers' and consumers' choices.

**Chart 6. Percentage Producer Support Estimate¹
1986-88 to 1997-99**



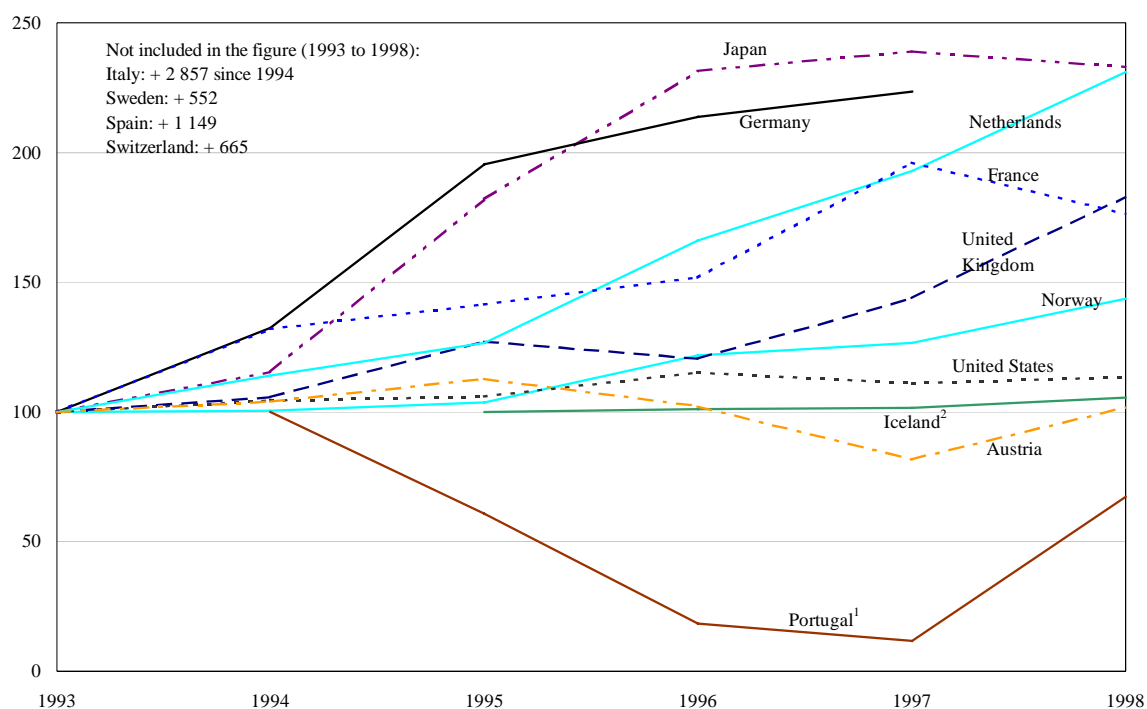
Notes:

1. The Producer Support Estimate (PSE) is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at farm gate level, arising from policy measures which support agriculture, regardless of their nature, objectives or impacts on farm production or income. The percentage PSE measures the share of support to producers in total gross farm receipts.
2. EU-12 for 1986-88; EU-15 for 1997-99. PSEs are not calculated by the OECD Secretariat for individual EU Member states.
3. OECD includes the most recent Member countries for both periods (date of OECD membership in brackets): Czech Republic (1995), Hungary (1996), Korea (1996), Mexico (1994), and Poland (1996).

Source: OECD, *Agricultural Policies in OECD Countries, Monitoring and Evaluation*, Paris, 2000.

**Chart 7. Public expenditure on agri-environmental policy measures
1993-98**

Index 1993 = 100



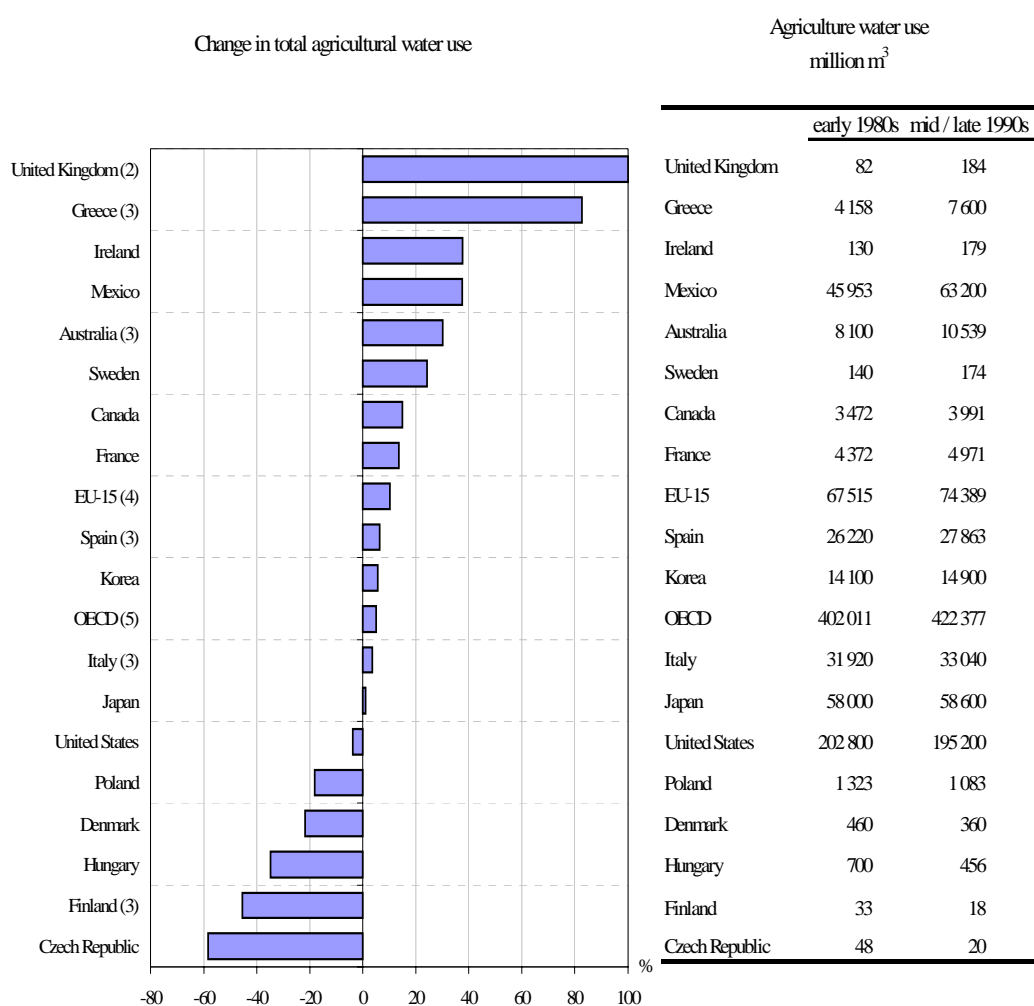
Notes:

1. 1994 = 100.
2. 1995 = 100.

Source: OECD, *Environmental Indicators for Agriculture, Volume 3: Methods and Results*, Paris, 2001.

There has been a continuous upward trend in agricultural water use, mainly for irrigation, in most OECD countries since the early 1980s, associated with the increase in the irrigated land area (Chart 8). The expansion in the irrigated area has been encouraged in many countries by government investment in irrigation infrastructure and *irrigation water subsidies*. The price of water paid by farmers is often substantially below that paid by industrial and household users, even when differences in water quality and costs of distribution systems between agriculture and other users are considered (Chart 9).

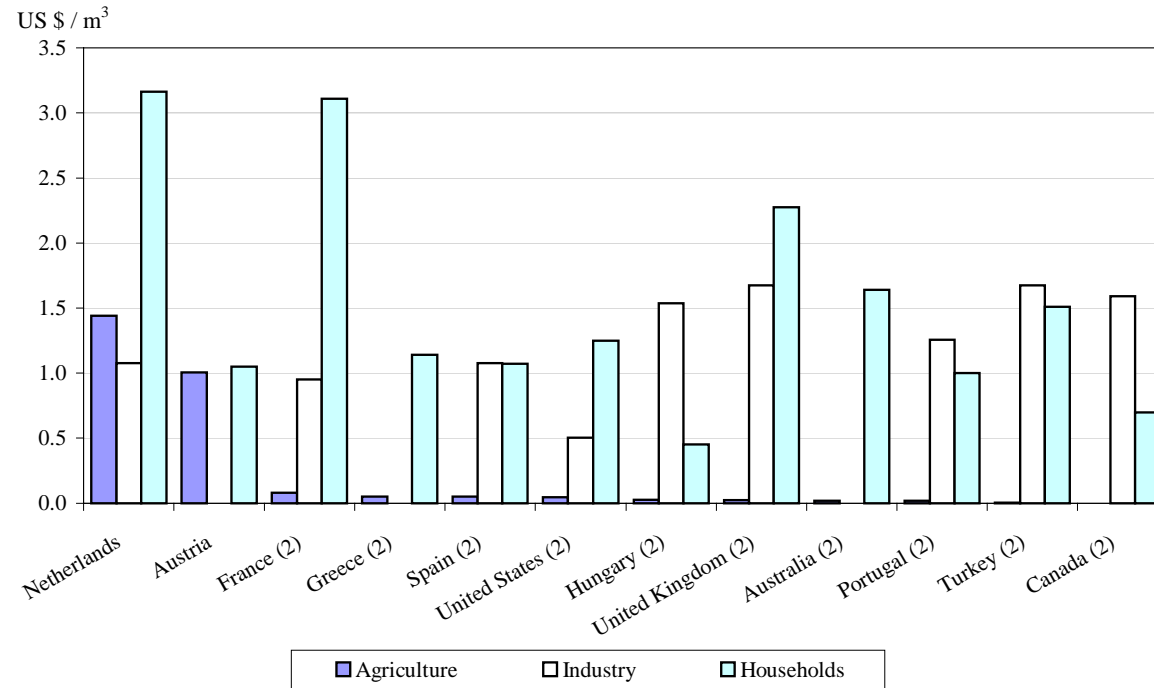
**Chart 8. Total agricultural water use¹
early 1980s to mid/late 1990s**



Notes:

1. Agricultural water use includes water abstracted from surface and groundwater, and return flows (withdrawals) from irrigation for some countries, but excludes precipitation directly onto agricultural land.
 2. England and Wales only. Percentage equals 124%.
 3. Data for irrigation water use were used as data for agricultural water use are not available.
 4. Austria, Belgium, Germany, Luxembourg, the Netherlands, and Portugal are excluded.
 5. Austria, Belgium, Germany, Iceland, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Switzerland and Turkey are excluded.
- Source:* OECD Environmental Data Compendium, 1999.

**Chart 9. Comparison of agricultural, industrial and household water prices¹
late 1990s**



Notes: Some caution is required in comparing agricultural water prices with other user prices because water supplied to agriculture is usually of a lower quality than that provided to households and, on occasion, industry; while the capital costs of water conveyance systems are generally lower for agriculture than for household or industry.

1. For agriculture, industry, and households, prices are the median values for the range of prices for each category.

Source: OECD, *Environmental Indicators for Agriculture, Volume 3: Methods and Results*, Paris, 2001.

Reforms in the livestock sector are likely to have resulted in reduced grazing pressure and manure surpluses and, as a consequence, soil erosion and nutrient leaching. Where direct payments per head of animal have been provided with no limit on the stocking density, increases in stocking densities may in some cases have occurred. Moreover, looking to raise farming returns, farmers have used technologies that have tended to favour the concentration of livestock herds and larger production units, which, in some cases, have had some adverse consequences for the environment.

Policy reform has also contributed to slowing down or halting the **conversion of environmentally fragile or ecologically valuable land** to agricultural uses in OECD countries. Significant areas of wetland, forest and natural grassland have thus been preserved. In countries where support had previously favoured cropping rather than grass-based activities, shifts out of crop production into grazing and forage production have taken place. The grass or tree cover established on erodible land as a result of such shifts has reduced soil erosion rates and, in some cases, has helped restore already degraded soils.

Changes in land use have sometimes been encouraged by land diversion schemes, which have paid farmers to leave land idle, or to replace arable crops by less intensive forms of production and woodland. Over time, incentives to remove the most environmentally sensitive or ecologically valuable land from production have been introduced, and farmers have been required to make environmental improvements on the diverted land. As a result, the environmental quality of substantial areas of land has been improved, wildlife habitat has been created or restored, and the risk of nutrient leaching has diminished. Some of these improvements appear to have been sustained, while others disappeared when the land was brought back into production.

In some countries farming systems have been supporting a rich variety of flora and fauna as well as scenic landscapes that are valued by the population (in particular by tourists), and can extend over large expanses of semi-natural land. Elsewhere, agricultural activities have been associated with land conservation, including avoidance of landslides and flooding. As such production systems and activities would in some cases be unprofitable without support, there are concerns that such environmental externalities of agriculture could be reduced if reform causes the associated agricultural activity to shrink.

Where reform drives farms out of business and the land is not taken over by other farms for lack of profitability, the land may be idled or converted to other uses. In some cases, these land use changes will include reverting back to nature, or converting to forests, and may actually benefit the environment, as vegetation and wildlife continue to develop along the path of natural succession until a new ecosystem has developed in the absence of agricultural activity. In other cases, environmental degradation including soil erosion, irreversible damage to wildlife habitat, bio-diversity and landscapes, and loss of the flood- controlling function of the land may occur.

Agri-environmental measures appear to have been effective when the environmental objectives are clearly specified and the actions required by farmers are closely targeted to the objectives. This may include measures tailored to the environmental, economic and social situation prevailing in a given area; programmes focused on lands with a high conservation value; and incentives provided to farmers linked to the size of the costs or the income foregone by adhering to the restrictions. Agri-environmental measures may have also been effective when farmer compliance is closely monitored and the effects on farming practices and the environment are continuously assessed against the stated goals; and training and advice are provided to ensure that farmers are sufficiently informed about the measures and the best ways to implement them. However, it is not always evident that agri-environmental measures have been cost-effective by appropriately taking into account all the

costs and benefits of environmental externalities. There is therefore a need to find the appropriate way of taking account of such costs and benefits.

What have been the environmental impacts of trade liberalisation?

A gradual reduction of market price support and associated price distortions have occurred as a result of the agricultural trade liberalisation associated with the implementation of the 1994 Uruguay Round Agreement on Agriculture. The reduction of trade barriers has the potential to influence the overall scale of agricultural activities, the structure of agricultural production in different countries, the mix of inputs and outputs, the production technologies and the regulatory framework. These adjustments, in turn, impact on the international and domestic environment by increasing or reducing environmental harm and creating or destroying environmental amenities. International environmental effects include transboundary spillovers, such as greenhouse gas emissions, changes in international transport flows, and the potential introduction of non-native species, pests and diseases alongside agricultural products. Domestic environmental effects include ground- and surface-water pollution from fertiliser and pesticide run-off, and changes in land use that affect landscape appearance, flood protection, soil quality, and bio-diversity.

The direction and magnitude of some of these environmental impacts has been analysed in the OECD by combining preliminary results on the commodity market impacts of agricultural trade liberalisation with agri-environmental indicators.² The international environmental impacts of trade liberalisation indicate that projected medium-term increases in ruminant livestock numbers could lead to substantial increases in methane emissions in some OECD countries, which could warrant the attention of policy makers in the context of existing Kyoto Protocol commitments on greenhouse gas emissions.

There are a variety of common agricultural practices which, if used more extensively, can contribute to the reduction of greenhouse gases. These practices can be inexpensive to implement; some are virtually costless. Often, all that is required is information dissemination about new practices or technologies and the provision of relevant training. When the practice is not economically beneficial to the farmer, then incentives may be required to facilitate its application. Several of these practices are already actively encouraged by OECD countries, albeit mainly for other environmental reasons. In a few cases, these practices are already starting to be encouraged for the purpose of reducing greenhouse gas emissions. Where the practices are not already encouraged, in many countries they are under active research. Many practices are still under development and further research is required to understand the potential and applicability of these options.³

With respect to domestic environmental impacts, the quantitative analysis suggests that agricultural prices and production intensity would decrease in countries that have had historically high levels of fertiliser and pesticide application, so that environmental stress in these countries would be relieved. Countries where increases in production intensity occur might be able to accommodate increased application rates of agro-chemicals relatively easily, as their historical levels of fertiliser and pesticide use tend to be low. Projections on the effects of further agricultural trade liberalisation on land use do not suggest substantial changes in agricultural land. However, the analysis does not yet allow firm conclusions to be derived on prospective changes in landscape appearance, soil and flood protection, and bio-diversity, since the projections did not explicitly consider some environmentally sensitive areas, such as pastures and marginal agricultural land.

Under the assumptions of the analysis, the environmental impacts of general economic developments are more important than the impacts of further agricultural trade liberalisation. This

suggests a need for policy options or alternative approaches to address such agri-environmental impacts in conjunction with trade policy reform. Environmental effects from changes in agricultural activities will most effectively be addressed through market mechanisms or targeted policy actions that affect agricultural production and distort trade to the least possible extent. As far as transboundary effects on the environment are concerned, international co-operation, for example in the form of international environmental agreements, might be necessary to overcome the free-rider problem.

Improving environmental performance: policies and markets

How can the environmental impacts of agricultural activities be taken into account?

Improving sector environmental performance is a concern in all economic sectors. The lessons from the experience of other sectors, particularly industry (Box 5) may be helpful when analysing the possibilities of taking into account the environmental impacts of agricultural activities. However, it is important to bear in mind the main characteristics of environmental impacts and outputs of agriculture. These main characteristics depend largely on the extent to which environmental impacts and outputs are linked to farming practices, as many of the impacts are closely related to the use of privately-owned land which is often the limiting factor of production.

Box 5. Improving sector environmental performance: the industrial sector experience

The agricultural industrialisation process can be related to what happened to the industrial sector after the industrial revolution. Increasing industrial production in OECD countries was accompanied by increased negative environmental impacts: higher levels of soil, water, air and noise pollution.

For a long time, industrial producers had the “presumptive right to pollute”, and there was no obligation to reduce the pollution of soil, water and air created by them. Such an obligation started to appear only when the pollution assimilative capacities started to be exhausted and it was realised that beyond some point pollution levels could not be tolerated, due to costs imposed on other sectors of the economy.

To reduce pollution created by industrial production, implicit or explicit benchmarks or environmental targets for pollution of soil, water and air were gradually established to be respected by industrial producers. Once such environmental targets were introduced, industrial producers were explicitly obliged not to pollute beyond such levels. Their property rights and environmental reference levels were defined accordingly and, since then, laws, regulations and standards attempt to hold industrial polluters to account for the pollution costs they generate with a wide-spread practice of restrictive approaches in attributing property rights with respect to the environment. That is to say, the polluter-pays- principle has increasingly been applied (Annex 3).

In the industrial sector, reference levels have in general been fixed for soil, water and air quality that can be achieved through the use of “good industrial practices”. Environmental reference levels have in some cases evolved together with technological progress, greater scientific understanding of damage functions and economic growth, and tend to match specific environmental targets (or standards) for soil, water and air, which are quality levels considered to be desirable for the ecosystems — *i.e.* for human health, and live habitats.

All economic activities have effects on the environment. However, such environmental effects remain in general unregulated (non-internalised) when the social cost of obliging an industry to respect certain targets – which often implies less production or more costly production techniques – is higher than the cost of eliminating these effects. In such cases, this cost is often met by the third party independently of who owns the property rights.

A necessary condition for taking into account and allocating environmental costs and benefits is the existence of property rights, which evolve over time in response to changing circumstances, and are secured only when accompanied by penalties on those who infringe them. To

provide the necessary parameters within which producers can expect to be charged or remunerated for the environmental effects they generate, it is necessary to clearly define and effectively implement property rights stipulating the appropriate reference levels of environmental performance to be achieved at the farmers' expense.

Environmental reference levels mark the borderline between the activities that farmers can carry out with the associated environmental effects, and the activities for which they are obliged to mitigate the associated environmental effects at their own expense (property rights). Reference levels can be defined in terms of those *good farming practices* that will achieve a specified environmental performance, with the costs resulting from the adoption of such practices falling on farmers (Annex 5). What may be crucial in this context are the *property rights*, which refer to the ownership or use of resources for which owners or users may be, on the one hand, remunerated for goods and services provided; and on the other hand, liable to charges, taxes or penalties should the use of those resources incur costs on other economic agents. The *polluter-pays-principle* (PPP) implies that up to the reference level the polluter should bear the expenses of carrying out pollution prevention measures or paying for damage caused by pollution. The setting of *environmental targets* might aim at achieving levels of environmental performance above the reference levels, which may be a means of accounting for the full social costs of environmental objectives through the full range of environmental policy instruments (including prevention and control measures, taxation and positive incentives to encourage a rational use of scarce environmental resources) and thus avoid distortions in international trade and investment.

Property rights and environmental reference levels, as well as environmental targets, evolve over time and differ among countries (regions or sectors) because of different pollution assimilative capacities, different social objectives and priorities attached to environmental protection, and different degrees of development and population density. Thus, the conditions under which farmers are rewarded or charged for their environmental performance evolve accordingly. The setting of property rights and reference levels may be complex as it involves issues of cultural tradition, equity in relation to what happens in other economic sectors and implications for efficiency especially in a dynamic context. In any case, defining the ways of taking into account the environmental impacts of agriculture requires a case-by-case response in relation to the settings of the environmental targets and definition of environmental reference levels based on the identification of existing property rights defining who can ask for remuneration and who is liable for charges.

The examples in the following sections may help to better understand the meaning of such concepts (or policy parameters) and provide some guidelines for using them in the design and implementation of policies and approaches to improve the environmental performance of agriculture. Such improvement depends sequentially on the following elements: first, on the extent to which the environmental problem can be identified and defined; second, on the availability and diffusion of the appropriate technology or "good farming practices"; third, on the extent to which markets provide the appropriate incentives to adopt such practices; and fourth, on the extent to which policies address adequately the lack of the previous two elements.

What is the role of markets and policies?

In OECD countries there is an increasing demand for the preservation and improvement in environmental quality across all sectors of the economy, although it is difficult to determine the level of demand and the value placed by the public on meeting that demand. While the demand for and supply of environmental quality can be considered like other goods and services, markets to express the nature and level of demand, and the signals to deliver the supply are often missing or incomplete.

When markets fail to incorporate environmental effects, it can lead to environmental damage and distortions in the allocation of resources, and the achievement of sustainability. Environmental externalities associated with agricultural production, and the lack of well-developed property rights means that producers often lack incentives to take the full cost of environmental degradation and the benefits of the provision of environmental services into account. Thus there may be too much environmental damage and not enough provision of environmental services associated with patterns of agricultural production. The question is how to take account of the costs and benefits associated with farming activities.

In the absence of well-functioning markets, a major problem concerns the identification, quantification and valuation of the demand for environmental outputs (goods and services). The supply of environmental goods and services, whether jointly produced with agricultural products or not, will be provided if farmers (and others) are facing appropriate signals. It is less clear as to the “real” level of demand, which tends to be expressed through the political process, surveys of public opinion (including contingency valuation), pressure from non-government organisations, and the media. As with any other scarce resource, the level, type, location and way environmental services are provided may not be appropriate if the incentives do not closely reflect the public’s demand.

In principle, what is required is that incentives are in place to lead farmers to provide the level of environmental service that is demanded. This cost is usually known for non-jointly produced environmental services (for example, building or preserving stone walls) and, in so far as their demand may be identified and quantified, it should be possible to enforce contracts so that the beneficiary pays. The same cannot be said for the supply of jointly produced outputs, whose costs are often unknown and difficult to evaluate.

Therefore, for those agri-environmental outputs that are externalities or public goods not charged or remunerated by markets, their provision also implies defining the policy parameters for developing the appropriate policy options. These include economic instruments (payments or taxes), regulations or voluntary approaches for encouraging farmers to adopt specified farming practices, as well as approaches for harnessing market forces and/or improving technology and information for the provision of environmental outputs. In either case the establishment of (public or private) allocation mechanisms would aim to internalise, account for, and allocate the environmental costs and benefits, to try to maximise overall welfare, including the required environmental performance of agriculture.

What is the role of technology and information?

The long-term view of technological evolution in most of OECD countries suggests that farmers have continually adapted farming practices to changing economic conditions. Thus, one important avenue for improving environmental quality in agriculture is through providing or facilitating research, information, advice and training to farmers focused on the “public good” aspects of farming practices. Historically, research and development activities have been aimed at developing technologies which, by maximising private profits, have contributed to a large increase in agricultural productivity and output, but which has not always been sustainable. The adoption of such technologies has been encouraged by support policies, which have changed profitability. For example, the relative profitability of monoculture has been raised by market price support and payments based on output, which have increased production through the intensive use of farm inputs, often at the expense of the environment. With the elimination of such commodity-specific subsidies, production diversification would tend to become more competitive using farming agricultural practices that can help sustainability.

Technologies have often in the past been adopted by farmers without taking into account the associated environmental costs and benefits. To contribute to the sustainability of agriculture, alternative technologies need to be both profitable and to improve the environmental performance of agriculture, thus helping to reconcile sustainable and profitable food production. The challenge is to identify which technologies work best in specific circumstances, and define and provide the right incentive framework, so as to facilitate the achievement of sustainability goals in accordance with policy principles agreed by OECD Ministers.⁴

Reconciling food production and environmental goals can sometimes be achieved through the adoption of appropriate technologies, but sometimes it can be achieved simply by changing the level, type and location of agricultural production. Reconciling those goals also means that the rights and responsibilities of farmers regarding the adoption of technologies and practices need to be clearly defined and applied (taking into account the current distribution of property rights), and thus the circumstances under which they are either entitled to remuneration or obliged to pay.

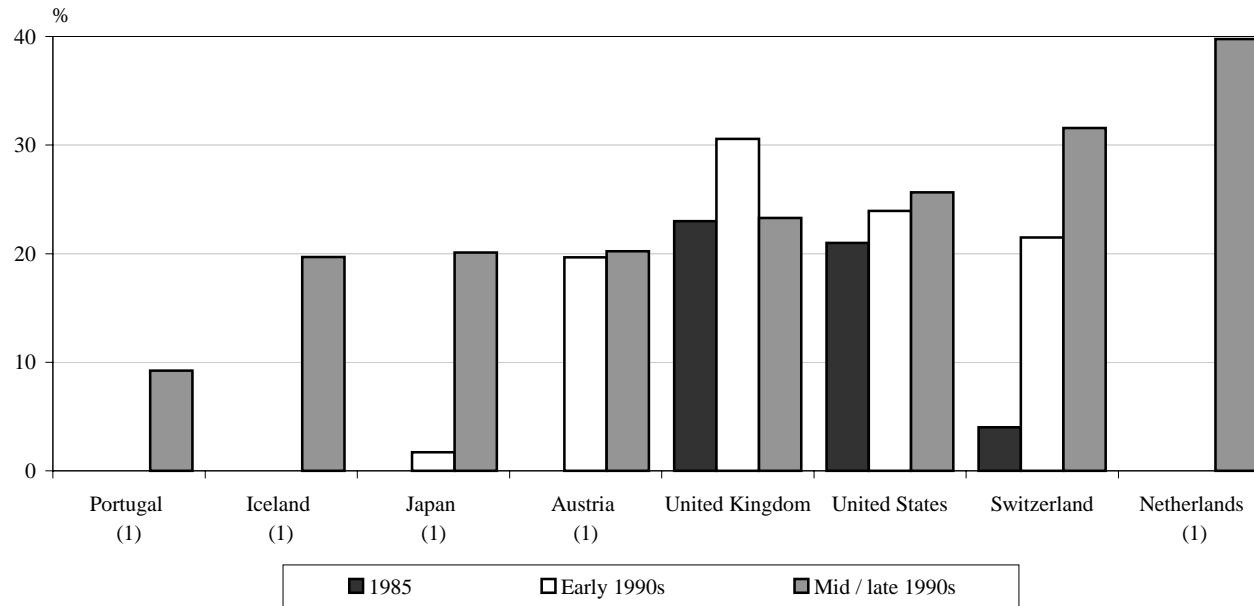
There is a need for greater follow-through in tracking the adoption of technologies for sustainable farming systems, and in the accountability of research efforts and policies for technology dissemination and adoption. Rigorous ex-post assessments of results could help ensure that corrections can be made before too much is invested in a wrong technology. This is important as technologies affecting agriculture arise from a wide range of sources and ranking technologies and identifying possible future trends can help the policy making process in moving towards sustainable agriculture.

The adoption of technologies for sustainable farming systems will be facilitated by a wider participatory approach involving a range of stakeholders. These stakeholders include farmers, the agri-food industry, consumer groups and non-government organisations with an interest in sustainable farming. As sustainable technologies are implemented at the farm level, a key requirement is to engage farmers in the dialogue on technology adoption. Ideally, there should be a greater sense of “ownership” throughout the agri-food chain in the choice of technology. Upstream and downstream sectors influence the adoption of technologies by farmers, but these sectors can also learn from farmers so that technologies implemented in the agro-food chain also take into account the effects on the farming sector.

Together with private sector efforts, a significant share of public expenditure on agricultural research is already spent on addressing agri-environmental concerns in many countries, and in some cases this share has been increasing since the mid-1980s (Chart 10). Overall, however, public funding for research on technologies in agriculture is limited and declining in many OECD countries, concentrating more on addressing public good rather than “near market” issues. But the methodological, analytical and information needs on devising and adopting appropriate technologies are also resource-intensive. Some countries are concerned about the capacity of extension services to cope with the wealth of detailed and complex information available to farmers. This highlights the need for transparency in research and information. From the perspective of policy development, the informational and policy capacity requirements are new, large in dimension, and will represent an intellectual challenge for the coming decades. This is also likely to require substantial resources.

Governments and the OECD can help to identify and analyse which technologies best work in which circumstances, and the most cost-effective ways to disseminate and adopt technologies. They can also provide information on what is helping and what is hindering the adoption of technologies that help achieve sustainability goals by: contributing to the development of criteria to assess technology adoption; analysing the appropriate ways to measure and assess progress; and outlining alternative policy and market options.

Chart 10. Share of public agri-environmental research expenditure in total public agricultural research expenditure 1985 to mid-late 1990s



Notes: Early 1990s: 1991 (United Kingdom, United States, Switzerland); 1993 (Japan); 1994 (Austria)
 Mid / late 1990s: 1995 (United Kingdom); 1996 (United States); 1997 (Switzerland, Portugal); 1998 (Austria, Iceland, Japan, Netherlands)
 1. Data not available for all periods.

Source: OECD, *Environmental Indicators for Agriculture, Volume 3: Methods and Results*, Paris, 2001.

How could market forces be harnessed to improve the environmental performance of agriculture?

Linked to the issue of market failure is the question of the valuation of resources, the provision of public goods, and the absence, or poor functioning, of some markets. When the demand for *production-linked environmental services* is fully satisfied through profitable farming activity at zero additional costs and remunerated through market returns, there is no market failure. Where a country reduces price support to commodities such as milk or rice, which are associated with particular landscape features in mountain areas and water-retention in paddy fields that are valued by the population, then a market failure may arise. This could occur if a change in policy reduces the supply of landscape and water-retention services that was previously considerate adequate. Whether or not a market failure occurs depends on how farmers adjust to the lower prices. If the least-efficient, highest-cost farmers go out of business, but their land is acquired by more efficient producers who continue to farm it (perhaps less intensively), then the supply of the desired environmental services may not necessarily fall below what is demanded.

If the land goes out of production, or is converted to production of other commodities with different or no landscape or water-retention value, there may be under-supply and some intervention may be warranted. Where the demand of such services may be identified and quantified it should be possible to harness market forces through *inter alia* enforcing contracts so that the beneficiary pays.

For example, to maintain the agricultural activity associated with the supply of some environmental services is, from the farmers' point of view, the provision of services using privately-owned resources and factors of production. Farmers will be interested in supplying these services if they are properly remunerated. This is equivalent to, for example, the provision of housing facilities and off-farm services provided by farmers to the tourism industry in many regions. In the same way, the remuneration of environmental services could be offered by charging all the industries that benefit through, for example, a tax on their revenues to make the necessary funds available. In this way the costs of such environmental outputs would be internalised in the prices of goods and services provided by the industries that benefit, thus avoiding distortions in the allocation of resources.

To be effective, equitable and minimise competition distortions between sectors and countries, the amount of any payment for providing the environmental outputs such as those in the previous examples, would need to cover the costs incurred to provide it. Therefore, where a link between the provision of public goods and individual benefits can be established, any sustainable solution for the financing of such environmental outputs should preferably be the result of an agreement involving all beneficiaries (private industries and public local or regional entities), under clearly defined property rights. Legislation sanctioning conservation easement contracts for conservation, scenic, and historic or cultural purposes could also be an appropriate way of harnessing market forces to finance such environmental services (Box 6).

Box 6. Conservation easements

Easements have traditionally been recognised when the owners of a specific property grant a limited right to someone else to use all or part of their property for a specific purpose. For example, one landowner might grant to a neighbour a right-of-way to cross his property or draw water from his well.

However, while traditional easements grant a right to a specific action, conservation easements prohibit specific actions to both parties. For example, an easement contract for the conservation or preservation of a building, a forest, or a wetland prohibits both the owner and the easement holder from altering or demolishing the building, cutting down the forest or converting wetland into cropland. The easement holder thereby acquires the right to enforce the contract restrictions on the use of the property by its owner, while the owner retains all other property rights.

In the United States, the use of conservation easements by non-profit organisations and government agencies is relatively recent, but it has increased rapidly in the last decade. These easement contracts have been used to protect a variety of land resources and characteristics, including farmland and other open spaces, wildlife habitat, erodible soil, and wetlands. While the current contracts are variable in their coverage, in general they include a common set of characteristics:

- a description of the property with its ecological conditions and known environmental hazards, together with an agreement by the owner to submit the land to an environmental assessment, to identify and correct or remove any encroachments or damage, and to meet certain standards in the management of the property;
- a description of the land uses that are allowed, which may limit the owner's ability to develop the land or alter its existing use, with a right granted to the easement holder to check and ensure that the contract has been honoured, and provisions for adjudication or arbitration in the event of an alleged breach of contract;
- demonstration by the owner that the property has no restrictions attached to it and application of the easement contract to all subsequent owners of the property, together with provisions setting out responsibilities, deadlines, and payments associated with the sale of the easement.

Conservation easements may be an attractive policy instrument because purchasing a partial interest in a parcel of land is less costly than acquiring full ownership and they involve voluntary transactions. Moreover, compared with conservation incentives (taxes or annual payments) or tradable development rights, easements do not necessarily entail large administrative burdens. In addition, easements necessitate few, if any, changes in environmental regulations and property rights.

* See Wiebe *et al.*, *Partial Interest in Land: Policy Tools for Resource Use and Conservation*, USDA, ERS, Agricultural Economic Report, Number 744, November 1996, and Boyd *et al.*, "Carving Out Some Space: A Guide to Land Preservation Strategies", *Resources*, Issue 136, Summer 1999 for more details.

The *non-production-linked environmental outputs* are goods and services provided through farmers' own agricultural resources with a level of supply independent of any commodity production. Some of these outputs are linked to buildings and other land features, with good construction practices defining the reference levels of environmental quality — for example, the aesthetics of farm buildings — to be achieved at the expense of the owner. In such a case, the demand for such outputs is satisfied at zero additional costs and therefore there is no reason for any particular policy action. The demand for these outputs risks not being satisfied when the buildings and other features are not constructed or preserved in accordance with required good construction practices, or when they are abandoned. When these features are classified, the modalities of charging or remunerating their preservation need to be in line with those applied to other non-farm buildings and features.

The same could be said of the construction or preservation of stone walls, hedgerows, and hillside terraces considered as having aesthetic value. These specific features concern not only agriculture, but also other industries in the region, in particular tourism. Therefore, sustainable solutions for the financing of such services should, wherever possible, rely on an agreement involving

private industries and public local or regional entities, under clearly defined property rights. However, when the cost allocation according to individual benefits received by individuals and groups is not feasible, local or national government programmes may be the only way to provide such environmental outputs, as is often the case with other assets of historical or cultural value.

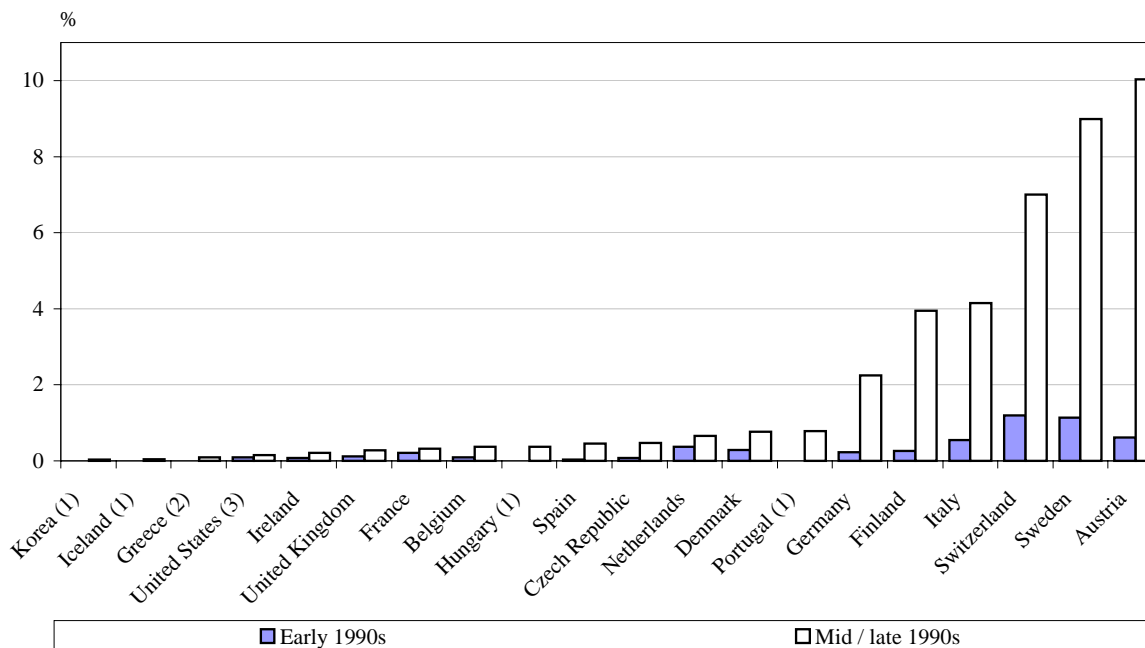
Other non-production-linked environmental outputs are, for example, the provision of biodiversity and habitats through specific land management, including preserving land set-aside from commodity production with specific conservation practices attached to it. Any demand for such services is satisfied only if farmers (or other economic agents) are specifically required or remunerated for using their own resources to supply it. The associated resource costs to provide such services are directly measurable at market prices and farmers (or any other provider) can be remunerated for achieving the desired target levels. The choice of the provider may usefully be made by auction.

In some cases, where there is an environmental externality imposed by farmers on a third party, the cost is met by the latter independently of who owns the property rights. In this case the PPP applies to *reducing environmental harm* and the solution should be based on establishing or clarifying property rights, with institutions and legal systems that can enforce contracts so that indeed the “polluter pays”. Developing tradable pollution rights also offers some scope for finding an acceptable distribution of rights to pollute. However, the costs of identifying the polluter and enforcing contracts can be high, as can those to monitor and enforce a regulatory approach. This is why in some countries, co-operative efforts to deal with local, common problems are seen as low cost-effective solutions.

The PPP could also be enforced through market incentives imposing a tax raising the price of the polluting input (such as fertilisers or pesticides) or setting a maximum allowable amount of point source pollution (for example, animal waste run-off) with a penalty when it is exceeded. The latter is widespread in industry but little used in agriculture. Developing markets for food and fibre produced under environment-friendly conditions would also be a way of harnessing market forces to remunerate environmental quality.

A link between market mechanisms and good farming practices can be established when the environmental performance of certain systems of production can be remunerated through a price premium received from commodity markets (organic farming, for example). In this case, setting a range of different good farming practices could be used as an instrument for product differentiation protected through controlled labels based on production process or quality standards. This approach would remunerate farmers’ efforts in improving their environmental performance through price premium in the market. In this case, the necessary monitoring mechanisms have to be set in place in order to assure consumers that such labelling schemes differentiate commodities according to objective and reliable criteria. However, many countries are encouraging conversion to organic farming by providing financial compensation to farmers for the costs incurred during the conversion period. As a result, the share of agricultural area under organic farming has increased significantly over the past ten years, but from a very low base and with wide variations among the OECD countries (Chart 11).

Chart 11. Share of the total agricultural area under organic farming, early 1990s and mid/late 1990s



Notes:

1. Data for the early 1990s are not available.
2. Percentage for the early 1990s equal 0.003%.
3. Data for the United States are taken from Welsh (1999).

Source: OECD, *Environmental Indicators for Agriculture, Volume 3: Methods and Results*, Paris, 2001.

What is the role of agri-environmental policies?

When private and public mechanisms designed to facilitate the improvement and diffusion of appropriate farming practices and market forces are not enough to ensure the supply to meet the demand of environmental services, specific agri-environmental measures at the farm level may be needed. Such measures may be necessary to reduce the environmental harm or enhance the environmental benefits of farming activities. When designing and implementing such policy measures a number of **general policy principles** should be taken into account in the choice of the type of the policy incentive or disincentive — payment or tax (Box 7).

The PPP applies to **reducing environmental harm** for which farmers, as any other polluter, should be accountable. However, the PPP guiding principles recognise the possibility of different property rights and reference levels among countries, with the possibility of offering transitional financial incentives to encourage farmers to adopt appropriate production practices for improving their environmental performance through reducing environmental harm. It includes the case of transitional financial assistance provided to stimulate the development of new pollution control technologies and abatement equipment to achieve a better environmental performance through improved production practices (Annex 3).

Box 7. General policy principles

When markets do not exist to allocate costs and benefits of agri-environmental impacts and outputs, policy action may be needed to account for the costs of not respecting environmental targets and to ensure the provision of environmental benefits. When designing and implementing policy measures, the environmental problem needs to be clearly defined and the following principles for policy design need to be kept in mind:

- The necessary condition for a welfare gain from implementing an agri-environmental policy measure is that the resulting environmental benefits exceed the costs associated with the policy. These costs include those due to a reduction in output, those costs associated with more environmentally friendly technologies and practices, and the transaction costs (administrative costs) of policy implementation and enforcement.
- When farmers and other economic agents provide a specific environmental service the level of benefit should be clearly specified and efforts made to ensure that the most efficient operator is the provider.
- When a specific environmental outcome is jointly the result of agricultural output, its provision by an individual farmer may be achieved by a wide range of policy options and approaches that either provide *positive incentives* (through, for example, a payment) or *negative incentives* (e.g. a tax). If incentives are set correctly, it would be in the individual farmer's interest to achieve the outcome and receive the incentive payment, or achieve the outcome and avoid paying the tax.
- The effectiveness of either a tax or a payment depends not only on whether it correctly confronts the farmer with the opportunity costs of not respecting environmental requirements, but also on the degree to which the associated obligations can be enforced and tailored to local environmental circumstances and demands. The more the payment or tax is tailored to specific circumstances, the larger the need for monitoring, the lower the probability of individual control, and the higher the transaction costs.
- As in other economic sectors, both a payment and a tax may give rise to moral hazard* in that some farmers (or any other economic agent) may claim to fulfil the associated obligations (claiming for the payment or not paying the tax), which are in fact not fulfilled. Others may farm on fragile or flood-prone areas just to benefit from a payment. This is often the result of an information asymmetry, farmers holding information about their actions relative to their obligations, which are not sufficiently known by implementing and enforcement bodies or agencies. The larger this asymmetry, the larger the difficulty of monitoring (the payment or tax) and the risk of abuse.

(continued)

Although either a tax or a payment may achieve the same environmental outcome in each individual farm and globally, they have different implications as regards the levels of financial transfers between the various parties and different effects on farm incomes.** Given the different income effects, the overall production outcome for the sector can be different, as there would be an incentive for more farms to exist in the sector under a payment than under a tax approach.

Although both taxes and payments can achieve the same environmental outcome, there could be different effects on income and the availability of capital over time, which thus leads to changes in resource allocation through time.

No matter whether the costs of environmental protection are internalised through taxation (direct cost) or through positive incentives (opportunity costs of payments foregone), the positive or negative incentives need to be set at a level which ensures that the desired environmental outcome is achieved. In both cases, internalising the cost of environmental protection would be reflected in the agricultural commodity prices. When the costs of environmental protection are not internalised, prices of commodities are thereby lower and there is a risk of higher demand and supply of commodities causing further environmental damage.

When due to a lack of internalisation of environmental costs (all other things being equal) farmers (or sectors) in different countries produce under different price and cost conditions, competition for investment and trade can be distorted, with possible conflict between countries (or sectors).

* Moral hazard refers to the risk that a policy measure may alter farmers' behaviour and actions in ways not intended, thereby increasing the possibility and the degree of benefiting from the policy without the knowledge of the policy maker.

** The amount of a tax to achieve a given reduction of negative environmental effects (case 1) would be exactly the same as an environmental payment designed to achieve the same improvement in environmental quality (case 2). In case 1, up to the point where the amount of the tax to be paid is higher than the income forgone, farmers would prefer to reduce the negative environmental effects and not pay the tax, and thereby minimise the associated income loss. In case 2, farmers have an incentive to reduce environmentally harmful production levels and receive the associated payment. Whereas taxation has an immediate cost effect, accounting for environmental costs through financial incentives results from the payment forgone in the case of not respecting environmental requirements. In both cases, the outcome of the policy action in terms of environmental quality achieved is the same. However, as regards the income effects, the tax results in income losses at the farm level either through taxes paid or income effects resulting from reduced production levels or more costly production techniques. In contrast, the environmental payment keeps the farmer's income unchanged. Although the payment and the tax reduce the negative environmental effect in each farm by the same amount, it could be expected that more farms would remain in the sector in the case of a payment than in the case of a tax.

However, by encouraging increases in production through the use of agricultural chemicals, the drainage of wetlands in agriculture, or farming on environmentally fragile land, agricultural support policies have induced changes in farming practices that often reduced environmental quality. If farmers' property rights have evolved together with the farming practices applied and currently come close to, or even match, the prevailing farming practices, changes to farming practices required for achieving specific environmental target levels above current property rights might require financial incentives. It could also involve the redefinition of property rights in favour of the public's right to a healthy environment without, therefore, any financial incentive.

Any financial incentives need to be consistent with the PPP, since the PPP does not imply an uncompensated expropriation of private property rights where the productive use of privately owned resources and factors of production impedes the pursuit of environmental objectives. However, environmental policies are often implemented within a legal context where property rights in land use are merely "presumptive" rights without being based on explicit legal definitions. In such cases, property rights would become explicitly defined through the definition of appropriate reference levels.

The above examples of landscape and water-retention services provided by mountain milk production and rice paddy fields are two examples of *production-linked beneficial environmental*

outputs. In the first example, preserving the specific agricultural habitat and associated landscape of the mountain region may be considered necessary for preserving tourism activity. In the second example, preserving a certain agricultural activity may be considered necessary to reduce the flooding risk in the paddy field region, while preserving the agricultural landscape. But when the demand of these environmental outputs is fully satisfied through profitable farming practices at zero additional costs and remunerated through the market returns, there is no reason for any particular policy action.

However, the demand for these environmental outputs risks not being satisfied when the associated farming activities are reduced. In this case, if no way is found to make the beneficiaries pay, policy action would be needed to satisfy demand. But providing such outputs can also be seen in the same way as providing any other regional infrastructure, for example, roads for tourism or a dam for flooding control which are often financed by public (local, regional or national) budgets, which are not necessarily within the scope of agricultural policies.

Guidelines for policies

How to determine the need for policy action?

The environmental impacts of agriculture are either externalities resulting from agricultural production, the costs of which farmers do not always take into account, or outputs where markets do not exist and for the benefits of which farmers do not always get paid (public goods). The OECD work on agri-environmental indicators may help to monitor such impacts. Moreover, the analysis of policies and approaches that can contribute to improving the environmental performance of agriculture in a sustainable way has developed a set of general policy principles (Box 7) and criteria for examining the need for policy action (Box 8), which can be summarised as follows:

- The **general policy principle** is that the provision of a specific environmental outcome by an individual farmer may be achieved by voluntary measures, regulation, payments, or taxes related to the associated costs incurred by the farmer or imposed on the rest of the society. However, the effects on farm incomes are different, and the global sector outcome can be also different, as there would be an incentive for more farms to exist in the sector under a payment than under a tax approach. Environmental targets may be different among countries or regions, as well as the range of instruments used to provide them. When there is non-internalisation of environmental costs (all other things being equal) contributing to farmers (or sectors) in different countries to produce under different price/cost ratios, competition for investment and trade can be altered, with possible conflict between countries (or sectors).
- The **general criterion for policy action** determining whether there is a case for any policy action is, on the one hand, whether it is technically possible to replace current farming practices by more environmentally friendly (good) farming practices and, on the other hand, whether this is economically efficient in the light of the costs and benefits involved. As a basic requirement, farmers need to adopt good farming practices and achieve the environmental reference levels at their own expense, or give up the related farming activity where they cannot achieve the required environmental performance. However, if farmers are required to achieve a level of environmental performance through using privately owned factors of production beyond the reference level, they may need to be compensated, or charged, if they fall below the reference level.

The diversity in agricultural production systems, legal traditions, and policy objectives in OECD countries may require different policy actions to determine who pays for the environmental

costs, or receives payments for environmental benefits. But, adhering to these policy principles and criteria could contribute towards transparency in the way in which these policy actions are undertaken in different sectors and countries. Moreover, it would reduce the potential risk for policy action introducing competition distortions on investment and trade between sectors and countries.

Box 8. General criteria for policy action

The general criteria to determine whether there is a case for any policy action to improve environmental performance by accounting for environmental costs and benefits require responses to the following sequence of questions:

First, is there evidence that there is a demand to enhance environmental benefits, and/or a need to reduce environmental costs currently generated by farmers without being remunerated or charged? If yes, consider the following question. If not, there is no need for any policy action.

Second, is it technically possible and economically efficient to change current farming practices by more environmentally friendly (good) farming practices? If yes, the desired environmental target levels have to be made operational and used as a basis for the necessary allocation of the associated costs and benefits. If not, current farming practices are already achieving the best possible environmental performance without any need for policy action at the farm level, although research and development could be encouraged to improve the farming practices.

Third, are current farming practices covered by existing farmers' property rights? If yes, farmers can expect to be compensated for providing environmental quality beyond good farming practices. It could also involve the redefinition of property rights in favour of the public's rights to a healthy environment without, therefore, any financial incentive. In particular, when land use rights are merely implicit or "presumptive", farmers' property rights would become explicitly defined through the definition of the reference level associated to good farming practices. If not, farmers should be obliged to adopt the appropriate farming practices required to achieve the environmental target levels at their own expense.

How to choose the appropriate agri-environmental policy measure?

The criteria in Box 8 determine whether there is a need for policy action, without defining the nature of such action. There may be alternative options or approaches for taking account of the costs and benefits and satisfying the demand of a given environmental outcome. Alternative options and approaches to achieve a given environmental objective or outcome may be characterised by the following elements:

- The **environmental target** defined in terms of the level of emissions, farming practices (*e.g.* production techniques, input use, and abatement technology), or environmental output (*e.g.* number of specific plant species on a chalk meadow, number of visitors to a nature reserve).
- The **policy instrument** defined by the type of instrument — incentive (payment) or disincentive (tax) through output or input market prices, regulation, or voluntary action.
- The **instrument target** defined by the primary incidence or economic level of application of the instrument — individual farmer or landholder, up- or down-stream industries and services, research and development institutions.
- The **policy target** defined in terms of the primary incidence or geographical level of application of the policy — farm, local (*e.g.* environmentally sensitive area, country's region, province, state), national (country), regional (group of countries), or global (multilateral agreements) policy.

The possible combinations of these four elements define the number of alternative options and approaches towards achieving a given environmental outcome. The policy parameters and the general policy principles defined in the previous chapters provide the framework necessary to evaluate the different alternatives. Within this framework, to assist the choice of the alternative options and approaches each of them should be examined against the following general evaluation criteria:

- **Economic efficiency:** The marginal value of the environmental outcome should be at least equal to the marginal cost of generating it. Often these marginal values are not available and this criterion can not be made operational. But, it provides a useful signal indicating to policy makers that the design of any policy action is essentially an exercise of weighing benefits against costs and maximising the net benefit.
- **Cost-effectiveness:** The best possible environmental outcome should be achieved for a given cost; or a given environmental outcome should be achieved at the least possible cost, *i.e.* compliance costs (the opportunity costs incurred by farmers), and transaction costs (policy enforcement costs). But it is essential that the environmental outcome associated with the policy action is additional, *i.e.* its outcome would not have resulted in the absence of the policy action. If this is not the case, it implies that beneficiaries of any payment associated with the policy action are being paid for doing nothing.
- **Flexibility:** The diversity of agricultural and environmental situations should be *targeted* to specific environmental outcomes, *tailored* to the necessary incentive to achieve clearly identified outcomes, and *adjusted* to changing objectives and priorities. The higher the flexibility, the easier the tuning, enforceability and acceptability of the policy action.
- **Enforceability:** Adequate enforcement needs to be undertaken at farm level, which involves compliance monitoring and sanctioning, although with actions implemented through markets, such as inorganic fertiliser or pesticide tax, there is no need for compliance monitoring at farm level. The more difficult the measurement of the required farm obligation or outcome, the greater the enforcement cost (budgetary cost and environmental losses associated to the degree of non-compliance). For example, prescriptions that can be observed visually (*e.g.* land set-aside, establishment of green covers or landscape features) are easier to monitor and enforce than non-visible constraints which require sophisticated technical equipment to get reasonable compliance records.
- **Transparency/fairness/equity:** Objectives should be easily identifiable in terms of their costs, benefits and distribution, in relation to how the associated costs and benefits are distributed or which groups in society gain and lose from the policy action. The more the distribution is in conformity with clearly defined and accepted property rights, the greater the acceptance and the lower the enforcement cost.
- **Policy compatibility:** The degree of conflict or synergy of the policy action needs to be assessed in relation to other policy objectives, in particular to avoid unintended effects. Many environmental outputs are jointly produced with agricultural commodities and therefore any policy action aimed at internalising environmental costs and benefits may affect the quantities produced and consumed of the commodity and therefore the related trade flows, prices and incomes. The higher the conflict (synergy), the greater (lower) the risk of imposing a burden on others, and the lower (greater) the degree of fairness/equity and the political acceptability.

- **Political acceptability:** Respecting clearly defined and accepted property rights and reference levels may be the single most important factor determining the acceptability of any policy action, although this depends on each of the previous criteria.

Adhering to such criteria in the design and implementation of policy actions for improving the environmental performance of agriculture could contribute to cost efficiency and transparency in the way in which environmental costs and benefits are allocated in different sectors and countries. It would mark an important step, given the potential risk for inefficient policy settings and associated welfare losses that could also cause frictions in international trade relations due to competition distortions on trade and investment between countries.

How to design and implement agri-environmental measures?

In the light of the above policy principles and criteria, the OECD work on agriculture and the environment outlines a number of cases or guidelines that might help in the design and implementation of agri-environmental measures, which can be summarised as follows:

- When farmers’ property rights do not cover the prevailing farming practices, the costs of **reducing production-linked environmental harm** (up to the reference level) through the adoption of good farming practices should be at the expense of the farmers. However, transitional financial assistance could be offered to encourage farmers to adopt appropriate production practices for improving their environmental performance. This would be a temporary derogation from the PPP. When property rights in land use are merely “presumptive” rights, without being based on explicit definitions, it might be appropriate that farmers’ property rights move from presumptive to more explicit property rights.
- The supply of **production-linked beneficial environmental outputs** can be associated with farming practices covered by private property rights. Up to the level where the demand for such outputs (habitats and amenities) is satisfied at zero additional costs to farmers, there is no reason for any policy action. The demand for these environmental benefits risk not being satisfied when farming activities associated with environmental targets are shrunk or abandoned, which can put at risk other economic activities. In this case policy action may be needed to satisfy demand, which could in some cases be funded through a tax on the revenues of the activities that benefit.
- Some **non-production-linked environmental outputs** are amenities linked to farm features (for example, buildings, hedges and walls). Up to the level where the demand for such amenities is satisfied at zero additional costs, there is no reason for any policy action. When farmers’ property rights do not cover adverse construction and maintenance practices, the costs of avoiding the deterioration of the amenity through the adoption of good practices should be at the expense of the farmers whose action would otherwise spoil the amenity value. But, when farm buildings and other features are classified such that they should be preserved, whereas preservation activities following specific quality standards or target levels can often be imposed, the modalities of charging or remunerating the associated costs and benefits need to be in line with those applied to other non-farm buildings and features.
- Other **non-production-linked environmental outputs** are not linked to farm features and cannot be provided through private or public allocation mechanisms as services using

privately owned resources or factors of production. Any demand for such services will be satisfied by farmers (or other economic agents) if appropriate incentives are in place. The associated costs to provide such services are measurable and farmers (or any other provider) could be remunerated for the opportunity costs of achieving the required environmental outcome. The choice of the provider may best be made through an auction system.

Concluding comments

Environmental concerns in agriculture are important for all OECD countries. Agricultural policy has affected environmental performance, and reform which changes agricultural production and trade will affect the environmental performance of agriculture. Changes in environmental policies will also affect agricultural production and trade. There is a need to ensure the compatibility of environmental objectives of policies with economic, social, trade and other international objectives. Defining the rights and responsibilities of farmers' vis-à-vis the rest of society is crucial in order to determine who pays for the environment. The attribution of property rights that define the desired level of environmental performance to be achieved at the farmers' expense has important implications for the distribution of income and wealth and for equity.

This report outlines a number of general policy principles and criteria, and suggests some guidelines that can help governments to choose the appropriate cost-effective solutions to improve the environmental performance of agriculture. The objective is to help to enhance policy transparency and define "good policies and approaches" through comparative analysis and evaluation of policies and approaches used to address the main environmental issues in agriculture in the context of agriculture and trade policy reform. In order to achieve these objectives it will be necessary to :

- Improve the understanding and measurement of environmental effects of agricultural activities through *agri-environmental indicators*, and their use in policy analysis;
- Undertake an inventory, *review and assessment* of policies and approaches addressing environmental issues in agriculture (*e.g.* pollution, biodiversity, land management, water conservation); including the production and trade impacts; the impacts of trade liberalisation and new technologies on the use of water (*e.g.* on water pollution from livestock production); and the analysis of climate change and agriculture (*e.g.* emissions trading, carbon sequestration, and approaches to meet Kyoto Protocol commitments for agriculture); and
- Draw together the analysis of the above issues to identify the characteristics of operational "good policy practice", and the possible adjustment of the agricultural sector in a longer-term perspective of *sustainable agriculture*, agricultural policy reform and trade liberalisation.

NOTES

1. To provide such information, the OECD has identified a number of priority areas for which indicators are being developed to cover agriculture's management and use of natural resources and farm inputs (farm management and use of nutrients, pesticides and water); and agriculture's environmental impacts (through greenhouse gas emissions, soil and water quality, land conservation, bio-diversity; habitats, and landscape). For more details see *Environmental Indicators for Agriculture, Volume 3: Methods and Results*, OECD, 2001.
2. See *Domestic and Environmental Impacts of Agricultural Trade Liberalisation*, OECD, 2001 for more details.
3. See *Agricultural Practices to Reduce Greenhouse Gas Emissions: Overview and Results of Survey Instrument*, OECD, 2001 for more details.
4. See *Adoption of Technologies for Sustainable Farming Systems — The Wageningen Workshop*, OECD, 2001 for more details.

Annex I.

Recent OECD Publications

Adopting Technologies for Sustainable Farming Systems — The Wageningen Workshop, 2001

Analytic Report on Sustainable Development (chapter on “Sustainable Agriculture”), 2001

OECD National Soil Surface Nitrogen Balances: Preliminary Estimates 1985-1997, 2001

Environmental Indicators for Agriculture: Volume 3 — Methods and Results, 2001

Agricultural Practices to Reduce Greenhouse Gas Emissions: Overview and Results of Survey Instrument, 2001

Production Effects of Agri-Environmental Policy Measures: Reconciling Trade and Environment Objectives, 2000

Information Note on the Use and Potential of Biomass Energy in OECD Countries, 2000

A Policy Decision-making Framework for Devising Implementation Strategies for Good Agricultural and Environmental Policy Practice, 2000

Domestic and International Environmental Impacts of Agricultural Trade Liberalisation, 2000

Environmental Indicators for Agriculture: Volume 2 — Issues and Design (The York Workshop), 1999

The Agri-Environmental Situation and Policies in the Czech Republic, Hungary and Poland, 1999

Agriculture and the Environment: Issues and Policies, 1998

The Environmental Effects of Reforming Agricultural Policies, 1998

Sustainable Management of Water in Agriculture: Issues and Policies — The Athens Workshop, 1998

Co-operative Approaches to Sustainable Agriculture, 1998

Annex 2.

Main Domestic and International Events Shaping Agricultural Sectors and Policies

Domestically, the effects of agriculture on the environment have become an important consideration in designing new agricultural and environmental measures, modifying existing agricultural support programmes and evaluating projects in the agro-food sector. Most OECD countries have often been delivering high levels of support to farmers, which have affected farming practices, agricultural production, the environment and trade. Agriculture is also being increasingly influenced by regulations governing water quality, pesticides, waste disposal, food quality and safety, and animal welfare. These regulations, together with rapid developments in technology, structural changes in the agro-food sector and farming practices, as well as the evolution of consumer demands, for example for organically produced food, are increasingly influencing environmental performance in agriculture.

Internationally, the agricultural sector and agri-environmental policy are being shaped by a number of influences, including:

- globalisation and the commitment to agricultural policy reform and trade liberalisation, following the conclusion of the Uruguay Round of multilateral trade negotiations, and the agreement for further agricultural trade negotiations as from 2000;
- the directions set for sustainable development at the United Nations Conference on Environment and Development (UNCED) in Rio in 1992, which will be reviewed in 2002;
- a range of international environmental agreements, such as the commitments to reduce greenhouse gas emissions made under the Kyoto Protocol in 1997 and reiterated at the meeting in Buenos Aires in October 1998, and the Convention on Biological Diversity and the commitment of OECD Member countries to conserve and sustainability use biodiversity; and
- regional economic and trade agreements, which often include environmental provisions (e.g. EU and NAFTA).

At the OECD level, Ministers of Agriculture in March 1998 agreed that OECD Member governments should provide the appropriate framework to ensure that the agro-food sector achieve a set of shared goals, including the “contribution to the sustainable management of natural resources and the quality of the environment”. In striving to realise the shared goals, Ministers adopted a set of policy principles, including the need for governments “to take actions to ensure the protection of the environment and sustainable management of natural resources in agriculture by encouraging good farming practices, and create the conditions so that farmers take both environmental costs and benefits from agriculture into account in their decisions”.¹

1. See *Agricultural Policies in OECD Countries: Monitoring and Evaluation 2000*, OECD, Paris, 2000.

OECD Environmental Ministers in April 1998 reaffirmed the leadership role and special responsibilities of OECD countries in the world-wide pursuit of sustainable development, in accordance with Agenda 21, as elaborated at the UN General Assembly Special Session in June 1997. Ministers agreed on a number of shared goals to promote an integrated policy approach that encourages coherence among economic, environmental and social policies, including through integrating the environmental dimension into sector policies. Ministers highlighted the need for OECD work to deepen the analysis of the impact on the environment of globalisation, especially of trade and investment, including by deepening work on integrating environmental concerns into key economic sectors, including agriculture.

Finally, an OECD initiative on sustainable development started in June 1998 on the basis of a strong mandate from OECD Ministers and of the recommendation of the High Level Advisory Group on the Environment in November 1997 that: “the OECD should become the key intergovernmental organisation that will help governments move towards sustainable development”. The OECD has approached the latter from the perspective of economic development. This means recognising that economic decisions, through market forces and public policies, are driving phenomena like human-induced interference with the climate system and unsustainable exploitation of some natural resource. It also recognises that the response to these global and long-term problems hence requires modifying economic incentives to take the full cost of environmental degradation into account. A fundamental objective of the current initiative is to provide coherence and visibility to the work on promoting sustainable development as a unifying principle for economic, social and environmental policy making, and for looking at these issues in a medium- and long-term perspective. The present stage of the sustainable development project is due for completion in 2001.

Annex 3.

The Polluter-Pays-Principle¹

The OECD Council adopted the PPP in 1972 as a part of a package of guiding principles concerning international aspects of environmental policies. It was explicitly reaffirmed by the OECD Council in 1974 as “a fundamental principle of allocating costs of pollution prevention and control measures”, and widely adopted in the Single European Act (1987), the European Maastricht Treaty (1992), and the Rio Declaration (1992).

The 1972 OECD Council guiding principles state that “*the principle* to be used for allocating costs of pollution prevention and control measures to encourage rational use of scarce environmental resources and to avoid distortions in international trade and investment is the PPP. The principle means that the polluter should bear expenses for carrying out the above mentioned measures decided by public authorities to ensure that the environment is in an acceptable state. In other words, the cost of these measures should be reflected in the cost of goods and services, which cause pollution in production and/or consumption. Such measures should not be accompanied by subsidies that would create significant distortions in international trade and investment”.

However, *the guiding principles* recognised that “differing national environmental policies, for example, with regard to the tolerable amount of pollution and to quality and emission standards, are justified by a variety of factors, including among other things different pollution assimilative capacities of the environment in its present state, different social objectives and priorities attached to environmental protection, and different degrees of industrialisation and population density”.

The PPP as such is a non-subsidy principle. However, the 1974 OECD Council Act on the implementation of the PPP specifies the situations where subsidies could be offered to help polluters to comply with environmental measures: *i)* to ease transition periods when specially stringent environmental protection regimes are being implemented; *ii)* to stimulate the development of new pollution control technologies and abatement equipment; *iii)* in the context of measures to achieve specific socio-economic objectives, such as the reduction of serious regional imbalances. It was specified that any support granted under these *exceptions* should be selective and restricted to those parts of the economy where severe difficulties would otherwise occur; limited to well-defined transitional periods, laid down in advance; and should not create significant distortions in international trade and investment.

In 1991, OECD Council recommendation on the use of economic instruments in environmental policy adds to the above exceptions by stating that financial assistance may be applied in the framework of appropriately designed re-distributive charging systems (in which pollution charges imposed on polluters are redistributed back to the same polluters as, for example, manure charges that are redistributed back to polluters in the form of subsidies for manure disposal facilities),

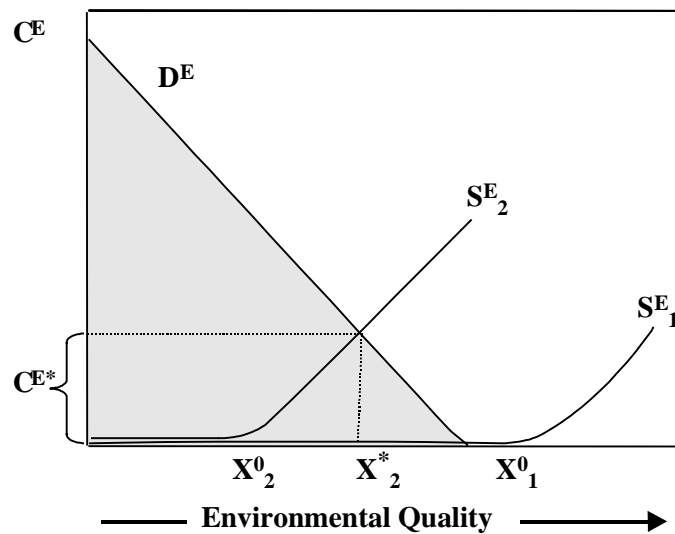
1. Source: *Agriculture and the Environment: Issues and Policies*, OECD 1998.

or in circumstances where payments are made to reinforce other measures designed to achieve appropriate natural resource use.

When the PPP was first adopted by OECD its institutional foundations and the implications of property rights as determining reference levels were not yet endorsed. More recent discussions have pointed out that, where a demand for environmental benefits goes beyond a reference level marked by defined property rights, the pursuit of environmental targets cannot be enforced without interfering with such rights. Any improvement of the environment involving privately owned factors of production, which can be considered as providing a service, will be delivered at a satisfactory level only if it is appropriately remunerated. This does not affect the validity of the PPP, which should be applied where agricultural activities encroach on public property rights through imposing environmental harm. In such cases polluters (farmers and others) should be held accountable.

Annex 4.

**Joint Provision of Environmental Impacts (Outputs)
of Agricultural Production**



This figure represents the economic relationship between agricultural production and the associated environmental outcome (externality or output), where: S^E represents the supply curves of a specific agricultural commodity with the associated level of environmental quality X^0 under two different economic situations; D^E represents the demand curb expressing the society's preferences for the environmental outcome; and C^E represents the cost to achieve a given level of environmental quality.

Under the first situation the level of agricultural production corresponds to the individual production optimum that provides the level X^0_1 of environmental quality. With the supply curve S^E_1 the marginal cost of providing higher environmental quality become positive only beyond X^0_1 . But, as society' preferences as represented by D^E are below X^0_1 there is no reason to increase environmental quality. In this case the environmental quality demanded by the society is an externality fully satisfied at zero additional costs.

Changing economic conditions in commodity production (situation 2) that creates a reduction in commodity prices and pushes farmers towards either more intensive production or use of less land area would change the commodity supply curve to S^E_2 and reduce the level of environmental

quality to X_2^0 . The latter is the level of environmental quality resulting from the individual optimisation of commodity production under these new economic conditions.

Under these conditions, any increase on the environmental quality beyond X_2^0 would create positive marginal costs as indicated by the upward slope of S_2^E . The social optimum of environmental quality would be achieved where the supply curb S_2^E intercepts the demand curve D^E . At this point, agricultural production would generate the social optimal level of environmental quality X_2^* . To generate this level of environmental quality farmers have to change the allocation of resources used to produce the commodity in order to specifically produce the desired environmental quality X_2^* that ceases to be an externality and becomes a joint output with agricultural production. As this environmental output has the characteristics of a public good or service for which there is no market, it would be provided by farmers only if there would be incentives to cover the unit costs C^E .

Annex 5.

Environmental Reference Levels: Allocation of Costs and Benefits Associated With Environmental Quality

Environmental reference levels mark the borderline between the activities farmers can carry out with the associated environmental effects according to their own interests, and the activities for which they are obliged to mitigate the associated environmental effects at their own expense (property rights). Thus a key issue is whether reference levels should be set in terms of the environmental outcome, or the appropriate farming practices (for example, maintaining buffer zones along water courses) or emission levels (for example, the quantity of sediments, nutrients, and pesticides in the water courses) to achieve such outcome. Given the non-point source nature of many environmental impacts of agriculture they cannot always be defined in terms of emission levels. This is why the environmental performance of agriculture is often defined in terms of the best available technology for generating a given level of environmental quality, rather than in terms of a desired emission level. The value of environmental quality is often difficult to establish, but it can sometimes be defined in physical terms (for example, number of specific plant species on a chalk meadow).

In contrast to the case of industry, the environmental effects of agriculture are in many cases closely related to land use for which traditional or “presumptive” property rights can be claimed. When traditional or “presumptive” property rights in land gain priority over societal claims for certain land-use-related environmental qualities (soil and water quality, and bio-diversity) the pursuit of environmental objectives may infringe on such rights and, therefore, may require compensation for the expropriation of such property rights. Thus, this expropriation implies a change from presumptive rights into effective rights defined by the reference level. There are also cases where environmental reference levels evolve together with technological progress and economic growth and tend towards specific *environmental targets* for soil, water and air, which are quality levels considered desirable for the ecosystems, *i.e.* for human health and live habitats.

The definitions of environmental targets and reference levels vary between countries. Environmental targets depend on society’s preferences for environmental quality, while reference levels depend on the country’s traditions in defining property rights. The efficient setting of environmental targets has to balance the benefits of pursuing environmental objectives against any resulting welfare losses due to lower production or consumption of other goods and services. In other words, the overall welfare optimum is achieved by reflecting the environmental quality that can be achieved in the light of the prevailing technological conditions and societal preferences for all goods and services. But, whereas the setting of environmental targets is based on “eco-efficiency”, or ecological or human health considerations, the issue of identifying the relevant environmental reference levels (who should bear the costs of reallocating resources to meet environmental targets) is based on distribution (equity) considerations and property rights.

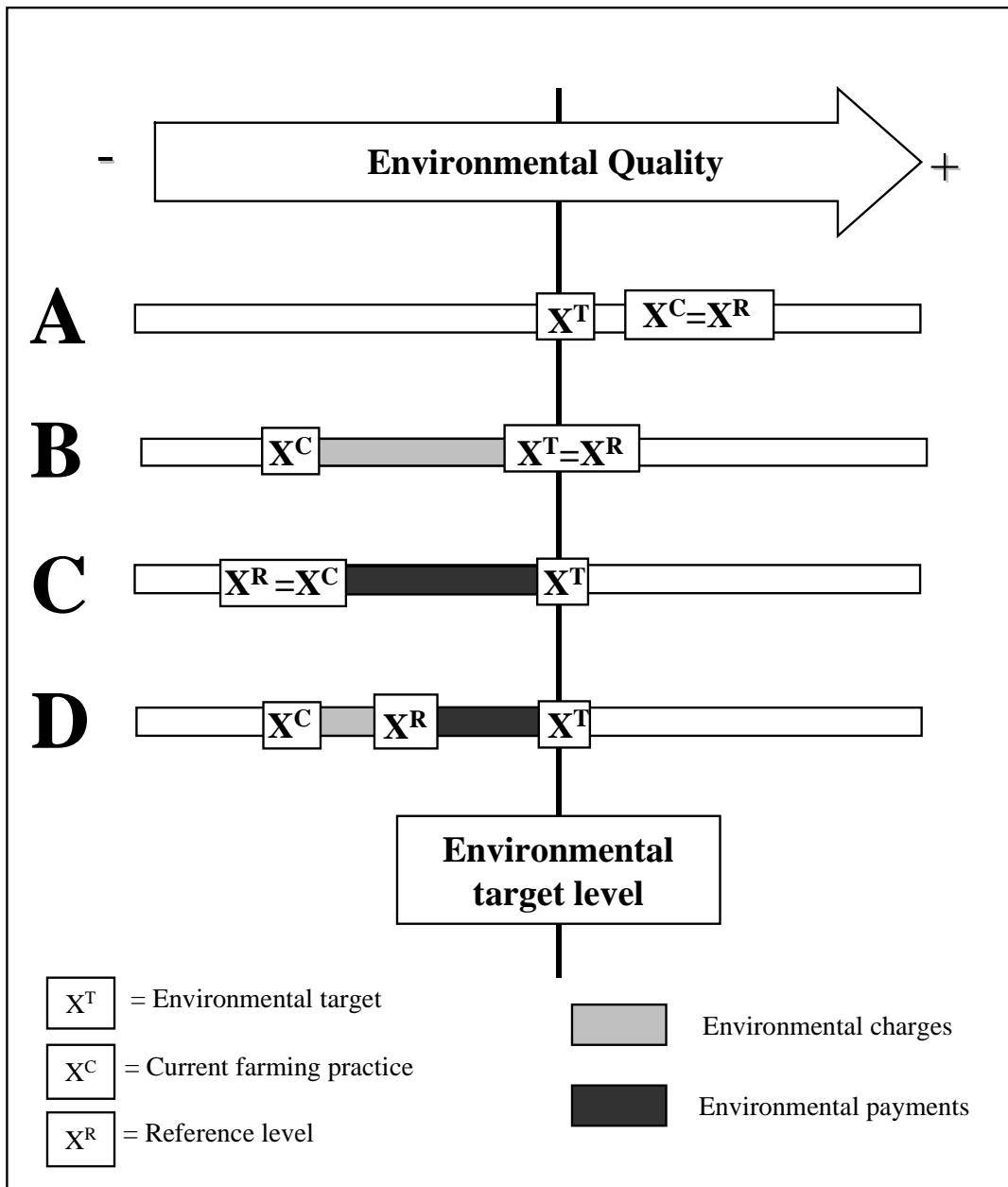
Chart A5.1 illustrates four different cases to which farmers may be confronted in relation to such parameters (where X represents the level of environmental quality corresponding to environmental targets (X^T); reference levels (X^R); and current farming practices (X^C)). All cases (A to D) represent an identical environmental outcome and allocation of farm resources as the environmental target X^T is the same. What differs among these cases is the distribution of costs associated with achieving the defined environmental target (*i.e.* who pays or who is charged).

- **Case A** represents a situation where current farming practices provide a level of environmental quality corresponding to a reference level ($X^C=X^R$) above the environmental target (X^T). Thus, farmers are already using the farming practices required for achieving the socially desired environmental outcome. With X^T and X^R achieved at zero opportunity costs, *no policy action* is needed. In such case, the reference level X^R would normally be achieved through current farming practices X^C (here referred to as “good farming practices”).
- **Case B** represents a situation where current farming practices (X^C) provide an environmental performance below the reference level defined at the level of the environmental target ($X^T=X^R$). In this case, farmers need to adopt farming practices required to achieve the desired environmental target level (X^T) *at their own expense*, which is consistent with their own property rights and the PPP. However, applying the instrument of transferable discharge permits¹, could also permit to achieve the desired environmental quality.
- **Case C** represents a situation where current farming practices achieve an environmental performance corresponding to the reference level ($X^C=X^R$) that is below the target level (X^T). As in this case property rights in land use are attributed to farming practices achieving an environmental reference level below the environmental target level, farmers *may need to be compensated* for changing from current farming practices (X^C) to practices required to achieve the environmental target (X^T). This is consistent with the PPP as this principle does not imply an uncompensated expropriation of private property rights where the productive use of privately owned resources and factors of production competes with the pursuit of environmental objectives. However, environmental policies often face a legal context where property rights in land use are merely “presumptive” rights without being based on explicit legal definitions. In such cases, the definition of property rights might well move from presumptive rights at X^C to more restrictive ones at X^T .
- **Case D** represents a situation similar to Case C where current farming practices (X^C) provide an environmental performance below the environmental target level (X^T), but with the reference level above the environmental performance level of current farming practices (X^C) and below the environmental target (X^T). For improving their environmental performance, farmers need to adopt appropriate farming practices *at their own expenses* up to the reference level (X^R). Requirements for farmers to further improve their environmental performance beyond X^R (for example, to reach the environmental target X^T) may need adequate compensation, but might in some cases be only transitional.

Good farming practices are usually site and farm system-specific. They depend on natural conditions, types of production systems, agricultural structures, and social perceptions. Therefore, good farming practices and the associated level of environmental performance is not a unique point on the scale of environmental quality. It can vary from country to country and region to region. For example, good farming practices in mountain areas would be different from that in lowland areas or countries differ in their attitudes towards poultry produced in batteries and those raised in the open.

1. Permits that specify an allowable rate of pollution that can be bought or sold.

Chart A5.1. Allocation of environmental costs and benefits



**Non-Member Economies and the OECD Guidelines
for Multinational Enterprises**

by Christopher Wilkie, Catherine Yannaca-Small,
France Benois and Edward Smiley

***Non-Member Economies and
The OECD Guidelines for
Multinational Enterprises***

OECD PROCEEDINGS

Non-Member Economies and The OECD Guidelines for Multinational Enterprises

Paris, 12 December 2000

TABLE OF CONTENTS

FOREWORD	4
DECLARATION ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES.....	5
SUMMARY	7
WELCOMING STATEMENT	15
SESSION I - THE OECD DECLARATION ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES	17
The Objectives and Approach of the OECD Declaration.....	17
Open Discussion Highlights.....	21
SESSION II - THE RESULTS OF THE 2000 REVIEW OF THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES	22
Introduction	22
Responsible Business Practices in the 21st Century	24
Guidelines Provisions of Particular Interest to Developing Countries:.....	29
The Role of National Contact Points in Implementing the Guidelines	31
Business and the Guidelines.....	34
Trade Unions and the Guidelines	36
Non-Governmental Organisations (NGOs) and the Guidelines	38
Open Discussion Highlights.....	40
SESSION III - THE RELEVANCE OF THE GUIDELINES FOR NON-ADHERING ECONOMIES	44
Introduction to the Guidelines and Declaration in non-Adhering Countries.....	44
Non-Member Adherence to the OECD Investment Instruments.....	45
The Implementation of the Guidelines in Non-Adhering Economies and Related Issues	48
Open Discussion Highlights.....	51
CONCLUSIONS.....	60
ANNEX I: CONFERENCE DOCUMENTS	61
PROGRAMME	61
ANNEX II THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES: TEXT AND IMPLEMENTATION PROCEDURES	78
Text.....	78
Implementation Procedures	100

FOREWORD

In June 2000, Ministers from all 30 OECD Member countries, plus representatives from three non-OECD countries (Argentina, Brazil, and Chile) adopted revised and updated Guidelines for Multinational Enterprises (MNEs). The Review was conducted by the 33 adhering country governments in an open process involving consultations with business, labour, non-governmental organisations (NGOs), representatives from developing countries, and the general public via the Internet. The result is a robust set of recommendations to multinational enterprises from adhering countries wherever they invest, coupled with enhanced implementation procedures to improve the effectiveness of the Guidelines.

The aim of the Guidelines is to help MNEs operate in harmony with government policies and societal expectations. Their recommendations provide guidance on appropriate business conduct across the full range of MNE activities, including environmental standards, labour relations, human rights, and the conduct of business partners (including suppliers and subcontractors). The Guidelines provide a benchmark for MNE activities. They do not override applicable law.

The OECD Guidelines, first adopted in 1976, are part of a balanced framework of inter-related instruments designed to improve the international investment climate and encourage the positive contributions multinational enterprises can make to economic, social and environmental goals. This framework, known as the OECD Declaration on International Investment and Multinational Enterprises (the “Declaration”), also contains commitments by adhering governments to provide National Treatment to established foreign-controlled enterprises, to avoid making MNEs subject to conflicting requirements, and to co-operate with other governments on measures providing incentives and disincentives to international direct investment. The OECD encourages non-Members to adhere to the Declaration.

On 12 December 2000, the representatives of 28 non-OECD economies met with officials from the adhering governments in Paris to discuss the revised Guidelines and the Declaration as a whole. While consultations with non-Members had already occurred during the Review, the December 2000 meeting provided an opportunity for OECD Members to present the results of the Review, and for non-OECD Members to speak frankly not only with their counterparts in the OECD, but with representatives from business, labour, NGOs and other international organisations. The December meeting also made an important contribution to enhanced dialogue between developed and developing countries on issues related to international investment, development, and the activities of MNEs.

This volume is prepared under the auspices of the Centre for Co-operation with Non-Members and is published on the responsibility of the Secretary-General of the OECD. We are grateful to the many participants who contributed to the success of the dialogue and whose contributions are featured in this volume. Thanks are due to Christopher Wilkie, Catherine Yannaca-Small, France Benois, and Edward Smiley for preparation of this volume for publication.

DECLARATION ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES

27 June 2000

ADHERING GOVERNMENTS¹

CONSIDERING:

- That international investment is of major importance to the world economy, and has considerably contributed to the development of their countries;
- That multinational enterprises play an important role in this investment process;
- That international co-operation can improve the foreign investment climate, encourage the positive contribution which multinational enterprises can make to economic, social and environmental progress, and minimise and resolve difficulties which may arise from their operations;
- That the benefits of international co-operation are enhanced by addressing issues relating to international investment and multinational enterprises through a balanced framework of inter-related instruments;

DECLARE:

- | | |
|--|---|
| Guidelines for Multinational Enterprises | I. That they jointly recommend to multinational enterprises operating in or from their territories the observance of the Guidelines, set forth in Annex 1 hereto ² , having regard to the considerations and understandings that are set out in the Preface and are an integral part of them;" |
| National Treatment | II.1. That adhering governments should, consistent with their needs to maintain public order, to protect their essential security interests and to fulfil commitments relating to international peace and security, accord to enterprises operating in their territories and owned or controlled directly or indirectly by nationals of another adhering government (hereinafter referred to as "Foreign-Controlled Enterprises") treatment under their laws, regulations and administrative practices, consistent with international law and no less favourable than that accorded in like situations to domestic enterprises (hereinafter referred to as "National Treatment"); |

-
1. As at 1 June 2001 adhering governments are those of all 30 OECD Members, as well as Argentina, Brazil, and Chile. The European Community has been invited to associate itself with the section on National Treatment on matters falling within its competence.
 2. The text of the Guidelines for Multinational Enterprises is reproduced below in Annex II.

2. That adhering governments will consider applying "National Treatment" in respect of countries other than adhering governments;
 3. That adhering governments will endeavour to ensure that their territorial subdivisions apply "National Treatment";
 4. That this Declaration does not deal with the right of adhering governments to regulate the entry of foreign investment or the conditions of establishment of foreign enterprises;
- Conflicting Requirements III. That they will co-operate with a view to avoiding or minimising the imposition of conflicting requirements on multinational enterprises and that they will take into account the general considerations and practical approaches as set forth in Annex 2 hereto³.
- International Investment Incentives and Disincentives IV.1. That they recognise the need to strengthen their co-operation in the field of international direct investment;
2. That they thus recognise the need to give due weight to the interests of adhering governments affected by specific laws, regulations and administrative practices in this field (hereinafter called "measures") providing official incentives and disincentives to international direct investment;
 3. That adhering governments will endeavour to make such measures as transparent as possible, so that their importance and purpose can be ascertained and that information on them can be readily available;
- Consultation Procedures V. That they are prepared to consult one another on the above matters in conformity with the relevant Decisions of the Council;
- Review VI. That they will review the above matters periodically with a view to improving the effectiveness of international economic co-operation among adhering governments on issues relating to international investment and multinational enterprises.

3. The text of General considerations and Practical Approaches concerning Conflicting Requirements Imposed on Multinational Enterprises is available from the OECD Website <http://www.oecd.org/daf/investment>.

SUMMARY

by the Secretariat

The OECD hosted an Outreach meeting with non-Members on the OECD Guidelines for Multinational Enterprises on 12 December 2000. This meeting was organised by the Committee on International Investment and Multinational Enterprises (CIME) in co-operation with the centre for Co-operation with non-Members (CCNM) and was open to attendance by representatives of OECD Members, non-Members, the business community, employee organisations, other non-governmental organisations and regional and international organisations.

The purpose of the meeting was to make the Declaration on International Investment and Multinational Enterprises and in particular one of its components—the newly revised Guidelines for Multinational Enterprises—better known to non-Member countries, and to provide an occasion for dialogue in view of possible future adherence of these countries to the instrument. Twenty-eight non-Members were represented⁴.

The business community was represented by the Business and Industry Advisory Committee to the OECD (BIAC), the employee organisations by the Trade and Union Advisory Committee to the OECD (TUAC) and the non-governmental organisations by the Northern Alliance for Sustainability (ANPED). A number of international and regional organisations were also present: the International Labour Organisation (ILO), the International Monetary Fund (IMF), the Organisation of American States (OAS), the United Nations Environmental Programme (UNEP) and the United Nations Industrial Development Organisation (UNIDO).

As set out in the conference programme (see Annex I, below) the discussion was organised in three sessions. The first consisted of an introduction to the Declaration on International Investment and Multinational Enterprises and was chaired by Mr. Manfred Schekulin, former Vice-chair of the CIME and current chair of the CIME Working Party on the OECD Declaration on International Investment. The second concerned the Results of the 2000 Review of the OECD Guidelines and was chaired by Mr. Marinus Sikkel, former chair of the Working Party on the Guidelines and current chair of the CIME. The third focused on the relevance of these instruments for non-adhering countries and was chaired by Mr. Wesley Scholz, Head of the United States delegation to the CIME and the Committee's current vice-chair. Delegates introduced the instruments and business, employee and non-governmental organisation representatives, presented their positions. In accordance with the themes

4 Non-Member participant representatives were from: Azerbaijan, Cameroon, Chinese Taipei, Colombia, Croatia, Egypt, Estonia, Haiti, Indonesia, Israel, Jamaica, Kazakhstan, Kenya, Latvia, Liberia, Lithuania, Malaysia, Mongolia, Peru, Russia, Singapore, South Africa, Tunisia, Ukraine, Uzbekistan, Venezuela, Vietnam and Yugoslavia.

outlined in a paper of issues for discussion drafted by the OECD Secretariat (also in Annex I, below), questions by participants and discussion followed each presentation⁵.

Session I - Introduction: The OECD Declaration on International Investment and Multinational Enterprises

The introductory session explored the results of the Review of the Guidelines in their broader context, and explained the general philosophy and balanced approach to international investment issues embodied in the OECD Declaration.

The Declaration was presented by a CIME Delegate as a contribution to improving the investment climate as well as facilitating the positive contributions enterprises and trans-border investment flows can make to economic, social and environmental development. The balanced approach of the Declaration and its four components: the newly revised Guidelines for Multinational Enterprises, National Treatment, Conflicting Requirements and International Incentives and Disincentives were introduced. It was noted that the Declaration is based on the general philosophy of the OECD that an appropriate form of international co-operation is often more effective for attaining certain objectives than legally binding frameworks. The approach of the Declaration is based on:

- A balance between the shared expectations of the adhering governments for the behaviour of the business community and the responsibility of governments to promote a favourable climate for international investment;
- A balance between stable common philosophy and basic principles of the Declaration on one hand, and the flexibility to reflect national circumstances and changes in international scene on the other;
- Balances between multinational enterprises and between multinational enterprises and their domestic counterparts.

The Declaration represents a real political commitment and was dynamic in nature and content. Adhering governments express their willingness to consult one another on the matters set out in the Declaration but also to engage in an open dialogue with other stakeholders: business, labour unions, non-governmental organisations, non-adhering countries. Finally, reviewing the Declaration is an important means for making it effective and relevant in a constantly changing world.

During the discussion, business noted its strong support for the comprehensive approach of the Declaration stressing the importance of all four components as a package in confidence building. A representative from a non-adhering country acknowledged the importance of the Declaration for small countries, in particular its contribution to creating a predictable and stable environment for FDI.

Session II – Results of the 2000 Review: OECD Guidelines for Multinational Enterprises

Session II focused on changes brought about as a result of the 2000 Review of the Guidelines, which resulted in an updated and expanded text, extension of the geographical scope and enhanced implementation procedures. Business, labour and NGO representatives explained their role in the Review.

5 Other supporting documentation included the text of the Guidelines and associated documentation, reproduced below in Annexes I and II.

- *Text of the Guidelines*

The Chair of the Working Party of the Guidelines and a number of other delegates made a presentation on each of the chapters of the revised Guidelines. The Chair insisted upon the fact that, although the Guidelines are a voluntary instrument, they cannot easily be ignored because they are supported by 33 governments, business federations, labour unions and NGOs. They apply to all enterprises, including SMEs and domestic ones. Most of the MNEs nowadays take their responsibilities seriously and have adopted their own codes of conduct, which in many respects go beyond the Guidelines. However, there are always a few that may be tempted, under heavy pressure of competition to adopt inappropriate standards. The Guidelines make clear that governments don't appreciate such an attitude. They complement and reinforce various forms of private efforts.

The new text of the Guidelines contains far-reaching changes that reinforce the economic, social and environmental elements of the sustainable development agenda. Recommendations have been added on the elimination of child labour and forced labour, so they now cover all internationally recognised core labour standards. A recommendation on human rights has been introduced, and new chapters on combating corruption and consumer protection have been added. The environment section now encourages multinational enterprises to raise their environmental performance through improved internal environmental management and better contingency planning for environmental impacts. The chapter on disclosure and transparency has been updated to reflect the OECD *Principles on Corporate Governance* and to encourage social and environmental accountability. Chapters on science and technology, competition and taxation have been updated.

During the discussion, a participant asked about possible conflicts and dilemmas MNEs could face between requirements of the Guidelines and domestic law. In response, it was made clear that the Guidelines do not impose conflicting requirements. National law prevails but the Guidelines encourage MNEs to do better than national laws if possible, without conflicting with them.

Discussion also addressed the benefits of the Guidelines for developing countries. It was pointed out that the Guidelines could be a useful additional instrument to improve the investment climate and to help maximise these benefits especially in the area of environment, labour, transfer of technology.

- *Geographical scope*

As a result of the Review, the text makes clear that the geographical scope of the Guidelines is global, i.e. the recommendations of the Guidelines apply to the world-wide activities of enterprises operating in countries adhering to the Guidelines. This is particularly important because of the increasing multinational enterprise activity in non-adhering countries, and avoids a double standard: adhering countries recommending certain practices in one part of the world while turning a blind eye elsewhere.

- *Implementation procedures*

The National Contact Point chairman of an adhering country introduced the implementation procedures of the Guidelines. Adhering countries are required to set up NCPs to further the effectiveness of the Guidelines. They must operate in accordance with the core criteria of principles of visibility, accessibility, transparency and accountability. Adhering countries have flexibility in organising NCPs: the NCP could be a government official, a government office or a co-operative body of agencies and organisations, including business, labour unions and other interested parties. Its task is to undertake promotional activities, handling inquiries and contributing to the resolution of issues that arise relating to implementation of the Guidelines in specific instances.

During the discussion, a question was raised about mechanisms to ensure that NCPs respect their commitments. It was pointed out that the enhanced implementation procedures set out more specific rules on the functioning of NCPs as well as new annual reporting requirements. In addition, the peer pressure process operative in the OECD would reinforce this. A business representative supported this position and affirmed that peer pressure will help an effective implementation so that no great differences occur between countries. Business supports a “level playing field” in order to avoid competitive disadvantages.

Furthermore, promoting awareness of the Guidelines is an important element of their success and effectiveness and that it should be a shared responsibility of all the partners in this exercise (governments, business, labour unions and NGOs).

- *Business position*

A business representative expressed the business sector’s favourable position towards widening participation of non-Member countries and their adherence to the Declaration. He insisted on the importance for the business community of the voluntary nature of the Guidelines and of the fact that they are integral part of the Declaration. This is important in the case of adherence of new countries because their acceptance of the Declaration as a whole would mean acceptance of all the principles that it includes.

BIAC stressed that they would promote the Guidelines in a very dynamic and constructive way, not only to large MNEs, some of which have already incorporated the Guidelines in their own codes of conduct, but also to SMEs, which initially may be more reluctant to do so because they lack adequate organisational capacity.

This challenging new phase of economic development should be a unique opportunity for both developed and developing countries. The Review of the Guidelines was absolutely necessary to encompass new developments brought up by globalisation, such as the great increase in the number of global enterprises as well as new issues such as on-line services and electronic commerce. The Guidelines could be part of a wider package of analyses and proposals made by the OECD in the area of the new economy considering issues such as trade liberalisation and sustainable development.

Finally, this representative stressed the need for transparency not only in corporate activities but also in the market environment by having clear and transparent common rules such as non-discrimination, and a fair and level playing field to avoid any risks in this critical phase of change. He finished with an optimistic statement that the new internet economy and the global scenario could benefit both developed and developing countries by offering possibilities to reduce poverty and unemployment imbalances. The implementation of the Guidelines should be in line with these targets.

- *Employee organisations*

The TUAC representative made remarks on the more general context in which the discussion of the Guidelines is taking place: the review itself and the implementation of the Guidelines.

General context: TUAC welcomed the new focus of the discussion in the OECD on global governance issues and the recognition that global markets need global rules which need to be set by governments. In this vein, TUAC views the development of codes of conduct by many corporations as a sign of the gap between government responsibilities and public expectations. It is time that governments set a floor of regulations and expectations as to how corporations based in their countries perform.

Review of the Guidelines: Although TUAC was sceptical at the outset of the Review as to whether the Guidelines could play a useful role, it found the results significant and positive. While the text could have been better and stronger in some areas, nevertheless Guidelines are worth having. TUAC is in close discussion with their global union partners in the ICFTU, sector organisations (the International Trade Secretariats), and in particular developing countries unions, about active follow-up.

Effective implementation: TUAC sees seven priorities for an effective implementation:

- Where they do not exist, functioning NCPs should be created;
 - Awareness of the Guidelines should be raised in other intergovernmental fora;
 - NCPs should use the Guidelines effectively to stop negative investment competition and should publish their recommendations;
 - Companies should meet with the International Trade Secretariats and sign agreements on how the Guidelines should be implemented;
 - The Guidelines should be used as points of reference for state aid and export credit guarantees;
 - The OECD should hold regional meetings with non-Members to raise awareness of the Guidelines; TUAC could help with funding;
 - The CIME Committee should produce a new user guide including the clarifications of elements of the Guidelines that have not been changed.
- *Non-Governmental Organisations*

The representative of an NGO said that NGOs are interested in a quick change from current unsustainable development to sustainable development, a reversal of the deteriorating trends in the environment, the elimination of poverty, the elimination of abuses of human rights, and other key elements of sustainable development. They consider the Guidelines as one of the many tools available to affect change in corporate behaviour, including legal challenges, public campaigns, direct NGO-company codes and contracts. The Guidelines are an initiative of great importance, as the only government-operated one.

The NGOs were initially critical of the Guidelines. They wanted a binding instrument. They also considered that although many good things were taken up in the Guidelines, some were left out, especially with respect to transparency and disclosure. However, although some NGOs will continue to flatly reject voluntary codes as a mechanism for “controlling” corporations, the NGOs that were involved in the Review recognise the importance of the Guidelines and are currently working to spread the information related to them to their colleagues around the world. As a first step they will have to be convinced that their scepticism about the political will to implement these Guidelines was misplaced. In this respect, they will focus on the NCP procedures, their uniform application, their transparency in procedures and outcomes and the actual observable impact on company behaviour.

Session III – Relevance for Non-Adhering Economies

The third session was divided into two parts: The first addressed the issue of the adherence of non-Members to the Declaration and its contribution to an enhanced investment climate for non-Members. The views of several representatives from non-Members were heard. The second part of the session focused on practical aspects of implementing the Guidelines in non-adhering economies.

- Adherence to the Declaration

The chair placed the Guidelines in the context of the Declaration from the point of view of their relevance for non-adhering countries. He pointed out that the objective of non-adhering economies in absorbing the potential benefits of globalisation depends on their ability to attract investment which will be applied in a way that promotes social and environmental progress as well as economic. Creating this environment depends on the creation of a sound policy environment that includes issues of non-discrimination, transparency and the rule of law generally. Many OECD countries have sought to promote this environment through bilateral and regional investment rules that provide specific protection to investors. On this point the chair added that efforts to develop multilateral rules in the OECD failed for two reasons: a lack of policy consensus within the OECD, but in addition a lack of flexibility in a process attempting to negotiate legal rules in the context of an increasingly challenging globalised world.

The true relevance of the OECD Declaration for non-adhering countries is the same as it is for OECD countries: the flexibility that it provides for policy dialogue. Unlike investment treaties, informal rules – such as the OECD Declaration—are founded on dialogue and discussion; it is the process of equals bringing their own experience and informing one another of how they deal with the complex challenges they face. In addition, it is the only instrument that addresses both the rights and responsibilities of MNEs.

A member of the Secretariat explained that adherence to OECD instruments by developing countries means undertaking the same political commitments as the OECD countries and others that have adhered, and participating in the follow-up procedures with other adhering countries. Those procedures call for periodic examinations of each country's investment policies, participation in OECD discussions of all the issues relating to the Declaration, and setting up effective National Contact Points to help implement the Guidelines for MNEs. For countries not ready to adhere to the Declaration, OECD provides other forms of co-operation with non-Members on investment issues. In particular, the Global Forum for International Investment is being established to provide for an on-going dialogue between OECD Member and non-Member countries.

One developing country representative asked some critical questions about the Guidelines Review and the Declaration. She wondered how developing countries could adhere to an instrument when they have been exposed very little to the entire framework and have not participated in the Review. She also questioned the benefits of a multilateral approach versus a bilateral approach. She questioned whether these OECD instruments took sufficient account of developing country interests and whether they had a real incentive to adhere to them. Finally, she considered the implementation mechanism weak. She concluded, however, that she would do the necessary to make the Guidelines known in her country and examine the benefits for possible adherence to the Declaration.

OECD delegates responded that there had been information sessions for non-Member countries during the Review, but the negotiations involved only adhering countries, including both developing and transition countries. It is an instrument designed among adhering countries which are also benefit from, and try to attract, FDI. There is no real dichotomy between developing and developed country interest; maybe a different appreciation on how to achieve goals. While the instrument is voluntary,

the implementation procedures exist to make it effective. As to bilateral versus multilateral approaches, it was stressed that the amount of analysis done in the OECD, the richness of the policy dialogue, the exchange of experience among thirty plus countries, in co-operation with non-Members, all at different stages of development provides a much more complete environment for dialogue than at a bilateral level. Finally, it was pointed out that the Declaration is based on critical political commitment of governments that provide an opportunity for an ongoing dialogue; it is not a static agreement with a set of binding legal rules.

Representatives of two emerging economies presented the political and investment climate situation in their respective countries and highlighted the difficulties they face in their way to development and market economy. They appreciated the importance of the Declaration and the Guidelines and the benefits that these instruments could bring to their countries and expressed interest in adhering to the instruments.

Finally, one representative from a developing country raised the issue of “outsourcing” and the importance that the phenomenon of sub-contracting has taken in a globalised world. OECD delegates drew attention to the fact that the Guidelines address this issue in their General Policies chapter, where enterprises are encouraged to advise their business partners including their suppliers and sub-contractors to apply principles of corporate conduct compatible with the Guidelines. It was recognised, however, that effective implementation of this recommendation would depend in part on the level of influence that particular enterprises have on their suppliers.

- *Implementing the Guidelines in non-adhering countries*

An OECD Member country representative made a presentation on issues related to implementation of the Guidelines in non-adhering countries. He pointed out that there are references to co-operation, general discussion and implementation in non-adhering countries in the Guidelines decisions, texts and commentaries. Along these lines, international co-operation including consultation on issues relating to the Declaration is extended to all countries and that consultation in the form of outreach events or with individual countries is provided for. In the case of issues arising in non-adhering countries, NCPs should take steps to develop an understanding of the issues involved and follow the same procedures set out for issues arising in adhering countries, where relevant and practicable. Possible conflicts with domestic laws in non-adhering countries may make it more difficult to implement the Guidelines, given the fact that the Guidelines are not intended to place MNEs under conflicting requirements. The commentary to the Guidelines suggests steps an NCP may take to develop an understanding of the issues, such as contacting the management firm in the home country and government officials in the non-adhering country. Parties involved in any specific issue need to be aware of possible limitations in implementing in non-adhering countries. Guidelines issues in non-adhering countries may be discussed in NCP meetings with a view to building expertise in handling issues arising in these countries.

How should issues relating to non-adhering countries be dealt with? One avenue would be to make the Guidelines known to non-adhering countries by means of further meetings (in the OECD or regionally), dissemination of documents and articles in publications in non-adhering countries. In his country, one method under consideration to increase awareness is to use embassies overseas when conducting investment promotion work. In this way, any potential overseas investor requesting market information from its embassy would also receive a short explanation of the Guidelines and their practical application (including the message that when an MNE invests overseas the government expects them to behave in accordance with the Guidelines). The same participant also raised the issue of whether it would be useful and appropriate to contact other interest groups in non-adhering countries.

It was recognised that dealing with cases occurring in non-adhering countries is complex and difficult. During the negotiations of the relevant provisions in the Guidelines, the adhering countries were very cautious in defining the responsibilities of the NCPs. The situation may differ case by case, in terms of the relationship between the NCP government and the government where the MNE is operating, and in terms of its ability to deal meaningfully with this issue. There is no easy answer or clear formula that could be applied; it is necessary to develop case-by-case experience to face not just the theoretical problems but also practical ones.

On this point, the ILO representative noted that there could be other avenues to be pursued and existing procedures which could be helpful. He mentioned that for example, there could be an organic link between the NCP process and processes existing in each state, including non-adhering ones that are members of the ILO, for improving the implementation of international labour standards. The unions and employer organisations in all those states would have something to contribute in Guidelines related cases arising in non-adhering countries from their ILO experience.

Concluding Remarks

The chair commended the participants for their participation, their willingness to absorb all the information about the Declaration and the Guidelines and their engagement in a very fruitful dialogue. He reiterated that co-operation with non-adhering countries is vital and welcomed the interest that was expressed by some of the participants to adhere to these instruments and by others seeking more information. He concluded that dialogue is very important and assured the participants that further opportunities would be created for consultation with non-adhering countries.

WELCOMING STATEMENT

Mr. Manfred Schekulin (Austria), Chairman of the OECD Working Party on the Declaration on International Investment and Multinational Enterprises, and former Vice Chairman of the OECD Committee on International Investment and Multinational Enterprises (CIME)

Welcome. Today's is the third in a series of meetings between OECD Members and non-Members on the OECD Guidelines for Multinational Enterprises. The two previous events took place during the Review of the Guidelines -- in September 1999 and February 2000.⁶ The difference between previous events and today's is that this meeting is taking place with the Review of the Guidelines successfully behind us. With this success in mind, and in view of the fact that the Guidelines are one of four constituent elements of its Declaration on International Investment and Multinational Enterprises, OECD Ministers reaffirmed last June that the Declaration "provides a balanced framework to improve the international investment climate", and that the OECD "will encourage non-Members to adhere to the Declaration on International Investment and Multinational Enterprises".⁷ This event is one element in that effort, which in the first instance seeks to better inform non-Members not only on the results of the Review of the Guidelines, but how they fit into the broader context of the OECD Declaration, as well as contributing to the continuing dialogue between OECD and non-OECD Members on issues related to international investment. This is a dialogue that OECD Members take seriously, as increasingly outreach efforts indicate.

I am pleased to see such a broad cross-section of representation here today. Not only are there a great number of OECD Members and non-Members from all corners of the world, but representatives from business, labour, and NGOs are here today to add their voice to this dialogue. As most of you know, the OECD consults with business and labour representatives through the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC). Both of these bodies, as well as NGOs, were closely consulted during the most recent Review of the Guidelines and contributed to its success. There is little doubt in my mind that all of us must improve our efforts at communication on investment issues if we are to improve the welfare of our citizens, and I know I speak for many in welcoming our social partners as a continuing part of that dialogue -- and especially in view of their interest in development issues.

Documentation pertaining to the sessions today is available for all of you. This consists of a booklet on the OECD Guidelines, which encompasses the OECD Declaration, as well as Guidelines Recommendations (divided into ten chapters), their implementation procedures, as well as

6 The September 1999 Meeting was part of a larger conference on issues related to the Guidelines, Corporate Responsibility, and FDI in general, which resulted in an OECD publication entitled *Foreign Direct Investment, Development, and Corporate Responsibility* (OECD, 1999). A summary of the February 2000 Meeting is contained in unclassified OECD document DAF/IME(2000)9, accessible through the OECD website.

7 See paras. 26-27 of the June 2000 Ministerial Press Release "Shaping Globalisation" at: <http://www.oecd.org/media/>.

commentaries on all aspects of the Guidelines in order to help those of you interested in more background to the issues covered by the Guidelines. In addition, we have made available an annotated agenda, as well as a brief paper outlining issues that may be of interest to participants throughout today's proceedings [both reproduced in Annex I, below].

The main topic today, of course, is the Guidelines. The organisation of today's meeting is as follows: we will begin with a short introductory session (which I will chair), which puts the Guidelines into a broader perspective for those who are relatively new to both the Guidelines and the Declaration. Session 2, chaired by Marinus Sikkel of the Netherlands, who chaired the Working Party on the Guidelines throughout the Review, will examine the Guidelines in greater detail. We have asked representatives of adhering countries closely involved in the Review to address different aspects of these instruments -- and you will note that one of these is a representative of a non-OECD Member that adheres to the Guidelines and the other OECD investment instruments. Finally, Wesley Scholz, Director of the Office of Investment Affairs of the US Department of State, will chair Session 3 on the Relevance of the Guidelines for non-Adhering Economies.

We look forward to a good dialogue among you all today and, in particular, look forward to hearing from participants from non-OECD Members. We have scheduled ample time for discussion during each session.⁸ Let us begin.

8 Highlights of the Discussion at each Session are also reproduced in this publication.

SESSION I - THE OECD DECLARATION ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES

The Objectives and Approach of the OECD Declaration

Mr. Daisuke Koroke, Assistant Director, Japanese Ministry of Foreign Affairs

This session will take into account the general philosophy and balanced approach to international investment issues embodied in the Declaration. One might then ask, “What is this general philosophy and balanced approach of the OECD in its Declaration”?

One basic idea behind the framework at the OECD is that legally binding frameworks do not always contribute to attaining desired objectives. Instead, an appropriate form of international co-operation which aims at striking the following balance may be preferable:

- A balance between the shared expectations of the adhering governments for the behaviour of the business community and the responsibility of governments to promote a favourable climate for international investment;
- A balance between stable common philosophy and basic principles of the Declaration on one hand, and the flexibility to reflect national circumstances and changes in international scene on the other; and
- Balances between multinational enterprises, and between multinational enterprises and their domestic counterparts.

Let me elaborate on this, starting with a brief history of the Declaration.

By the time the Declaration was originally adopted in 1976, multinational enterprises had come to play an important part in the world economy and in international economic relations. Through international direct investment, multinational enterprises were known to contribute to an efficient use of capital, technology and human resources between countries through better realisation of comparative advantages, and thereby bring substantial benefits to both home and host countries. Multinational enterprises could fulfil an important role in promoting economic and social welfare.

Those thoughts that the drafters of the original 1976 Declaration had remain valid, and in recent years, the international community has generally come to share these views. Attitudes and policies towards international investment and multinational enterprises have changed significantly. Increasing recognition of benefits of foreign direct investment has led a large number of countries to liberalise barriers and controls over the entry of foreign direct investment and the operations of multinational enterprises for their own benefit. The number of multinational enterprises has increased, and the structure of foreign direct investors has diversified.

At the same time, there was also concern when the Declaration was adopted that the ability of multinational enterprises to organise their operations beyond the national framework could cause

possible conflicts with national policies and concentrations of economic power. The difficulty of clearly perceiving complex structures, operations, and policies of multinational enterprises sometimes contributed to this. The drafters of the Declaration viewed international co-operation as essential in responding to such concerns. The result is that through co-operation, governments would act in a way that would strengthen the positive aspects of foreign direct investment. Secondly, they would encourage the positive contribution by multinational enterprises to promote economic, social and environmental progress; and minimise and resolve difficulties that may arise from their operations.

The first part of the Declaration reflects the expectations of governments towards multinational enterprises. The Guidelines for Multinational Enterprises, addressed to multinational enterprises, provide voluntary principles and standards for responsible business conduct. Adhering governments jointly recommend to their enterprises the observance of the Guidelines wherever they operate. The details of the Guidelines are set forth in Annex I to the Declaration. They are the only multilaterally endorsed and comprehensive code that governments are committed to promoting.

Although, in our view, the Declaration has generally achieved its objectives, there still remain concerns about the operation of multinational enterprises. Foreign direct investment is one of the most important elements in the process commonly called "globalisation", and multinational enterprises are perceived as principal architects as well as beneficiaries of the process. This view and public concerns on the impact of deepening globalisation underline the issue of corporate responsibility. Against this background, the Review of the Guidelines for Multinational Enterprises was carried out.

In the process and results of the Guidelines review, you can find some examples of the balanced approach of the Declaration. The review was conducted with a view to making the Guidelines more relevant and effective, keeping in mind the need for the basic principles to be stable. For instance, the non-legally binding character of the Guidelines, whereby observance of the recommendations is voluntary remains unchanged. However, there are also far-reaching changes to the text of the Guidelines that reinforce the core elements of the sustainable development agenda: economic, social and environmental progress. The review took place in constructive dialogue with the business community, labour representatives and non-governmental organisations and this contributed to keeping the balance of the Declaration.

The revisions to the implementation procedures, while maintaining the focus on the National Contact Points as the key government institution responsible for furthering effective implementation of the Guidelines, have resulted in more detailed guidance to National Contact Points in fulfilling their role and have clarified the CIME's role. A balance is also to be found here, i.e. through the objective of functional equivalence of National Contact Points while taking into account each country's national situation. In other words, the balance between stability and flexibility was preserved. We will later have an opportunity to discuss various issues related to the Guidelines and the 2000 Review in more detail in later sessions.

National Treatment, the second part of the Declaration and at the other side of the "balance" from the Guidelines, is a commitment by adhering governments to accord national treatment to foreign-controlled enterprises operating in their territories with respect to laws, regulations and administrative practices. The political commitment take into account some important considerations such as consistency with needs to maintain public order, to protect essential security interests and to fulfil commitments relating to international peace and security.

The National Treatment Instrument addresses the treatment of foreign-controlled enterprises after establishment. In this respect it differs from another OECD instrument, the Code of Liberalisation of Capital Movements, which seeks, among other things, a non-discriminatory right of establishment of foreign-controlled enterprises.

Another difference is that the Code is legally binding on OECD Members, whereas the National Treatment Instrument is not: for OECD countries, national treatment of foreign-controlled enterprises on their territories constitutes a voluntary undertaking. However, it was underpinned in 1988 by a unanimous pledge of all Member countries to refrain from introducing new exceptions.

Like other parts of the Declaration, the National Treatment Instrument has follow-up procedures. These procedures are designed to encourage the fullest possible application of National Treatment by Member countries, and are set out in an OECD Council Decision of December 1991. The Decision comprises an annex that lists exceptions to National Treatment as notified by each adhering country and accepted by the OECD Council. Exceptions are typically limited to certain sectors, notably mining, transport, fisheries, broadcasting and telecommunications. Even there, many exceptions are of a limited nature and exceptions are reduced in scope or deleted as a result of unilateral measures by the countries themselves, or as a result of the periodic examinations in the OECD.

National Treatment is one of the cornerstones of investment agreements, whether they are bilateral or multilateral. The OECD was in the vanguard in recognising this through the Declaration, and continues policy analysis and research in this and related domains.

The remaining two substantive parts, the third and fourth parts of the Declaration, both serve to keep and improve the stability of a favourable climate for foreign direct investment, thereby increasing opportunities to enhance the benefits of foreign direct investment. The third element of the Declaration calls on adhering governments to avoid or minimise conflicting requirements imposed on multinational enterprises by governments of different countries. Conflicting requirements imposed by countries on multinational enterprises arise when a country's legislative or legal requirements with extraterritorial reach conflict with legislation or policies in other countries, and affect the operations of entities of multinational enterprises. Such situations create a climate of uncertainty that may lead multinational enterprises either to scale back existing international operations or to hesitate to undertake new ones. Adhering governments, therefore, will co-operate with each other with a view to avoiding or minimising the imposition of conflicting requirements on multinational enterprises.

For example, in contemplating new legislation or action under existing legislation which may conflict with the legal requirements or established policies of another Member country and lead to conflicting requirements being imposed on multinational enterprises, the Member countries concerned are expected to:

- Have regard to relevant principles of international law;
- Endeavour to avoid or minimise such conflicts and the problems to which they give rise by following an approach of moderation and restraint, respecting and accommodating the interests of other Member countries;
- Take fully into account the sovereignty and legitimate economic, law enforcement and other interests of other Member countries;
- Bear in mind the importance of permitting the observance of contractual obligations and the possible adverse impact of measures having a retroactive effect.

They are also expected to endeavour to promote co-operation as an alternative to unilateral action to avoid or minimise conflicting requirements and problems arising therefrom. Member countries should on request consult one another and endeavour to arrive at mutually acceptable solutions to such problems.

The final substantive element of the Declaration is entitled "International Incentives and Disincentives." It shows the recognition by adhering governments of the need to give due weight to the interests of other adhering countries affected by laws, regulations and practices concerning official incentives and disincentives to international direct investment. Adhering governments will endeavour to make such incentives and disincentives as transparent as possible, so that their importance and purpose can be ascertained and that information on them can be readily available.

Such efforts include consultations in the framework of the Committee on International Investment and Multinational Enterprises. At the request of a Member country which considers that its interests may be adversely affected by the impact on its flow of international direct investments of measures taken by another Member country providing significant official incentives and disincentives to international direct investment, consultations will take place with a view to examining the possibility of reducing such effects to a minimum.

The Declaration is not -- and should not -- be static; it is a real political commitment, dynamic in nature and content. To put our commitments towards international co-operation into effect in the real world, operational provisions are indispensable. Adhering governments therefore express their willingness to consult one another on the matters set out in the Declaration. These consultations are conducted in conformity with the relevant Decisions of the OECD Council.

Again using an example from the Guidelines for Multinational Enterprises, National Contact Points in different countries are expected to co-operate if such need arises, on any matter related to the Guidelines relevant to their activities. They shall meet annually to share experiences and report to the Committee on International Investment and Multinational Enterprises.

Review is also an important task in making the Declaration effective and relevant. Adhering governments review the Declaration periodically with a view to improving the effectiveness of international economic co-operation among adhering governments. Prior to the 2000 review, previous reviews were conducted in 1979, 1984 and 1991.

In sum, adhering government are trying to achieve objectives that contribute to improving the welfare and living standards of all people, through a balanced framework of co-operation.

Japan has benefited from the OECD investment instruments. The Declaration has facilitated domestic discussions and contributed to formulating policies in the investment field. Liberalisation of foreign inward direct investment is one of the results. Other adhering governments to the Declaration have had similar experiences, and I believe they will share these with you today.

Japan continues to support underlying tenets of the Declaration, including national treatment and recommendations for enterprises. It believes that in this era of globalisation, the relevance and importance of the Declaration is increasing. However, the objectives of contributing to the improvement of the welfare and living standards of all people cannot be achieved by adhering governments to the Declarations alone. Discussions with our partners, bilaterally and in their broader context, are indispensable. Indeed, this is one reason why we are here today. I very much look forward to a candid dialogue among OECD and non-OECD Members on the relative merits of the various elements that constitute the OECD approach to international investment as expressed in the Declaration.

Open Discussion Highlights

Mr. Schekulin: I would summarise the OECD approach to international investment in the Declaration by saying that it provides a framework to improve the investment climate and optimise the positive contributions that enterprises and trans-border investment flows can make to economic, social and environmental development. Other elements I would like to stress are the fact that the four constituent elements of the Declaration provide a balanced framework and that the Declaration is a dynamic rather than static means of addressing investment issues. The recently concluded Review of the Guidelines is one example of this, including with respect to a dialogue with non-Member countries that characterised it. Finally, the Declaration contains voluntary instruments but adhering countries believe that it is in their interest to implement them.

Mr. Harry Van Egmond, Economic Advisor, Unilever NV (OECD Business and Industry Advisory Committee (BIAC)): I would like to express business's strong support for a comprehensive approach such as the one described in Mr Koroke's speech. The main objective of the Declaration is to improve the conditions for, and the benefits of, FDI and make sure that it is in the interest of both business and host countries. The National Treatment Instrument is a key element in creating a positive investment climate. This does not imply unrestricted access to markets; it implies non-discrimination.

The second element in the Declaration on conflicting requirements is important because it can prevent costly and damaging conflicts affecting business. The third element is incentives and disincentives, which is moving gradually to the top of the international agenda, in particular, the issues of transparency and the opportunity to consult are very important. Finally, we come to the Guidelines, which are also acceptable to business. We are in the process of disseminating them to our members. All these instruments are important as a package – and in confidence building.

Finally, we come to the issue of greater outreach on the basis of the full Declaration. This, too, is in the interest of business but I hope that it will be recognised by non-Member countries that it is also in their interest.

Mr. Mati Murd (Ministry of Foreign Affairs, Estonia): The Guidelines are an important instrument for promoting a predictable and stable environment for FDI. This is important not only for large economies but also for small countries like Estonia. Amongst Estonia's rapid and radical economic reforms, the driving force has been FDI inflows. Estonia is now one of the most advanced transition economies regarding FDI inflows per capita. There is, however, a need for continual development of the business environment. In a globalised economy, implementation of international instruments such as the Declaration and Guidelines should be one of the most important tasks in this regard. Estonia is already implementing most of the underlying principles of the Guidelines. As a next step, Estonia will officially apply for adherence to the Declaration. We are also applying for membership in other important investment related instruments, such as the Bribery convention. I would like to confirm Estonia's strong interest in close co-operation with OECD Member and non-Member countries to implement and improve the Guidelines.

Mr. Schekulin: The announcement that Estonia will apply for adherence to the Declaration is a welcome one. Without further delay, I now turn to the next item on our agenda, the OECD Guidelines themselves.

SESSION II - THE RESULTS OF THE 2000 REVIEW OF THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES

Introduction

Mr. Marinus Sikkel (Netherlands), Chair of the CIME and former Chair of the Working Party on the Guidelines

FDI has grown enormously recently. We all want our fair share of it and at the same time the maximum benefits that FDI can provide. This is exactly where the Guidelines come into play. They are an instrument that can contribute to creating confidence, improve the investment climate, contribute to sustainable development, while maximising the positive contributions from FDI and minimising possible difficulties to which FDI may give rise. How do we begin to ensure that all this happens?

First, by making the Guidelines a voluntary instrument: the Guidelines are recommendations, not binding legal rules. This does not mean that they can easily be ignored; they are supported by 33 governments (most of whom are OECD Members, but some who are not), as well as business federations, labour unions and NGOs. When we talk about enterprises, we mean all enterprises, not only big ones. Investment today has new players, indeed tens of thousands of them from all over the world (big, medium or smaller size) and we expect the same behaviour from all of them. Of course SMEs [small- and medium-sized enterprises] do not have the same facilities available to them as larger firms, and we recognise this.

In general, do we have problems with MNEs? No. If you look at most of them you will see that they take their responsibilities seriously; many have their own codes of conduct which in many respects go further than anything we put in the Guidelines. But there will always be a few, under the heavy pressure of competition, that may be tempted to direct inappropriate standards to gain undue advantages, and for those companies the Guidelines make clear that governments don't appreciate such attitudes.

The Guidelines complement and reinforce all forms of private efforts. Of course, governments have other ways to achieve this: we do have rules and regulations and all forms of international co-operation, which the Guidelines also recognise. (The labour chapter makes reference to the ILO; the Universal Declaration of Human Rights, as well as the Rio Declaration are also referred to.) All these are expressions of our commitment to continue the improvement of policies to improve the welfare and the living standards of all people.

A few words on process: this is one of the strengths of the Guidelines, largely because we have involved all our stakeholders from the outset. We started out with an assessment of the existing instrument, sent out a questionnaire, organised a Conference in Budapest⁹, began talking with other stakeholders and non-adhering countries, and tried to involve all stakeholders at the outset. In addition, we put out the text in the Internet and asked for input from everybody. The input was constructive, and contributed to the success of our open and inclusive process, which is one reason why we are committed to continuing the dialogue with you here today.

During this session, we are going to hear from a number of presenters closely involved with the Review. To begin with, Mr. Vernon MacKay of the Canadian Department of Foreign Affairs and International Trade, will speak about the Guidelines in the context of responsible business practices, highlighting five chapters of the Guidelines (on Concepts and Principles, General Policies, Disclosure, Employment and Industrial Relations, and the Environment), as well as the important issue of the Geographical Scope of the Guidelines. Then, Mr. Lauro Soutello of Brazil, representing a non-OECD Member that was closely involved with the current Review, goes on to explore five more chapters of the Guidelines, including those that may be identified as of particular interest to non-OECD economies (Combating Bribery, Consumer Interests, Science and Technology, Competition, and Taxation). Thirdly, Mr. Henning Envall of Sweden will speak to you about the important and unique implementation features of the Guidelines, in particular the role of National Contact Points that exist in each and every country adhering to the Guidelines to assist in this process. Finally, we have also asked social partners, including a representative from business, labour, and NGOs to intervene on aspects of the Guidelines that they would wish to highlight from their perspective, before we move on to discussion.

9 A conference in Budapest in November 1998 marked the formal beginning to the Review which culminated at the OECD Ministerial Meeting in June 2000. The Budapest conference report is available at: <http://www.oecd.org/daf/investment/>. “The OECD Guidelines in a Globalising World”, a paper based on a presentation at this conference by Prof. Arghyrios A. Fatouros of the University of Athens is available at the same website address.

Responsible Business Practices in the 21st Century

The Geographical Scope, Preface, and First Five Chapters of the OECD Guidelines for Multinational Enterprises

Mr. Vernon MacKay, Canadian Department of Foreign Affairs and International Trade, Investment Trade Policy Division

First of all, I wish to reassure our non-Member guests who are not familiar with the OECD Guidelines for Multinational Enterprises or maybe have not heard of them at all. Because before I came to work on this file two years ago, I had not heard of them either. But I can tell you that after having been involved in them over the past two and a half years that I believe the Guidelines are going to enjoy a higher profile as we move into the 21st century, and continue to be relevant to global international investment activity.

I should add that the title to my presentation: “*Responsible Business Practices in the 21st century*” is not endorsed by the CIME nor used by the OECD Secretariat, but was created just for this presentation.

I would like to introduce to you the first five chapters of the Guidelines, as well as briefly introduce the subject of the geographical scope of application of the Guidelines. I’ll structure my presentation as follows:

- A few words on the Preface to the Guidelines;
- Concepts and Principles (chapter 1), which set framework of the Guidelines
- A few words on geographical scope, an important issue in Review of the Guidelines
- Then, into the actual recommendations: General Policies (chapter 2), Disclosure (reporting practices; chapter 3), Employment and Industrial Relations (chapter 4), Environment (chapter 5).

Preface

The Guidelines were created in 1976 and are part of the Declaration on International Investment and Multinational Enterprises. The most recent review completed in June 2000, when the Ministers of OECD Members and four non-Member countries endorsed the Guidelines.

Why was this review carried out? Periodic reviews are required under the Guidelines, and the recent Review in June 2000 was the fourth such review, to ensure that Guidelines remain relevant to changing circumstances of international business.

To reiterate the points made by Mr. Sikkel in his introduction to this session, there is an important role to be played by the Guidelines in terms of ensuring business operations that are in harmony with host government policies. They can also contribute to improving the foreign investment climate as well as sustainable development in a world where multinational enterprises are making an increasing contribution to development - not just economic development but environmental and social development as well.

The preface to the Guidelines acknowledges that they provide a framework for the activities of multinational enterprises and a framework for interface with governments and communities in host countries.

Chapter I: Concepts and Principles

The Guidelines are recommendations to multinational enterprises, jointly addressed by adhering governments. Adhering governments include 29 OECD Members plus 4 non-Members, so 33 governments that adhere to the Guidelines.

They are voluntary, not legally binding. They encourage principles and standards of good practice.

It is clear that some multinational enterprises are already practising standards and principles that go beyond the Guidelines, but we feel the Guidelines have settled on a level of good practice for *all* companies and enterprises. They are encouraged to act consistently with applicable law: domestic law and international law ratified by host countries prevails. The Guidelines are not designed in a way to place multinational enterprises in conflict with the laws of the land.

Finally, adhering governments have obligations. While the recommendations are not binding on multinational enterprises, governments have obligations to implement. But more will be said on that later.

Geographic scope

This was an important issue during the Review because the previous Guidelines were unclear on their application outside the OECD. As a result of the Review, the geographical coverage was confirmed to be global.

This specifically means that the recommendations are addressed to multinational enterprises operating in or from adhering countries wherever they operate. To use my country as an example, it would cover a multinational enterprise from the USA operating in Canada, and Canadian multinational enterprises operating globally, whether in an adhering or non-adhering country.

A multinational enterprise from a non-adhering country, for example from Egypt or Malaysia, operating in another non-adhering country, is obviously not covered by the Guidelines. These multinational enterprises are free to draw inspiration from the Guidelines, but there would be no formal provision for this relationship between a multinational enterprise and its government in this instance if the government in question has not endorsed the Guidelines.

I would like to reiterate that this was an important issue -- and result -- of the Review. We expanded the geographical scope -- and the text was clarified to ensure that this was understood -- because of increasing multinational enterprise activity in non-adhering countries. It also avoids situations of double standards, whereby adhering countries would recommend certain practices in one part of the world but then turn a blind eye to them elsewhere. Social partners (business, labour, and NGOs) were generally supportive of expanding the geographical scope of the recommendations.

The Guidelines are also designed to avoid conflicting requirements. Because they are voluntary, they are not a substitute for applicable law, but are rather intended to be supplemental to applicable law. So they encourage multinational enterprises to first and foremost obey domestic law and then aspire to a higher standard as long as it is consistent with that law.

Chapter II: General Policies

This is the first chapter to deal with specific recommendations to multinational enterprises. It sets the tone for the following chapters which address specific areas such as the environment, and employment and industrial relations.

As I proceed through these recommendations, I will highlight those that I believe to be of interest to non-Members. But I encourage you to look at the complete set of recommendations in the documentation available to familiarise yourself with the range of recommendations. And the next speaker, my colleague from Brazil, Mr. Lauro Soutello, will also be addressing those recommendations that may be of particular interest to developing countries.

The first recommendation is to obey domestic law.

The second is to contribute to sustainable development. The “triple bottom line” issue underlies this: paying attention to not just the economic aspect of operations to but social and environmental priorities as well often pays off on a company’s bottom line.

An important recommendation, which is new, is on human rights. This was the subject of a lot of discussion. Rather than try to sum up those discussions, I will just read to you the recommendation as it is in the General Policies chapter, which says:

“Enterprises should [...] respect the human rights of those affected by their activities consistent with the host government’s international obligations and commitments.”

It encourages multinational enterprises to be sensitive to the human rights of their employees, as well as those that are affected by their operations, again consistent with the obligations of the host country in the international arena.

Concerning local capacity building and human capital formation: Multinational enterprises are encouraged to strengthen their local operations to further the goal of a thriving local business, and to do so in close co-operation with the local community. Human capital formation aims to also ensure employees are provided with training opportunities and opportunity to expand their skills. Finally, another idea is to foster confidence and mutual trust with the communities in which they operate.

Abstaining from seeking or accepting exemptions not provided for in the statutory or legislative frameworks of the host country, with respect to such issues as financial incentives, taxation, labour, the environment, etc. is another important recommendation of this chapter.

Diffusing good practices to suppliers, subcontractors and business partners: This is to remind enterprises that the practices consistent with the Guidelines are good practices for suppliers, subcontractors and business partners globally, not just in OECD countries.

Chapter III: Disclosure chapter

The purpose of this chapter is to encourage improved understanding of MNE operations through increased transparency. It provides for reporting on all material matters, financial situation and performance, ownership and structure. These are typically addressed by multinational enterprises already because the laws of most countries require it, but new is the encouragement for reporting on environmental and social issues. It is recognised that there are no internationally recognised standards for reporting in this area as they are still evolving; nevertheless, businesses are encouraged to increase their transparency on these issues.

This chapter also recognises the need to balance the principles of transparency and confidentiality, recognising that businesses do operate in a competitive environment and that there will be some information which will remain confidential, and we of course respect that enterprises have to compete to succeed.

Chapter IV: Employment and Industrial Relations

This chapter received a lot of attention during the Review.

As highlighted in the introduction to this session by Mr. Sikkel, the ILO is the competent body to set and deal with international labour standards. However it was recognised that the Guidelines at the OECD do have a role to promote observance of international standards among multinational enterprises.

I will not deal with all recommendations, but just highlight the key ones.

Respect for core labour standards as defined by the ILO: child labour, forced labour, freedom of association and collective bargaining, and non-discrimination, with respect to such areas as race, religion, gender, etc.

Employ and train local personnel: For non-Member countries, this can be an important recommendation as it encourages multinational enterprises to take advantage of the available supply of labour, as opposed to employing home country nationals. It also encourages employment and upgrading of skills of local personnel.

Ensure occupational health and safety.

Co-operation with employees and government: This recommendation addresses situations where MNE activities can have a significant impact on employees, for instance relocation of an operation.

This is a very brief summary of the recommendations. I encourage you to look at them as there are some subtleties and qualifications provided in the recommendations as well as the commentaries that can provide further information.¹⁰

Chapter V: Environment

This chapter also received a lot of attention during the Review. When we speak about the environment, we are referring to the protection of the environment, as well as furthering the goals of public health and safety.

One of the key recommendations is the establishment of environmental management systems, appropriate to the operations of a multinational enterprise. Essentially, what is envisioned here is that multinational enterprises will establish data on their operations, set objectives with respect to environmental performance, and measure how they're performing against those objectives. The implication of this is that it will require some monitoring and verification within the multinational enterprise itself.

Another important recommendation was to assess potential environmental impacts and, if required by the law of the land or if preliminary assessments suggest it should be done, encourage full-blown EIAs

10 The Text of the Guidelines chapters, together with Implementation procedures and associated Commentaries, is reproduced below in Annex II.

(environmental impact assessment). The current recommendation only encourages this on the basis of *preliminary* environmental impact assessments.

Precautionary principle: Again, this recommendation was the source of much discussion and I would hate to misrepresent so I will read it in full:

“Enterprises should [...] consistent with the scientific and technical understanding of the risks, where there are threats of serious damage to the environment, taking also into account human health and safety, not use the lack of full scientific certainty as a reason for postponing cost-effective measures to prevent or minimise such damage.”

This is essentially a part of a company’s risk management approach, and, on the basis of the scientific and technical understanding (a key element here), they should not use the lack of full scientific certainty to postpone taking measures to mitigate damage to the environment.

Maintain contingency plans: to prevent and control any environmental situation that may arise.

Training of employees: Ensure that MNE operations staff are familiar with these environmental performance measures and can act on them.

In summary, we spoke about the Guidelines as non-binding recommendations to multinational enterprises in five chapters, including Concepts and Principles, as presented above, and we spoke of the geographical scope of recommendations. This is of course not the end of the story; other colleagues will offer further explanations of the MNE Guidelines as a result of the most recent Review.

Guidelines Provisions of Particular Interest to Developing Countries:

Chapters VI to X of the OECD Guidelines for Multinational Enterprises

Mr. Lauro Soutello, First Secretary, Embassy of Brazil in Paris

As a representative of a non-Member country which has fully adhered to the Guidelines, I should attempt to present them from a different perspective than Mr. MacKay, who addressed the first five chapters of the Guidelines. The chapters I will present, namely chapters VI to X, deal with issues close to the heart of emerging economies and developing countries.

Chapter 6: Combating Bribery

The first chapter in this respect deals with bribery. Unfortunately, this is a prevalent phenomenon in the areas of trade and investment and one of the most serious impediments to development. Bribery distorts trade and investment and stands in the way of establishing a level playing field for FDI and development. The revised Guidelines seek to deal with bribery in as comprehensive way as possible. I would like to draw attention to how this chapter can be seen as innovative or complementary to the OECD Bribery Convention. Paragraph 1 of this chapter addresses not only the supply side of bribery but also the demand side of bribery. This issue was not addressed in the Bribery Convention.

Paragraph 6 of this chapter deals with the issue of political parties—legal contributions to candidates for public office which might result in undue advantages for an MNE. This issue is not addressed in the convention but the Working Group on Bribery is conducting discussion in depth upon the Council's Recommendation.

All signatories to the Bribery Convention—except Bulgaria—are adherents to the Guidelines. Not all signatories of the convention have ratified or adopt and implement legislation. However, in this respect the bribery chapter fills an important gap until all signatories of the Convention have ratified it.

Chapter VII: Consumer Interests

This is an important chapter for developing countries.

MNEs exist for one reason: to provide goods and services. They need consumers, otherwise they wouldn't exist. Consumer interests is one of the areas where the priorities of business and consumers can collide. Unfortunately, not all MNEs enjoy a sterling reputation in the developing world. We all know the terrible effects of the Bhopal accident several years ago. There are other instances of negligence or non-sterling behaviour by MNEs in several developing countries. As FDI has out-paced GDP growth throughout the world, the South has been very concerned for the protection of consumer interests and public health and safety. My own delegation played a significant role in the drafting of this particular chapter and stressed the need for MNEs to co-operate fully in a transparent manner with public authorities in the countries where they operate in order to prevent serious risks to public health and safety. This is contained in paragraph 6.

A recommendation on this subject may seem obvious; in many countries public institutions have the mandate to ensure that public health and safety are respected and upheld. But in real life, the situation may be much more complex, and there are instances where MNEs have been less than co-operative. For instance the case of a pharmaceutical company from an OECD Member country which inadvertently switched two shipments of medicine which were to be sold in the Brazil market: a shipment of birth control pills was switched with a shipment of placebos (basically consisting of flour)

which was going to be used as part of a quality control experiment to be conducted by the company at the local affiliate in Brazil. You can imagine what the results were – dozens of unwanted pregnancies in particular to women who couldn't afford to have children. Eventually compensation was provided by the company but at the initial stages a campaign of misinformation was conducted by the company which was much publicised in the press, and acrimony between the MNE (headquartered in an OECD country) and the Brazilian government resulted. My question is: had the Guidelines been in effect three years ago, and had the Brazilian NCP been in place, would it have been possible for the local affiliate of the MNE and the Brazilian company to come to terms over the issue of the placebos without having to result in the kind of acrimony which was played out in the press? It could have been possible. It is a shame that the Guidelines were not in effect at this time in Brazil.

Chapter VIII: Science and Technology

R&D is a key feature of world-wide activities of all MNEs; it is part of their core business and part of their competitive edge. The days have long past where international conventions providing for compulsory transfer of technology were being discussed. None of those adopted at the UN and elsewhere ever brought the desired effects. Transfer of technology must be voluntary, part of the FDI process, and market oriented. We cannot force MNEs to transfer technology; what we can do is create a better business and investment environment and encourage MNEs to invest in technology instead of services where they operate world-wide. This chapter of the Guidelines deals with the issue in some detail and succeeds in raising the necessary issues. It is an important chapter to developing countries adhering – or wishing to adhere – to the Guidelines.

Chapter IX: Competition

This chapter attempts to fill a gap. There is no international agreement on competition policy. Competition policy has been discussed in the WTO. It could have been one of the features of the multilateral trade negotiations which should have been launched in Seattle. In the absence of international agreement in this field, this particular chapter fills an important gap in so far as it encourages MNEs to not engage in anti-competitive practices. We all know that MNEs can and often do play a role in a pro-competitive business environment. In Brazil, the privatisation programme undertaken the last few years has resulted in massive inflows of FDI and many MNEs have involved Brazilian public utility companies and others, which has had a very competitive effect in business.

Chapter X: Taxation

This chapter consists of one paragraph only and it is very straightforward. It translates basically the OECD transfer pricing guidelines (including the “arm's length principle”) into a rather manageable format which can be referred to by MNEs.

Conclusion

The accomplishments of the Guidelines Review, including with respect to Chapters VI-X which are of particular relevance to developing countries, encourage us to make greater efforts to make the Guidelines better known. We need to reflect further on the gap between aspiration and reality in order to make the Guidelines truly relevant to business activity world-wide.

The Role of National Contact Points in Implementing the Guidelines

***Mr. Henning Envall, Desk Officer,
Swedish Ministry for Foreign Affairs***

Thank you all for coming here today. I would like to deal with the role of National Contact Points. I will talk in my capacity as the Swedish representative in the CIME and WPG, and the chairman of the Swedish NCP.

I would like to start with the mandate of our OECD Ministers, i.e. the Decision of the OECD Council, which says on the National Contact Points:

“Adhering countries shall set up National Contact Points for undertaking promotional activities, handling inquiries and for discussions with the parties concerned on all matters covered by the Guidelines so that they can contribute to the solution of problems which may arise in this connection, taking due account of the attached Procedural Guidance. The business community, employee organisations, and other interested parties shall be informed of the availability of such facilities.”

I would like to highlight this procedural guidance and relate it to some Swedish experiences.

In doing so, this presentation deals with two things:

- What the Guidelines and the NCP should be: It is compulsory for governments to set up an NCP and to do certain things.
- What they could be: Although the Guidelines are non-binding, companies are encouraged to use and implement the Guidelines in their daily operations.

The role of the NCP is to further the effectiveness of the Guidelines. Companies have the prime responsibility to observe the Guidelines in their day to day operations. Adhering governments are there to contribute to the effectiveness of implementation procedures, via the NCP.

The NCP should operate in accordance with certain core criteria: visibility (seminars, publications to show that we are “there”); accessibility (having a phone and answering it); transparency (in most cases, there is little reason to be secretive of what we’re doing); and accountability (for all countries, there are annual NCP meetings, reports and meetings of the relevant Committee at the CIME). All this is with a view to an overall objective of functional equivalence, i.e. acknowledging that our aims are the same but our means of getting there are different.

Institutional Arrangements

We seek to balance functional equivalence with flexibility, and also seek the active support of social partners, including the business community, employee organisations and other interested parties, such as NGOs.

The NCP can be a government official, a government office, or a co-operative body of agencies and organisations. The objective here is to develop and maintain relations with the business community and other partners. The overall objective is to further the effectiveness of the Guidelines and we try to have relations with anybody who can help us do that.

In Sweden, the NCP has a long history. In 1973, a group was established to talk about multinational enterprises in general. This was turned into the NCP in 1979, and has been there ever since, irrespective of which government was in power. It is tripartite, chaired by the Ministry of Foreign Affairs, and contains government departments and business and labour organisations.

The NCP in Sweden convenes three to four times per year. Here are some examples of our NCP's activities: We've had the Swedish Accounting Standards Board study the information that Swedish multinational enterprises make; we've had discussions among various government agencies (in Sweden, we have a system of relatively independent government agencies); we've had the Swedish Board of Trade send out a questionnaire to companies about the Guidelines. And we've had regular Nordic (Denmark, Finland, Iceland, Norway and Sweden) meetings in co-operation with our neighbouring countries.

Information and Promotion

This is an important feature of the Guidelines. Basically, it means making the Guidelines known and available online, in national languages and to prospective investors as appropriate. It is about responding to enquiries that parties may have. In Sweden, since the conclusion of the last Review in June, we have done a number of things: translated the Guidelines, hosted a seminar, and put the translated Guidelines into an introductory handbook available to anybody interested. In addition, we have been involved with several smaller events with business and labour at which we discussed the Guidelines. We also set up a web page on the Guidelines.

Implementation in Specific Instances

The NCP should be a forum for discussion and assistance to the business community, to employee organisations, and to other parties concerned when there is alleged breach of the OECD Guidelines.

In Sweden, we had two such cases in 1980 and 1989. I won't elaborate about them now, other than to say they were apparently solved in the process provided by the Guidelines.

What will the NCP do when an instance arises in the future? The NCP will make an initial assessment answering the question: Does this issue merit further examination? If so, the NCP is there to provide good offices, to try to solve the issue by sitting down and talking to the parties concerned. In doing this, National Contact Points will obviously seek advice of experts, consult other NCPs if other countries are involved, seek guidance by the CIME if there is doubt on the interpretation of the Guidelines, and offer conciliation or mediation if appropriate. If there is no agreement, the NCP cannot do much more. It would then issue a statement that the process has been followed. During this process, it is important that the NCP protect sensitive information. Of course, we hope that in most cases the issue will be solved. In these instances, the NCP will consult with the parties on what could be revealed of the results, and these results would then be made publicly available.

As we mentioned when discussing the geographical scope, I can just say that issues in non-adhering countries will be pursued to the extent possible. The procedure provided by the Guidelines will be used where it is relevant and practicable.

Reporting

There is a reporting requirement on National Contact Points. We all make annual reports to the CIME on the nature and results of our activities, including implementation activities in specific instances, and discuss them in our annual meetings.

To summarise, the Council Decision binds all adhering governments to institute National Contact Points to engage in promotional activities, handle enquiries, have discussions, try to solve problems that arise, and inform about our activities.

Business and the Guidelines

***Mr. Bruno Lamborghini, Chairman of Olivetti Lexikon S.p.A.,
Chairman of BIAC (Business and Industry Advisory Committee to the OECD)***

I appreciate this event because the business sector is in favour of widening participation of non-Member countries in this initiative in order to have a wider application of the OECD Declaration and the other instruments. We are all increasingly involved in a global environment and business recognises its global role in this context. We are entering into a very critical and challenging phase of economic development (not only developed countries but also developing ones), and we will all have to seek to take advantage of this radical change. In this context, the Review of the Guidelines was absolutely necessary in order to adapt the Guidelines to this new environment.

We agree with the characterisation of the Guidelines – and Declaration – by Mr. Koroke in the introductory session as inherently dynamic. At a time of increasingly rapid change, we have to work fast to ensure that obsolete conditions do not limit the possibilities of new opportunities. It is a matter of fact that the number of MNEs have increased since 1976. We now have thousands of MNEs – global enterprises (some entering the global market through on-line services and e-commerce) – and we have to take this into account in considering how to dynamically approach this new environment.

There are at least two main points that remain clear following the Review of the Guidelines: the first is the voluntary nature of the Guidelines; the second is that they are an integral part of the Declaration. This is important when we talk about non-adhering countries' participation because they are basic elements for their participation and their acceptance of the Declaration and the principles that they include. The work on implementation is via governments on one side and via companies on the other. This is a process that BIAC contributing to constructively through, for example, contact with its national business associations. Businesses working with National Contact Points now have to become marketing people – they have to sell the Guidelines at the national level to the business sector and in particular to SMEs.

This is not easy. Many companies have today incorporated the Guidelines in their codes of conduct. Other companies have just begun to understand the importance of such initiatives -- SMEs, for example, largely because they do not have the capacity to integrate them in their organisational structure. With this in mind, we have to be careful not to create obstacles to company growth. But at the same time this learning process should proceed in co-operation with the OECD, particularly since the OECD can assist with selling the Guidelines.

The Guidelines are not the only part of the Declaration. They should also be seen as part of an even wider package of analysis and proposals made by the OECD. In this context, the new economy, trade liberalisation, and economic development should all be a focus at the next OECD Ministerial meeting on sustainable development. In this way, we can create the opportunities we need for social cohesion, positive development, improving quality of life and so on, considered together in an economic and a social perspective.

In sum, we not only need to improve transparency in corporate activities but also in the market environment. There is a need to have clear and transparent rules of the game for market conditions, integrating the principle of non-discrimination, in order to work towards a fair and level playing field with common rules on a global scale. This could help to realise major gains and opportunities at a time of real and comprehensive change. The “net economy” is opening national borders and creating the same market conditions everywhere. This new global scenario is an exciting challenge for us in both governments and the business sector. This new way of investment can bring jobs and wealth all

over the world. At the same time, reducing poverty and unemployment will also be possible as a result of this increase in economic activity, creating at the same time a real information network among all human beings and building a knowledge society where intelligence and skills are the strategic resource. The implementation of the Guidelines can – and should – be in line with these targets.

Trade Unions and the Guidelines

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

I would like to make three sets of remarks on behalf of TUAC. These cover, first, the context in which our discussion of the OECD Guidelines is taking place; second, the review itself and our opinion on the outcome; and third, what now needs to be done to implement and enforce the Guidelines.

With regard to the context, it is significant that the theme of the 2000 OECD Ministerial Council was *shaping* globalisation and that the discussion was focused on global governance issues. TUAC welcomed that shift of focus away from naive liberalisation and deregulation. It is recognised that global markets need global rules and those rules are also needed in the social area. Multinational enterprises are the principal actors in the global economy and so they also need to be covered by rules, but those rules need to be set by governments. The fact that over the last decade so many individual firms and corporations have developed their own codes shows the gap that has developed between government responsibilities and the expectations of consumers, responsible investors, unions and NGOs. It is significant that many corporations are signing agreements with international union groups or have turned to NGOs to assist with verification of their private codes. It is our view that governments nevertheless need to set a floor of regulations and it is right that they should have expectations as to how the corporations based in their countries perform. It is necessary to have rules that protect those corporations which observe environmental standards and which treat their workers well, from those that don't.

To be frank, at the outset of the Review many of our members in TUAC were sceptical as to whether the OECD Multinational Guidelines could play a useful role. With a few notable exceptions, National Contact Points were largely non-existent. Clarifications issued by the CIME Committee were incomprehensible and at times "Kafkaesque". Any attempt to go beyond this was met with howls of anguish from the few business representatives who knew that the Guidelines existed. In fact, the Guidelines had become a pretext for inaction rather than a living document. For some, that scepticism remains today, as can be seen from remarks from some NGOs.

To comment on the Review therefore it is important to restate that TUAC found the results significant and positive. The new language covering the global reach of the Guidelines, the supply chain, human rights, core labour standards, and the revised chapters on corruption and the environment all improve the text and make it a more relevant document in the current world. The text could have been better and stronger and TUAC certainly did not feel happy with some of the weak language on child labour, information disclosure and health and safety rights. Nevertheless, we feel that the Guidelines are a document worth having and we are in close discussion with our global union partners in the ICFTU, the sector organisations (the International Trade Secretariats), and in particular developing countries unions, about active follow-up.

The key issue for TUAC is now how to ensure that the Guidelines become a living instrument through effective implementation. We felt it was significant that the Guidelines include procedural guidance to National Contact Points (NCP's) on what their responsibility should be and in particular what should be the expected outcome on particular instances or cases.

I would therefore like to set out seven priorities that TUAC feels should exist for follow-up:

- First, get the National Contact Points operating. We have posted on our web site, in October 2000, a matrix of information on developments that have taken place at the national level since June. Whilst some of that is encouraging, a majority of countries remain blank on that chart. That implies either that nothing has happened, or that the trade union organisations in those countries are not aware of any action.
- Second, we need to raise awareness in other intergovernmental fora. I have spoken at recent meetings of the Global Compact under the auspices of the United Nations, and at the Global Reporting Initiative which is moving fast in the area of social reporting. But no one else mentioned the Guidelines in any of their presentations despite the fact that there were many OECD government participants and businessmen present. This is worrying.
- Third, the NCPs need to start using the Guidelines effectively to stop many examples of negative investment competition occurring in export processing zones or the threat of relocation by firms to areas of lower labour standards. The NCPs need to publish their recommendations.
- Fourth, in some positive cases, where unions are invited to be on company stakeholder groups, we are trying to promote the Guidelines. Companies should meet with the International Trade Secretariats and sign agreements as to how the Guidelines can be implemented.
- Fifth, the Guidelines should be used as points of reference for state aids or export credit guarantees. It is reasonable to expect standards from companies that accept taxpayer support.
- Sixth, the OECD should hold regional meetings with non-Members to raise awareness of the Guidelines. TUAC has also sought funding and resources to put this into action.
- Seventh, the CIME Committee should produce rapidly a new user guide including the clarifications from the elements of Guidelines that have not been changed. The NCPs will be meeting in June and will need to show progress underway.

To conclude, I would say that the Guidelines are not an alternative to more legal regulation of companies but are an important complement. We have a “window of opportunity” to now show that the Guidelines can make a difference. As I said in June we have to start a race to the top.

Non-Governmental Organisations (NGOs) and the Guidelines

***Mr. Pieter Van der Gaag,
Executive Director, Northern Alliance for Sustainability (ANPED)***

ANPED, the Northern Alliance for Sustainability, is a “northern” network of Non-governmental organisations working to ensure that the northern wealthy countries – and that includes all OECD Member states – assume their responsibility in ensuring that this world becomes sustainable.

ANPED considers the revised OECD Guidelines an important step in assuring that all entities from the North do their part in achieving sustainable development. We do not believe that they go far enough to ensure a balancing of MAI type rules, which I believe was the original intent of this exercise. Yet, the fact that home governments of the OECD tell their multinational enterprises that they are to follow certain rules for good behaviour is an important achievement in fulfilling the mandate set at Rio in 1992 by the world’s governments where the North is to put under the principle of “common but differentiated responsibilities” an extra effort into achieving sustainable development.

Corporations have not always been good partners in Sustainable Development. There are countless examples of the dumping of technologies, such as medicines, that are considered unsustainable or in some cases even unhealthy. There are examples of abuses of market position, abuses of the difficulties that exist in the enforcement of labour laws and environmental regulations, etc. We believe that the Guidelines should be considered a signal that the adhering governments are saying “stop” to these practices. These governments have the commitment from my organisation and from many of my colleagues around the world, to help make the Guidelines work and to ensure that the signal given in June does not stay with words.

ANPED is also encouraged by the many voices from the business community that say that the result produced by the working party is workable, and that they are willing to contribute to making the standards in the OECD Guidelines the basis of their behaviour, even in many cases going further than the standards prescribed. We believe that the development and the well-being of all people in the world is served best, when what can be considered the most powerful entities in the world are going to play the role they should.

Even though the term Sustainable Development was coined decades ago, and Agenda 21 was framed nearly 10 years ago, it has taken much longer to move away from the “business as usual” scenarios that are the reason why Agenda 21 was developed. Environmental and social conditions are not improving and in many cases are even deteriorating further. Part of that “business as usual” scenario that is actually helping to enforce the worsening environmental and social conditions is the ability of corporations to manoeuvre between policy frameworks in different countries around the world to escape their responsibility. The cross-border application of these OECD standards will perhaps help in that respect.

The world does not need investments that abuse people, abuse the environment, and exploit resources without any return to those who have a right to them. This type of investment will bring us the kind of development that we do not want.

In that light we were pleased that adherence to the Guidelines was detached from the other investment rules in the OECD 1976 Decision. We believe that the debate around National Treatment and other rules is too controversial to have the “world” join in. The excesses described earlier were and are in desperate need for rules. The Guidelines as part of the decision should not be used as a back door to give the world MAI type rules.

The NGOs were critical of the Guidelines. Although many good things were taken up in them, many necessary things were left out, especially on transparency and disclosure. We also believe that some of the norms included are behind on what current practice and current needs require. Still, ANPED recognises the Guidelines as the only government operated game in town, and are willing to work with them.

Some NGOs will continue to flatly reject voluntary codes as a mechanism for controlling corporations. The NGOs that were involved are currently working to spread the information related to the Guidelines to their colleagues around the world. A first step should be to collect information and evidence around the Guidelines that will help determine their practical use. Some first cases may already be brought to OECD home governments in the short term.

I do not believe the Guidelines will work without our involvement. Codes need monitoring and verification. As a first step we will have to be convinced that our scepticism about the political will to implement these guidelines is misplaced. To convince ourselves we will focus on the NCP procedures, their uniform application, their transparency in procedures and outcomes, and the observable impact on company behaviour.

In the light of the concerns that NGOs have around non-binding rules, the first endeavours will be to see whether or not the impact of the Guidelines will be real, and whether or not their clear potential can actually be realised.

There is already a global network of NGOs developing around the implementation of the Guidelines. These NGOs view the Guidelines as one of the many tools available to affect change in corporate behaviour, including legal challenges, public campaigns, direct NGO-Company codes and contracts, and more. It is likely that the Guidelines will be used as part of a campaign that uses one or more of these other tools.

To conclude: NGOs are interested in a quick change from current unsustainable development to sustainable development, a reversal of the deteriorating trends in the environment, the elimination of poverty, the elimination of abuses of human rights, and progress towards other key elements of the sustainable development agenda. The Guidelines will not provide solutions for all these issues but could contribute significantly to solutions if their full potential is achieved.

Open Discussion Highlights

Mr. Steven Oates (International Labour Organization): The principle of proceeding on the basis of dialogue is one that we share, and it is clear that the Declaration and the revised instruments are a very important complement to the instruments of the ILO. Enterprises, along with trade unions, have a role in ILO procedures, i.e. in the supervision of the implementation of international labour standards and the ILO Declaration on fundamental principles and rights. Regarding reporting standards, there is an element which I think could be exploited further: the role of multinational enterprises in so far as they participate in organisations of employers, in providing information and in criticising in a constructive way the way in which Member states implement their obligations in meeting labour standards.

I have a question: I have noticed two potentially conflicting obligations: one is to obey domestic legislation and the other the obligation to respect human rights. As the OECD study on international labour standards has shown, there are many cases where international human rights obligations, including those under international labour conventions, are not in fact respected. This may create a dilemma for multinational enterprises operating in those countries, where the domestic law does not reflect the international obligations. I wonder what sort of guidance and views you have on that area.

Mr. Sikkel: When we say to enterprises that we want you to obey domestic law, there may be potential conflict with any form of the Recommendations we have – and not only with respect to human rights. We do not want to impose conflicting requirements on companies. If a country has an explicit law for instance, to make it impossible to have labour unions, we cannot force our enterprises to start a local labour union. However, we can encourage them to do better. If there is a country where using child labour is allowed, enterprises could say that they were not going to do this, and refrain from doing so. National law prevails, but if you want to do better, we encourage you to do better.

Ms. Magda Shahin, Assistant Minister for international Economic Relations, Ministry of Foreign Affairs, Egypt: It has been said that in the review process the OECD was very keen on having a wide exchange of views. Have you thought of sending questionnaires to developing countries? It was said that the Guidelines are supported by 33 countries, business and NGOs. How do you perceive encouraging developing countries to support the Guidelines – only by making them transparent, explaining to them? What are the benefits for these countries? What about more focus on their development aspects, such as increasing the competitiveness of developing countries, the transfer of technology etc.

Mr. Sikkel: We did not send the questionnaires to developing countries because they were mostly concerned with the experience of OECD countries in implementing previous versions of the Guidelines. Nevertheless we had meetings with non-Members (September 1999, February 2000, and publishing the draft text on the Internet). How do we want to get support from developing countries? What is in it for you? Above all, we believe the Guidelines to be a useful additional instrument to improve the investment climate – which is one of the issues discussed also in Geneva, whether at UNCTAD or in the WTO. The Guidelines are an instrument that helps to maximise benefits, because you have better performance from MNEs, not only in the field of the environment and labour; they also encourage MNEs to transfer technology. And the Guidelines do have a chapter on transfer of technology, as noted in the presentation by Mr. Soutello from Brazil. In addition, as Mr. MacKay (Canada) mentioned, we do encourage capital formation as well as co-operation with local enterprises. If you go through the text you will see that we encourage MNEs to act “local” as well.

Mr. MacKay: I would like to add one additional point. The Guidelines are an instrument to all countries for interface with MNEs on what are becoming increasingly important issues that you have identified. You are probably familiar with the phenomenon whereby consumers put pressure on MNEs to behave in a certain way; and they are responding to this pressure. Through the market, MNEs are responding and the Guidelines provide an instrument for governments to interface with MNEs on these important issues.

Mr. Roustem Davletguldeev (OECD Trade Union Advisory Committee): Concerning the norms of the Guidelines in relation to applicable national law, is there a reference in the Guidelines to national labour standards as well as international ones?

Mr. Sikkel: During the review there was debate on how to present issues also being discussed in other fora, including those covered by the ILO Declaration etc. One of the proposals in this case was simply to refer to the ILO. We felt in the end that it would be useful to have our own set of recommendations which would mirror what is said in the ILO and what we independently think (33 countries) on how firms should operate wherever they invest and whatever country laws are. Some countries have strong labour laws, some less strong. Whatever the domestic law is, we encourage MNEs to respect these rules.¹¹

Mr. Raimondas Martinavicius (Head, Economic Strategy Monitoring Division of the European Committee, Lithuania): Lithuania is applying for EU membership and in the negotiation process many issues addressed today are already on our agenda. Is there any co-operation between the OECD and the EU with respect to MNEs? The signature of the Convention on Bribery was a pre-condition for joining the EU. Is this the case of the OECD Guidelines?

Mr. Sikkel: We certainly co-operate with the EU. In addition, the European Commission participated fully in the review process and is one of the international institutions supporting the Guidelines. When we had our Ministerial meeting, the European Commissioner was here and made it clear that the EC was fully supportive of the Guidelines. How the EU wants to use the Guidelines and how the national governments want to use the Guidelines for other purposes is really up to them.

Ms. Laura Williamson (United Nations Environment Programme): I would like to ask about the mechanism to ensure that the NCPs are properly and consistently funded. There is guidance in the Guidelines about how the NCPs should work but I can see that there could be problems arising from pressures from various interests to dilute the capacity of the NCPs in certain countries. How do you make sure that there is a certain commitment of the NCPs?

Mr. Sikkel: The commitment the governments have is to have a functioning NCP. This was an old commitment but not implemented by all governments. That is why we tackled this during the Review. We expanded a lot on the rules concerning NCPs, and we give a lot of guidance of how NCPs should function. Of course it is up to every government to fulfil its obligations and it is up to them how to do it. We came to the conclusion that we need some flexibility and that we cannot have a “one size fits all” approach but that we should look at the end results. On the other hand, NCPs are also required to report to the CIME, and there is also to be a yearly meeting of the NCPs which features the “peer pressure” process characteristic of the OECD. Thus, while we have no rules on funding, we have rules

11 Ed. Note: The relationship between national labour standards and international ones is addressed in the commentary to the Employment and Industrial Relations chapter of the Guidelines in Annex II (esp. paras. 19-20). Paras. 1-3 of the commentary to the General Policies chapter also addresses the relationship between the Guidelines and the law more generally.

on a functioning NCP which will report to its peers at the CIME every year.¹² If a government has not spent money for an NCP it will find itself in a difficult position at these meetings.

Ms. Williamson: It would be probably interesting to have a kind of ranking after a couple of years—how the NCPs are working and which is active and which needs some push.

Mr. Sikkel: We already know who is active – and share experiences as we try to stimulate the others.

Ms. Shahn: As I understand it, the Guidelines are recommendations made by the OECD countries to their MNEs in respect of their activities world-wide. The NCPs in the host countries are supposed to monitor the implementation of these activities. How far can they pressure these firms to obey? How does implementation work in the entire Declaration – in the area of incentives and disincentives, for example? After all, non-adhering governments will have to consider adhering not only to the Guidelines but to the entire Declaration.

Mr. Sikkel: The question addresses how the OECD functions. The OECD functions as an organisation for its members where a lot of analysis is done by the Secretariat and member states, and where we share experiences. It involves a process of consultations, trying to learn from each other and to influence each other. My country has benefited a lot, and has learned a lot from our colleagues. And at times we have experienced some pressure on us from our peers. We hope to achieve the same things with NCPs. Of course, in the end any government is free to do what it wants, but pressure is important. If an NCP has a strong opinion about how a case should be dealt with, an enterprise has an incentive to follow that guidance.

Mr. Roy Jones (TUAC): The Guidelines can be binding for governments if they transpose them into domestic law. Political will is the key here. Our intention is that the Guidelines be implemented by all MNEs everywhere, and trade unions and NGOs will raise issues wherever they arise. On the trade union side we will be working in co-operation with the International Confederation of Free Trade Unions (ICFTU) which groups unions in developing countries as well, to bring to the OECD the views of trade unions in those countries. And then we may also well do a ranking of NCPs. In addition, while it is not possible at the OECD level to name a company, it is certainly open to any government at the national level.

Mr. Gatis Eglitis (Senior Expert, Department of Economic Affairs, Latvia): I have a question on the practical implementation of the Guidelines. In Latvia large foreign MNEs are sometimes involved in anti-competitive practices. This is harmful to our economy, in particular because it is so small. Could you give me a reflection on how a NCP reacts to influence this?

Mr. Henning Envall: If this situation occurred in Sweden, it would be brought to the attention of the NCP. This means that the material of the case would be discussed by business and trade union representatives who would give their views on whether the case merits further examination. If this is the case, the NCP would get in contact with competition experts in the government and have their views on the case. In turn, if they thought that this was something to be pursued we would invite them to sit down with us and hear their views. However, in many cases, the case would be covered by national competition law and it may not evolve into a case for the NCP.

Dr. Kristian Ehinger, General Counsel, Foreign Holdings, Volkswagen AG (BIAC): We have heard the term voluntary and optional and I would like to state that business takes the Guidelines seriously. They are legally voluntary but we do not consider them to be optional.

12 “Procedural Guidance” for NCPs, including commentary is reproduced in Annex II of this document.

The Guidelines are relevant to business. With regard to the outreach question, BIAC itself has some difficulties in helping with the outreach process in so far as information is concerned. BIAC is an OECD affiliated organisation and as such does not have membership outside the OECD. However the ICC has linkages with non-OECD countries as well, so we are using those connections to reach a broader audience in business circles outside adhering countries.

The Guidelines are addressed to MNEs with home bases in OECD and other adhering countries, but also give guidance for firm behaviour on a worldwide scale. In implementing a given case in non-adhering countries, it should be taken into account that the basic idea of the Guidelines is that not only MNEs in FDI activities are concerned but also national companies. This embodies the idea of non-discrimination. This is important: when we speak about outreach in such countries, please take into account that the Guidelines are designed in such a way that they can also be relevant for domestic companies in non-adhering countries – and in the interest of bringing the best benefits, not just with respect to FDI but to economic activity in general.

The quality of NCPs will vary from country to country. What has been tried during the Review is to give guidance to implementation rules. They are not very strict per se r pressure will help effective implementation so that great differences between countries can be avoided. Business as such is interested in a similar level playing field in order to avoid competitive disadvantages.

Mr. Wes Scholz, Director, Office of Investment Affairs, US State Department and current Vice-Chair of the CIME: I would like to make an observation with respect to the comment that the Guidelines have not received the right attention and publicity. The US NCP has been somewhat frustrated by this. We need to look at this issue as one of shared responsibility. We, as OECD governments, are committed to the Declaration and the Guidelines, and it is our responsibility to be out there promoting awareness of the Guidelines. But this is not only limited to the activities of NCPs – other parts of government organise meetings on such issues.

And it is also a responsibility of the partners in this exercise -- BIAC, TUAC, and NGOs. Of course some have reservations on the Guidelines; they see potential on the Guidelines that might not be fully realised and as a result they are more cautious to speak out and use the Guidelines. However to some extent, if we are going to overcome this problem of the Guidelines not having adequate visibility, all of us will have to take our responsibility seriously: to speak out on the subject of the Guidelines, to speak not only to our reservations with respect to what may not be achieved, but also our hopes as to what might be achieved. Perhaps that way, if outside groups including the media see that there is a growing recognition among interested groups that the Guidelines have potential, then they begin to see that there are some stories they may want to write about.

SESSION III - THE RELEVANCE OF THE GUIDELINES FOR NON-ADHERING ECONOMIES

Introduction to the Guidelines and Declaration in non-Adhering Countries

*Mr. Wesley Scholz, Director, Office of Investment Affairs, United States
Department of State, and current Vice-Chair of the CIME*

We spent a long time this morning considering the Guidelines, and we have had some useful comments on aspects of the Guidelines and how they relate to the interests of non-adhering countries, in particular those addressed in Mr. Lauro Soutello's presentation. I would now like to place the Guidelines into the context of the Declaration as we look at their relevance to non-adhering countries. As Mr. Lamborghini mentioned this morning, globalisation is a dynamic process that offers opportunities and challenges. John Evans noted that there is a need to try to respond to these challenges by shaping globalisation through governance and that the Guidelines might be a useful element in trying to fill a gap in that regard. Pieter Van der Gaag also observed that there needs to be a balance between rights and responsibilities. Frankly, I am not sure that these latter points are sentiments that BIAC would disagree with.

The objective of non-adhering economies in absorbing the potential benefits of globalisation depends on their ability to attract investment as well – and to see this investment applied in a way that promotes social and environmental progress as well as economic. Creating an environment conducive to this depends on the creation of a sound policy environment that includes attention to the issues of non-discrimination, transparency and the rule of law generally. Many OECD countries have sought to promote this environment through bilateral and regional investment rules that provide specific protection to investors.

I believe that the attempt to extend these efforts to multilateral rules in the OECD failed for two reasons: (a) a lack of policy consensus within the OECD; and (b) a lack of flexibility in the process that proved to be an impediment to developing this policy consensus, particularly given some of the challenges we face in a globalising world.

The true relevance of the OECD Declaration for non-adhering countries is the same relevance that it holds for OECD countries: the flexibility that it provides for the policy dialogue that was lacking in an attempt to negotiate formal legal rules on investment. Unlike investment treaties, informal rules such as the OECD Declaration are founded on dialogue and discussion. It is a process of equals bringing their own experience on these issues to inform one another of how they have dealt with the complex challenges that they have faced.

The Declaration is not an end in itself but it provides an opportunity for this dialogue to take place. It is important to recognise that it takes place among all the adherents to the Declaration. It also takes place in an environment in which all can bring their experiences together to work on the problem of both creating an attractive environment for FDI to promote their economic development, while at the same time focus on the promotion of social and environmental progress. That is the true value of the Declaration, which is also the only instrument that addresses both the issue of rights and responsibilities of MNEs.

Non-Member Adherence to the OECD Investment Instruments

***Mr. Robert Ley,
OECD Secretariat***

I would briefly like to address the following questions:

- What does adherence to the OECD Declaration on International Investment and Multinational Enterprises mean?
- Why are OECD countries in favour of wider adherence by non-Members?
- Why should non-Members consider this? Are some non-Members more likely than others to find this an interesting possibility?
- What are the procedures to follow for countries interested in adherence?
- What other forms of co-operation does OECD envisage for countries interested in investment issues?

What does Adherence mean?

Adherence to the Declaration on International Investment and Multinational Enterprises means undertaking the same commitments that OECD countries and others that have adhered to the Declaration have done, including participation in the follow-up procedures set out in OECD Decisions.

The substantive commitments are not legally binding, but the procedures call for periodic examinations of each country's investment policies, participation in OECD discussions of all the issues relating to the Declaration, and setting up effective National Contact Points to help implement the MNE Guidelines which are an integral part of the Declaration.

The principles that underlie the different parts of the Declaration fall into two categories: those related to the behaviour of companies (i.e. the non-binding recommendations from governments), and the other three (national treatment, conflicting requirements, and incentives and disincentives) which relate to the governmental side of the bargain.

- Transparency: This principle can be found throughout the follow-up Decisions. It means a commitment to be transparent domestically in laws or regulations, and a willingness to explain to other adhering countries what domestic regulations mean, and to help them help their enterprises understand what is expected of them.
- Dialogue: This is another fundamental element underlying OECD procedures which is often enshrined in Decisions.
- Problem Solving: All instruments have a vehicle for adhering countries to talk to each other in an OECD context. Of course, they may also talk to each other bilaterally, and we should hope that they do so. But, it is often useful to be able to bring these matters to a forum like the OECD to air the problem, see what other countries think about it and see whether there are solutions available that would not be available on a purely bilateral basis.

- **Peer Review:** This applies to all areas, although it is more explicit in relation to the MNE Guidelines and the National Treatment instrument. Explicit provisions exist concerning meetings, for the submission of information by the countries concerned, and for adhering countries to expose themselves to the views of other countries. This is not necessarily with a view to being criticised or to criticise others, but to learn collectively how best to go about solving problems. There is an element of peer pressure from the group towards countries that may not be responding fully to the expectations included in the instruments that they have signed.
- **Review:** Those who adhere to the instruments play a role in their general upkeep, promoting their effectiveness, and periodically reviewing their contents and effectiveness and deciding when it is necessary to conduct a major overhaul. Reviews do not necessarily generate a major overhaul: there can be reviews with no change at all. Any change is brought about on a basis of consensus, which is the rule of the OECD.

To participate in the Guidelines, a Government must set up a National Contact Point (NCP) and ensure that its duties are effectively fulfilled. It also needs to make resources available to participate in OECD meetings where government representatives exchange views with each other, with representatives of business, labour and NGOs, and on occasion with those of non-adhering countries. The Committee on International Investment and Multinational Enterprises (CIME) has the responsibility for clarifying the meaning of the Guidelines when issues are brought before it by an NCP, BIAC or TUAC the recognised non-governmental bodies that represent business and labour interests.. The CIME also oversees NCP performance and is generally responsible for the effective functioning of the Guidelines.

Why are OECD governments interested in broader adherence

OECD governments are interested in broader adherence for basically the same reasons they support the Declaration themselves: to favour international co-operation that promotes a better climate for international investment, to promote the positive contributions MNEs can make, and to provide mechanisms for dealing with problems that may arise – between governments or between governments and enterprises. It is not surprising that the OECD governments wish to extend the influence of this instrument to other like-minded countries.

With respect to the Guidelines, their influence will be greater if more adhering countries join in implementation. Procedures will be more efficient if there is a wide network of NCPs and less reliance on *ad hoc* procedures that are likely to be the norm in non-adhering countries.

So what's in it for non-adhering countries to become adherents to this instrument?

Non-adhering countries can demonstrate a commitment to a positive climate for international investment, and also have an opportunity to participate in the implementation procedures, i.e. “to hear and be heard”. Adherence would provide access to the network of NCPs and allow participation in OECD meetings that address a broad range of investment policy issues.

Adherence is likely to be of double interest to countries engaged in the international investment process as home as well as host country, when its stake in the investment process is greater and more varied. It would then also have multinational enterprises of its own to which it would recommend the Guidelines to address corporate responsibility world-wide.

What procedures have to be followed?

OECD Ministers are on record encouraging non-Member adherence to the Declaration. Interested non-Members are invited to make informal contact with members of the CIME or with the Secretariat to find out how to proceed.¹³

What about other forms of Co-operation with OECD on investment issues?

The OECD manages a wide range of non-Member activities at the global and regional levels. We are establishing a new body called the Global Forum for International Investment, which will provide a vehicle for addressing investment issues with countries with substantial investment flows, with countries interested in adhering to the Declaration, or which have already adhered, as well as with other countries whose presence at such a forum would be considered indispensable for an efficient discussion of the major investment issues of the day.

The purpose of this Forum is to establish an on-going dialogue at OECD with non-Members on investment policy issues, to draw lessons for good practice (for government policies and enterprises), to favour healthy investment climate and maximise benefits from MNE activity, and to help build consensus on effective international co-operation in this field. Non-OECD economies participating in this Forum may decide that adhering to the Declaration is a natural step, but there is no obligation on Forum participants to do so.

13 In May 2001, the OECD Council approved new CIME procedures through which non-adhering countries can participate in its work.

The Implementation of the Guidelines in Non-Adhering Economies and Related Issues

***Mr. Paul Hawker, Head, International Investment Policy,
Department of Trade and Industry, London***

This presentation is divided into three parts: a factual description of references in the Guidelines to co-operation and implementation in non-adhering countries; a description of the UK NCP's experiences so far on issues raised with it concerning MNE activities in non-adhering countries; and possible ways of improving co-operation and implementation.

References to Co-operation and Implementation in Non-Adhering Countries

There are references to co-operation, general discussion and implementation in non-adhering countries in the Guidelines decision, texts and commentaries as follows:

The Decision of the OECD Council of June 2000 (when the Guidelines were agreed) :

“Since operations of multinational enterprises extend throughout the world, international co-operation in issues relating to the declaration [which includes the Guidelines] should extend to all countries”

The formal commentary to this Decision [see Annex II] expands on this and states that the reference provides for consultations with non-adhering countries on Guidelines matters, including periodic meetings such as this outreach event, or with individual countries to cover general and/or specific issues.

OECD Guidelines Procedural Guidance for NCPs texts

NCPs are required to respond to enquiries about the Guidelines from governments of non-adhering countries.

On the handling of specific issues by NCPs the texts state that:

“if issues arise in non-adhering countries, NCPs should take steps to develop an understanding of the issues involved, and follow the procedures set out for issues arising in adhering countries, where relevant and practicable”.

Again, commentaries expand on this by highlighting some problems that may arise, such as not being able to bring interested parties together. They also state that conflicts with domestic laws, and other factors in non-adhering countries may make it more difficult to implement the Guidelines, and reiterate that the Guidelines are not intended to place MNEs under conflicting requirements.

However they also suggest ways an NCP may gain a full picture such as contacting the management firm in the home country and government officials in the non-adhering country.

Other issues covered here are that parties involved in any specific issue need to be aware of possible limitations in implementation in non-adhering countries and that Guidelines issues in non-adhering countries may be discussed in NCP meetings with a view to building expertise in handling issues arising in these countries.

These references recognise the difficulties involved in dealing with issues in non-adhering countries, but demonstrate adhering country determination to apply the Guidelines to MNEs wherever they operate as far as possible. The provisions also leave scope for development and discussion amongst us all. In the UK we welcome the clarification that the Guidelines are globally applicable and also the scope for further co-operation to improve the effectiveness of the Guidelines worldwide.

UK NCP Experience

Since the revised Guidelines were agreed in June 2000 no issues involving non-adhering countries have been raised with the UK NCP. However, we have had two such instances in the last three years, obviously based on the previous Guidelines, which were not so clear about the global applicability of the Guidelines.

I will now take you through the ways we tried to establish an accurate understanding of the issues. I will concentrate on the process involved rather than the issues or outcome.

CASE A

The UK NCP received details from the originator and asked the company headquarters in the UK for its comments and met company representatives.

We also used our embassy in the non-adhering country to establish facts, local reaction and the government stance to assist our understanding. They provided information including numerous press cuttings and confirmed that they had also been approached themselves about the issue by a different party based in the non-adhering country (although not in connection with the Guidelines). There was no shortage of information as it was a high profile instance. On this occasion the embassy did not contact, or make representations to, the local or national government of the country. However, we did have evidence of the government's views. The local press reported the raising of the issue with the UK NCP

CASE B

We received details from the originator and spoke to the company headquarters in the UK. We also contacted our embassy in that country and they provided information including on the consultation process that the non-adhering country's government had undertaken in relation to the issue. We spoke to the London embassy of the country, which offered to facilitate a meeting with its government to present their position if required.

By chance our Secretary of State for Trade & Industry was visiting the non-adhering country and was meeting the company involved. He took the opportunity to raise the matter with the chief executive of the company.

Again the local press reported that the issue had been raised with the UK NCP. Some welcomed this, whereas others thought it was a local problem which should not concern the UK Government. This demonstrates some of the sensitivities involved in considering issues in non-adhering countries.

Both these cases provided a valuable opportunity to draw an MNE's attention to the Guidelines and demonstrate their global applicability. Given the high profile nature of the two issues before complaints were received, it was not difficult for the UK NCP to obtain information. The complaints to the UK NCP were one element of larger NGO campaigns, and were used as another avenue for putting pressure on the MNEs concerned. I am not sure how easily accessible information would be in

the case of a less well known issue. We were satisfied that we had familiarised ourselves with the evidence so that we could make informed decisions.

It would be interesting in the discussions to hear of any other NCP and non-adhering governments' experiences with any cases and/or issues.

Possible Ways of Improving Co-operation and Implementation

I will divide this into areas for discussion of general and specific issues.

General Issues

We feel that there is great value in this kind of debate and that it should continue.

The UK and the other NCPs are actively engaged in raising awareness and this is something we could explore further -- for example, would non-adhering countries think it worthwhile to raise awareness in their own countries, or, within their own governments, particularly those parts dealing with MNEs? This could be along the lines of "this is how adhering countries expect MNEs to act in your country". If so, how best can we achieve this – CIME outreach work (in the OECD or on a regional basis), dissemination of documents, or articles in publications in non-adhering countries? Is there a role for social partners?

In the UK one method under consideration for promoting awareness is to use our embassies overseas when conducting their investment promotion work. Any potential UK overseas investor requesting market information from a UK embassy would also receive a short explanation of the Guidelines, how they relate to them (including the message that when a UK MNE invests overseas the UK government expects it to behave in accordance with the Guidelines), and where to get further information.

Specific Issues

Currently, in considering any specific issue in a non-adhering country raised with the UK NCP we would primarily use our embassies overseas to make any initial contacts with non-adhering governments. We rely on our embassies' knowledge on who best to contact; this seems sensible as the Guidelines cover a range of areas and non-adhering countries do not have NCPs. Is this appropriate or do you see a role for a single governmental contact in non-adhering countries or use of non-adhering country embassies in the NCP's country? Would non-adhering governments always want to know if an issue has been raised on an MNE activity in their country? If so, at what stage?

It is possible that NCPs would be reluctant to contact non-adhering governments as it may be viewed as unwelcome outside interference. One example of this would be if a case was raised that was already being considered in the court of a non-adhering country. The Guidelines state that non-adhering government's officials could be approached "as appropriate". Can anyone think of examples when it definitely would, or definitely would not, be appropriate. These could be used as guidance for NCPs. Is it better to elaborate now before any issues are raised or deal with them on a case by case basis? What about other interest groups being contacted in non-adhering countries? For example, local campaigners – can non-adhering governments envisage any difficulties here?

I realise that I have asked far more questions than I have answered but hope that these initial thoughts will help in our discussions.

Open Discussion Highlights

Mr. Andrew Berkeley, (BIAC): I would like to refer to a question asked by the delegate of Latvia. We need to approach the question as it was asked: Let us take a non-adhering country like Latvia, where there is a suspicion that an MNE operating in that country acts in a way which might be contrary to the Guidelines. How would this would be dealt with under the current Guidelines?

Mr. Scholz : Paul Hawker in his intervention highlighted some of the complexities that arise from the circumstances you described. It flows from the fact that in general the role of the NCP in an adhering countries is to undertake an assessment of what is going on with respect to the behaviour of the MNE within its own territory. Its access to information in that regard is much better than under circumstances where the behaviour which is questioned takes place in another (non-adhering) country.

In our discussions when we were negotiating the relevant provisions in the Guidelines, we were very cautious in defining the responsibilities of the NCPs. The situation may well differ case by case, in terms of the relationship that the NCP government may have with the government where the MNE is operating, as well as in terms of its ability to deal with an issue in a meaningful way. I don't think there will be any easy answers or clear formulae that can be applied; we will have to develop some experience on this on a gradual, practical, and case by case basis.

Mr. Hawker: Another point is that the company could be acting anti-competitively but wouldn't actually break national laws because they didn't have any local competition laws. In this case, we would seek to establish the facts of the case which would involve contacts in the company itself and the local embassy to find out how to get a fuller picture. Beyond that, we may get today some other ideas of other avenues to be pursued.

ILO representative: The ILO can help when there are problems of implementation of the different conventions or under the follow-up to the Declaration of Fundamental Principles and Rights: Trade unions and employers can also contribute where there are difficulties in implementing i.e. core labour standards. I would have thought that the unions and employer organisations in all states would have something to contribute from their ILO experience. I just raise that as another avenue or element of information which seems to me to be part of the process.

Mr. Scholz: This contribution raises an important point. Under the existing procedural guidance for NCPs, one of the things the NCP is supposed to do is to make an initial assessment and part of this assessment would be to review which procedures and avenues would be available for dealing with issues that may arise, either at the domestic or the international level. The existence of the ILO and the opportunities that it provides would be something that you may want to take into consideration in making such a judgement, in addition to it being a source of information. The procedures of the ILO may indeed be available to help the NCPs in discharging its responsibilities.

I do not necessarily see accepting the benefits of the Guidelines is a trade off between accepting other instruments which are not in one's interest to accept. I think that, fundamentally, all of the instruments of the Declaration are beneficial to countries that are willing to adhere to them. For example, looking at the National Treatment instrument: providing for a level playing field for investors in your own country is one of the most fundamental elements in creating an enabling environment for FDI to flow. There is a direct benefit to countries that are willing to undertake that type of commitment. It is not necessarily a trade-off. One gets the benefits of the Guidelines because one accepts other elements of the Declaration.

Mr. G. Rajasekaran, General Secretary, Malaysian Trades Union Congress (TUAC): I was impressed with the Guidelines. Very often we find that corporations operating in our countries demand from the government that all the things covered by the Guidelines must be left out: they will be free not to recognise trade unions, etc. Many of these governments feel that they are put in a corner, and allow these exemptions. I would like to return to a point raised earlier: how do we complain about this situation? Can we go and complain to the embassy of the company's host country?

Mr. Scholz: The question you raised highlights the value of adherence to the Declaration. The issues you describe are more challenging if the country is a non-adhering country and there are no established means of communication. We have to work through those issues: Contacting us through our embassy might be one means but there is no other established process that I can point you to. There may be instances where a government of a non-adhering country would prefer not to have the NCP from an OECD country taking the primary responsibility to look into those activities; maybe the government would prefer to deal with the MNE directly in discussing those kinds of issues.

Mr. Sikkel: With respect to the issue of an MNE asking the government of a non-adhering country not to be obliged to respect trade unions, this is indeed the point of the Guidelines. The Guidelines make perfectly clear that MNEs should respect union rights, they should respect core labour standards, and they shouldn't ask for exemptions from local rules and regulations. Even without any enforcement mechanism available to you, if you are approached by an enterprise making this kind of demand, you can point to the Guidelines.

What to do as a next step? How can we best handle questions raised in non-Member countries? These countries could become adhering countries and then set up their own NCPs; that may take some time. There is a second best solution: to use the NCP of the home country of the company either through embassies or through labour unions. Of course they will have to look into the merits of the case and get all available information. There are different ways of doing this, and we will need to build some experience with these ways.

- **Statement by Mrs. Magda Shahin**

*Deputy Assistant Minister for International Economic Relations,
Egyptian Ministry of Foreign Affairs*

I have gone carefully through the Guidelines, I have also listened attentively to views expressed in the first two sessions. Although the two previous sessions as well as this one were very informative and very helpful in clarifying many queries I had in mind, I still have a few questions.

Let me first, however, assure you that developing countries in general, and Egypt in particular, have undertaken numerous steps to improve the environment for investment and attract FDI. In fact, the last 20 years or so could even be characterised as "beggar thy neighbour" policies in terms of liberalising investment regimes in host countries and giving greater protection and incentives to FDI.

In this context, the Guidelines can constitute an additional step in improving the image of developing countries. I doubt that they would be difficult to adhere to. The issue at hand, however, is more complex than this.

But let me start with making a very obvious comment. First: developing countries have been little exposed to the entire framework of the OECD Declaration, including the Guidelines and other instruments. I doubt that countries would be interested in signing the Declaration without assessing its implications and evaluating thoroughly the pros and cons. This applies not only to the positive

implications of the Guidelines, of which one is surely improving the "image" of developing countries in a much larger context. But the question remains as to why any sovereign state should adhere to any Guidelines – no matter how voluntary they are – to which they were not a negotiator and without really having the full picture of their implications.

There is also a related question of a trade-off between bilateral and multilateral instruments. Hence the learning process and increasing awareness should not only be confined to the Guidelines, but to the other instruments in the framework of the Declaration. In considering how to address questions related to the Declaration, the \$64,000 question is: why should I trade off my bargaining power and use the multilateral level, instead of using the bilateral level?

Second: For an outsider – like my country – I cannot stop wondering whether these Guidelines and their extended coverage will prove a *strength* or a *weakness*. Are they to replace for the time being a much more ambitious objective that you failed to attain previously. Are these expanded, more comprehensive Guidelines in the framework of the Declaration supposed to be the minimum common denominator - as a more realistic way out - for the unfinished business of a Multilateral Framework for Investment. Is there any relationship between the two? Are they substitutable, or should a Multilateral Framework follow? Are the Guidelines an end in themselves, or only a prelude to something unknown? The fact that you tried to agree among all stakeholders – excluding developing countries – raises suspicions.

Third: I would not like to sound suspicious, but I am interested to seek more transparency, particularly on how do OECD countries link this exercise with the ongoing attempts in the WTO for an investment agreement? Has such a linkage ever been raised in your internal discussions in the CIME and if yes, how was it tackled? How did you address this here during the revision of the Guidelines?

Fourth: I still believe one of the major weaknesses in the Guidelines is the lack of balance in addressing issues of interest to developing countries to entice them to adhere to the entire package. The OECD is a rich man's club. If they want and are interested in making their work more attractive, and accepted on a wider scale, they should act – *maybe even think* – differently. A country like Egypt would be interested in seeing additions dealing with synergies between investment and trade, between investment and development.

How can investment be more diversified to add value to products from developing countries, and to help achieve tri-partite co-operation between investment, and host and home countries in this respect? Investment and Trade, Investment and Development, Investment and Technology need to be strengthened as balancing chapters for developing countries to encourage them to adhere, which I miss in the Guidelines. I would like to have seen non-binding Guidelines for these issues - to encourage a larger coverage on behalf of developing countries.

Fifth: The balance between the rights and obligations of MNEs should be strengthened. As far as the implementation mechanism is concerned, the way I view it is as relatively weak and it has so far been heavily criticised by the NGOs.

Last but not least, despite my criticisms and questions, I would like to assure you that this meeting has been very educational and worthwhile. The Guidelines and the whole Declaration will be addressed by the Government of Egypt to see how we can benefit from them.

Mr. Scholz: I will make an attempt to briefly respond to a couple of the issues raised in this latest intervention. First, the reason why we put the Guidelines as a subject of our discussion is because this is an instrument that was recently revised by the OECD. We talked about this issue ourselves before even scheduling this meeting and recognised that there was going to be a need for outreach activities

to address not only the Guidelines but also the issues raised by all the other instruments in the Declaration. We sought this as an opportunity to very briefly introduce the Declaration as a whole and then focus more heavily on what was recently revised.

There is a strong willingness among the members of the CIME to look for future opportunities to have a more thorough discussion of the other instruments that make up the Declaration. It is in the context of that kind of a meeting that we can go to much more depth on many of the questions that you have raised.

With respect to the question about the relationship between the Guidelines and the negotiation of the MAI, it is wrong to view the effort to promote adherence to the Declaration as an attempt to revive negotiations of the MAI. The Declaration is a different instrument, and is based on the critical commitment of governments to provide an opportunity for an ongoing dialogue. It is not a static agreement in the sense that you negotiate a set of binding legal rules with dispute settlement procedures and then allow countries to address what they may perceive as violations of those rules. Instead it provides for an ongoing process of engagement among the countries that are parties to the Declaration on the issues that are raised by these general political commitments. These are made in the context of the Declaration and provide an opportunity to bring the various perspectives together on those issues and to consider the relevance of other perspectives to further policy development either in the context of the OECD work or at the national level.

This is not an attempt to negotiate another set of international binding rules on investment; on the contrary, it is an opportunity for an ongoing policy dialogue among the countries involved that may complement efforts that may continue elsewhere – either by negotiating BITS, or regional agreements, or if sufficiently supported, negotiating global rules. It may turn out in the future that there may be some opportunities for this. But there is not yet any consensus in the WTO on whether or not there can be negotiations on investment rules.

Mr. Sikkel: In answer to your question: Why would you go multilaterally if you can go bilaterally? There is a bilateral treaty between Egypt and the Netherlands – there is even a consultation clause in that treaty. But there are things that we could not do at the bilateral level that could be obtained at the OECD. If you look at the amount of analysis done here, the richness of the policy dialogue, the exchange of experience not only between two countries but also among 30 or even more in different stages of development, much of what we do at the OECD is much better than we can do at the bilateral level.

Concerning transparency and the other instruments: you are right. If you want to adhere to the package, you had better know what the other elements of the package are. The whole package is balanced: respect of all the elements of the non-binding instruments and political commitments are important. This is a major difference between the draft MAI and this Declaration. The MAI also had a wider scope. In the OECD we don't only have the Declaration; we also have the Codes of Liberalisation which are binding instruments. What we attempted to do in the MAI is combine the Codes and the Declaration, make the Declaration binding, and on top of that try to discuss environment issues, labour issues, privatisation, add dispute settlement and so on. Even though we have great experience in the OECD on these issues, the MAI was too big even for us to swallow.

Why didn't we have more exchanges with on-Members during the Review of the Guidelines? We did have two exchanges: September 1999 and February 2000. Unfortunately, our resources simply did not allow for more consultations. And it must be recalled that this is an instrument designed amongst adhering countries – we are also beneficiaries of FDI and try to attract FDI.

However, I do not agree that there is a dichotomy between developing and developed country interest. Regarding the transfer of technology, if you try to force enterprises to transfer technology you will probably not get the technology you want; indeed you may get less than that available when you create the rights conditions for technology transfer. There are provisions in the Guidelines on this subject. They may be not as strong as you might want but like the coverage of other issues, it is something we can build on. I see no difference between countries; maybe a different appreciation on how to achieve out goals. We are willing to debate with you and hear your arguments, as today demonstrates. This instrument is also a fine example of rights and obligations with a mechanism which you may find weak, but all the cards are on the table to make it an effective instrument via peer pressure.

- **Statement by Mr. Victor Lysytskyi**

Secretary of the Government, Ukrainian Office of the Prime Minister

It is of crucial importance for Ukraine to be involved in an international network of different relationships. Whether OECD Members or non-Members, all countries interact in the same environment. The difference is that Member countries feel they are part of the same global community, and create new global capacities to help formulate and design desired processes in their countries. Take for example programmes that OECD countries are involved in, such as PUMA [Public Management and Governance], SIGMA [Support for Improvements in Governance and Management (in Central and Eastern European Countries)], PHARE [the European Union's financial and technical Co-operation programme with the countries of Central and Eastern Europe] and compare them to TACIS.¹⁴

After nine years of independence from the Soviet Union, Ukrainians have found ourselves isolated. We don't want to restore the Soviet Union alliances, but are not yet accepted in European groups. This is a dangerous situation because isolation from the governmental, professional, political and business networks is an obstacle to our continued reforms. Nevertheless, the Ukrainian government supports the OECD Guidelines and hopefully will adhere to the Declaration in the future. Ukraine has an integration processes with the EU countries. An NCP created by the Ukrainian government could help in this. It will facilitate the process of European integration from the point of view of business development and MNE activities in non-Member countries.

We have learned today that not only Member states have adhered to the Declaration but also non-Members (Argentina, Brazil and Chile). We understand how important OECD instruments are for improving the investment climate. The Ukrainian government is determined to improve the investment climate in Ukraine. But we have to remember that our society is undergoing the most difficult and rapid transformation in the history of mankind. Ukraine's reputation is not good as far as reforms are concerned. Usually, the blame is put on our legal/political framework. I would like to point to other reasons.

Ukraine is a successful post-Soviet country, consistently believing in democratic processes. Some post-Soviet countries have already chosen to restore Soviet-style societal bodies and authoritarian instruments. Ukraine has made a much more difficult choice: to bring the rule of law and discipline through democracy. This choice is much more difficult. First, democracy is incomparably more complicated and sophisticated, with checks and balances taking much more time to introduce than totalitarian systems. Secondly, we don't have the skills, experience, institutions, knowledge to make

14 TACIS is the EU initiative for the New Independent States and Mongolia which fosters the development of harmonious and prosperous economic and political links between the European Union and these partner countries.

changes very fast. And thirdly, we have been deprived of the institutional and technical guidance and support which our neighbours in Central Europe have benefited from in the European integration process. Instead of support, institutional and capacity building, the new Ukrainian government has received sophisticated policy advice which we were not able to digest very well.

Nonetheless, and last but not least, it is with great pleasure I would like to inform you that yesterday, a co-operation agreement between the government of Ukraine and OECD was signed. I would like to thank the OECD for giving us the possibility to participate in the process of improving the investment climate and business environment by introducing the Guidelines and other investment instruments.

- **Statement by Mrs. Pham Thi Lan Huong**

Senior Expert, Vietnamese Central Institute for Economic Management

I would like to take this opportunity to express my sincere thanks to the OECD Committee on International Investment and Multinational Enterprises (CIME) for inviting me to this meeting where I have learnt about the OECD Guidelines for Multinational Enterprises in much greater detail. I would like to give some comments on the Guidelines with respect to their possibility to be implemented in Vietnam.

Vietnam is among the “poor” countries of the world. With respect to issues related to the Guidelines, it is a host country that is willing to attract the activities of Multinational Enterprises as much as possible. Throughout today’s presentations and discussions, it is obvious that implementation of the Guidelines can enhance the substantially positive contribution made by Multinational Enterprises to economic, environmental and social progress in host countries like Vietnam.

Another facilitating aspect of the Guidelines is their “complementary” nature. For Vietnam, where the legal framework is incomplete, the Guidelines can serve to fill a gap for dealing with conflicts and cases with respect to multinational enterprise activity, and be a benchmark for issues associated with industrial relations, environmental protection, combating bribery, consumer interests and competition. In adhering to the Guidelines, a host country like Vietnam would have a better way to deal with conflicts occurring in multinational enterprise activities through the CIME, which will put pressure on unhealthy business conduct. Adherence to the Guidelines implies to foreign investors a willingness of the host country to create a level playing field for both domestic and foreign investors, which is an encouraging signal for multinational enterprises to invest there.

Shortage of capital is among the major concerns of the government of Vietnam. This can be solved to a great extent by attracting foreign direct investment. The government of Vietnam works hard to improve the environment for foreign direct investment and activities of multinational enterprises through simplifying administrative formalities, making new laws and regulations to provide a comprehensive legal framework for businesses, and deepening economic reforms in general and SOE [state-owned enterprise] reform in particular. In many respects, foreign-owned enterprises in Vietnam are treated in a more favourable manner than domestic counterparts. Nevertheless, some restrictions and prohibitions remain which stem from specific reasons such as national security and environmental protection.

If we were to adhere to the Declaration, Vietnam could face some difficulties initially. For instance Vietnam has no National Contact Point to promote the Guidelines and to facilitate discussion of issues associated with the Guidelines, and adhering governments should be transparent in their dealing with multinational enterprises. In some cases law implementation and interpretation in Vietnam is rather arbitrary and can be understood in contradicting ways. The government of Vietnam may have to

revise its laws and regulations to conform to the National Treatment principle and that may take some time.

I wonder in which ways the CIME and CCNM [Centre for Co-operation with Non-Members] could support countries that are interested in adhering the Guidelines, but have not sufficient means to do so. In addition, the asymmetry between government Guidelines commitments and their non-binding nature for multinational enterprises gives rise to a concern about the possibility that some multinational enterprises continue to conduct “unhealthy” business. How can the OECD and governments under this circumstance encourage more multinational enterprises to implement the Guidelines?

Mr. Scholz: OECD Member governments working through the CIME are interested in the questions that any non-Member government may have relating to the Declaration and the Guidelines, and look forward to the opportunity to arrange more events like this and discuss also other elements of the Declaration. We recognise that there may be some countries that have an interest in the Guidelines but may not be yet willing and able to take the necessary steps to meet the expectations of those instruments, and may not be fully prepared at the present time to adhere to those instruments. That does not mean that when there is a genuine interest in the medium or longer term, aspiring to eventual adherence, that this is an interest we don't value. We do.

Mr. Junior Lodge (Executive Director, JAMCO, Jamaica): After this debate I am better positioned to promote this instrument to both my organisation and my country. We welcome the spirit of dialogue extended to non-Members. Jamaica is a capital importing country, although we do have instances of investing in other countries ourselves. We have invested energy in negotiating BITs, engaged with CARICOM in terms of developing an investment chapter, participate in work on harmonising an investment code in the Western hemisphere, and participate in the ILO and the WTO. We are keen on creating an appropriate enabling environment as far as attracting FDI is concerned.

Both Egypt and Jamaica are members of the G-50 and we seem to be on the same wavelength regarding comments and questions. Part of the challenge for developing countries like ourselves -- and I took strong encouragement from what the BIAC representative said in this regard -- is in terms of the principles of National Treatment and non-discrimination and their implications.

In terms of the Guidelines, in order to secure or arrest any degree of cynicism it is important in terms of developing confidence building to examine how the NCPs share information with non-adhering members in terms of any investigation they might conduct. One of the challenges that we face in this globalised world is that we have seen a proliferation of the phenomenon called “outsourcing” (for example in manufacturing). This allows MNEs from OECD countries to be exempt from the duties and obligations of Guidelines principles because one is not looking at an investment *per se* in a foreign country but rather the sub-contracting of work. In light of the prevalence of this phenomenon, this might be an area where the Guidelines might be used to establish credibility and efficacy. And once these targets are attained, you will see a lot of developing countries joining in in a more meaningful way.

Ms. Milica Uvalic, Deputy Federal Minister of International Economic Relations, Belgrade, Yugoslavia: My government will consider whether to adhere to the Guidelines, and today's meeting has been very helpful. I am still however wondering about the costs and benefits of adherence and it would have been useful to hear from some of the non-Members who have adhered to the Declaration what they concretely found in terms of benefits. Why have so few non-OECD members adhered so far? Is it simply because it is a recent initiative? Or are the costs more substantial than what they seem? What are the political benefits? What is the link between this and another initiative the Investment Compact?

Robert Ley: OECD Ministers in June 2000 encouraged non-Members to adhere to the Declaration. The Guidelines are part of the Declaration. There is a small financial cost but the main cost is an investment of time and effort on the part of your people who need to be involved in your capital and attending meetings to make sure that the commitments mean something.

Mr. Sikkel: I would like to attempt to answer a number of questions: First, how do NCPs share information with non-Members when they investigate in certain cases? If, for instance a Dutch enterprise is active in Jamaica and there are questions about its activities there, there will certainly be questions to the Jamaican authorities and ask their view on this matter. Our NCP can build a picture of what is happening and based on that try to solve the situation.

Concerning the remark on “outsourcing” from Mr. Lodge: We had a debate during the Guidelines Review on this. There is a provision in the general policies chapter of the Guidelines where we say that we encourage our enterprises to encourage their business partners -- including their suppliers and sub-contractors -- to apply principles of corporate conduct compatible with the Guidelines. This is not an easy question, because there are instances where enterprises have a big influence on their suppliers, and there may be instances where they do not have such a big influence. One example of the latter is that in the tea industry, you don’t know where tea on the open market comes from.

Mr. Jim Baker, Director, Multinationals and Organising, International Confederation of Free Trade Unions (ICFTU) (TUAC): If you compare 1976 and now there are substantive changes as to the degree to which the supply chain has substituted for MNEs’ own production. If you look at the way companies organise production, they increasingly slim down to core businesses and then “farm out”, even on a purely national basis. In some areas, this change in organisation has not changed responsibility or vigilance or control. This is true in, for example, quality control areas, when there is a product to be marketed either to the public or to another industrial consumer. But corporate social responsibility has not automatically been part of the vital core of things that gets monitored.

If you have a discussion about what the vast majority of MNEs are doing in terms of conduct and you talk with people from Sweden, the Netherlands, Germany or other countries where the laws are fairly strict, you discover that yes, there seems to be a case for the argument that corporate social responsibility is monitored. If you talk to countries where the laws are not very strict or not enforced very well (Malaysia, Bangladesh, Indonesia, or the US) you get a different view of the overall behaviour of companies, where many are trying to be anti-union, with some exceptions. In my 20 years’ experience, the same companies that are model companies in their home markets, and take public relations value from being so, are model companies because they are forced to do it that way. If they have the chance to operate differently in another country, then they do.

Secondly, it is important to look at what my trade union colleague from Malaysia has said: that you have extreme competitive pressures, particularly in certain industries, where companies can shift their production sites for incentives, indulging in competition among governments, not competition among companies. At that level, competition can include basic union rights and other labour rights. The difference is not between developed and developing countries, the difference is between countries that have standards and enforce them and those who don’t.

One must however recognise that in some developing countries there are much tougher pressures related to labour rights. In the IFCTU – with affiliates representing 150 million members -- we have had regular reports to our executive boards on the OECD Guidelines from the beginning – indeed prior to the beginning – of the Guidelines, where there was a parallel process of the ILO Tripartite Declaration being negotiated in the ILO at the same time as the OECD Guidelines in the mid 1970s. After the most recent revision of the Guidelines we went back to our executive board to discuss it, and we specifically asked people: “Whither the IFCTU?” Should we intensify our co-operation with

TUAC to make sure that non-adhering countries could have a chance to use these procedures? We had a discussion and had unanimous agreement that we should. We intend to try to use the OECD Guidelines in non-adhering countries and we intend to apply the same standards there based on these Guidelines and deal with all those problems that will come up.

Another point on the question of adherence to the Guidelines: Our understanding was that part of the dynamic process that was discussed at the beginning of the day was that you were not really confronted with anybody requesting to come in and only adhere to the Guidelines. We had the impression that the position on adherence to the Declaration was more agnostic than “all or nothing”.

Ms. Nellie Munin, Minister Counsellor of Economic Affairs, Israeli Mission to the EU, Brussels:

We are very aware of the importance of encouraging FDI. Israel has started to examine the implications of adhering to these instruments. The most surprising thing is to see how the private sector joins this exercise and how they are ready to co-operate. I would like to hear from you how to gain the co-operation of the private sector.

Mr. Sikkil: The simple answer to the last question is talk to them and listen to them -- not only to business but all the stakeholders. We all had different views but by talking we reached an understanding. Most enterprises have already their own corporate codes of conduct, and there are enterprise organisations that have their own codes of conduct as well. In addition, companies can be susceptible to pressure from consumers, shareholders, etc. Furthermore, ethical corporations can also find that being ethical is a profitable way of doing business. So all kinds of arguments work in the direction of enterprises working and co-operating with us. From the beginning, in 1976, the Guidelines have been supported by business. There is no easy way to retain their support. We had hard negotiations but in the end we found a solution acceptable to all.

CONCLUSIONS

Mr. Sikkel: We have had an extremely intensive day, so I will be brief. We have made available a lot of information to non-Members, and have listened to you and I hope answered some of your questions. I want to thank you for having had the patience to listen to all of us and for absorbing all this information. We started with a presentation on the Declaration, and then we moved to the different instruments within it. It seems to me that there is a need to talk more about the other parts of the Declaration; many of the questions raised with respect to the other elements of the Declaration are very relevant ones. Indeed if we want to interest you in the whole package, then we need to tell you more about the other instruments as well.

Today we went in some detail into the revision of the Guidelines: we discussed the text and the implementation procedures, as well as its geographical reach. I hope we have impressed upon you that the instrument which has been around for some time is now a rejuvenated instrument that we intend to use. We are strongly convinced that if we work together with you, non-Members, we can ensure the even greater relevance of our instruments as a contribution to a better investment climate.

Finally, we addressed important issues of adherence to OECD investment instruments and about the implementation of the Guidelines in non-adhering countries. There again, I think the conclusion is clear: co-operation is vital. We recognise with great pleasure that some of you have already indicated that you are considering to adhere to these instruments and others are seeking more information; we will be happy to provide any additional information. Dialogue is important, we are looking forward to continuing it in the months and years to come.

ANNEX I: CONFERENCE DOCUMENTS

PROGRAMME

Session I - Introduction: The OECD Declaration on International Investment and Multinational Enterprises

Purposes, Content and Main Features

- a. Guidelines for Multinational Enterprises
- b. National Treatment
- c. Conflicting Requirements
- d. Investment Incentives and Disincentives

Discussion

Session II - The Results of the 2000 Review: OECD Guidelines for Multinational Enterprises

1. Text and Geographical Scope
2. Implementation Procedures
 - a. National Contact Points (NCPs)
 - b. Business and Industry Advisory Committee (BIAC), Trade Union Advisory Committee (TUAC), and other Non-governmental Organisations (NGOs)

Discussion

Session III - Relevance for Non-Adhering Economies

1. Non-Member Adherence to OECD Investment Instruments
2. Implementing the Guidelines in non-Adhering Economies

Discussion

Concluding Remarks

Annotations to the Draft Agenda

Session I – Introduction: The OECD Declaration on International Investment and Multinational Enterprises

This introductory session would be largely informative, to explore the results of the Review in their broader context, taking into account the general philosophy and balanced approach to international investment issues embodied in the OECD Declaration. This session will include a summary of the key features and distinctiveness of the Guidelines, noting their non-binding nature, the fact that they are government-backed, that they enjoy the support of a wide variety of social partners, and that there are important implementation procedures associated with them. A period for questions and discussion will conclude this and each successive session of the meeting.

Session II – The Results of the 2000 Review: OECD Guidelines for Multinational Enterprises

This second session will offer an opportunity to get into further detail about the Guidelines, emphasising changes brought about as a result of the Review, in particular changes to the text, concerning geographical scope, and with respect to implementation procedures.

The discussion of the revised text will be divided into two parts, the first of which will begin by noting the geographical scope of the Guidelines, and then address the chapters on concepts and Principles, general Policies, Disclosure, Employment and Industrial Relations, and the environment. The second part will address the remaining chapters (Combating Bribery, Consumer Interests, Science and Technology, Competition and Taxation).

Discussion of implementation could focus on the respective roles of the different actors in the implementation procedures at the national and international levels. Thus, brief presentations will take place on what National Contact Points (government appointed offices on the Guidelines in each adhering country) do, as well as the roles of the social partners by representatives of BIAC, TUAC and NGOs.

Session III – Relevance for Non-Adhering Economies

The first part of this session focusing on non-adhering economies will address how adhering governments and other actors see the revised Guidelines and other elements of the Declaration in the context of its contribution to an enhanced investment climate for non-Members. OECD and CIME policy toward adherence to the instruments could be addressed, and links between the provisions of the Guidelines and investment promotion efforts by non-Members could also be explored. The views of representatives from non-Members on these issues are particularly encouraged.

The second part of the session would focus on practical matters associated with implementing the Guidelines in non-adhering economies. Aspects of the relationship between non-adhering economies and the Guidelines in this context would include addressing the responsibility of NCPs to respond to enquiries from representatives of non-Member economies, and to develop an understanding of the issues involved, and where relevant and practicable follow the procedures outlined for implementation in specific instances as noted in the Procedural Guidance. Also relevant to this session will be CIME's responsibilities under the Council Decision to the possibility of holding exchanges of views on matters covered by the Guidelines with representatives of non-adhering economies.

Concluding Remarks

Concluding remarks will summarise the meeting and also seek to identify opportunities for intensifying the dialogue with non-adhering economies in the future. The results of the meeting will be made available for wider distribution early in 2001.

ISSUES FOR DISCUSSION

by the Secretariat

This issues paper was provided to all participants prior to the OECD Outreach meeting with non-Members on the OECD Guidelines for Multinational Enterprises on 12 December, 2000.

Introduction

This paper provides further background for participants at the OECD consultations with non-Members on the Guidelines for Multinational Enterprises on 12 December 2000. In conjunction with the draft annotated agenda [CCNM/DAFFE/A(2000)115/PROV], its purpose is to tie together the various documents available for participants, as well as to pose a series of questions to facilitate discussion during the meeting.

Three themes have been singled out for attention for the 12 December meeting on the OECD Guidelines for Multinational Enterprises: a) the institutional context for the Guidelines which are an important part of the OECD Declaration on International Investment and Multinational Enterprises; b) the results of the year 2000 Review of the Guidelines; and c) the relevance for non-adhering economies. These elements are also addressed below.

Session I - The OECD Declaration on International Investment and Multinational Enterprises

OECD governments, as well as other governments that adhere to the Guidelines, have confirmed that the Guidelines should be viewed as an integral element within the package of investment instruments that comprise the OECD Declaration on International Investment and Multinational Enterprises.¹⁵

For decades, the OECD has promoted co-operation on international investment through this Declaration. The Declaration sets forth non-binding principles and standards addressed both to governments and to enterprises to improve the investment climate and encourage the positive contribution multinational enterprises can make to economic, social, and environmental goals. It reflects a consensus based on a shared philosophy and a balanced approach to international investment issues among twenty-nine OECD and four non-OECD Member countries (Argentina, Brazil, Chile and the Slovak Republic¹⁶) and contains four inter-related elements:

- The Guidelines for Multinational Enterprises provide voluntary principles and standards for responsible business conduct addressed to multinational enterprises themselves;
- The National Treatment Instrument sets out member countries' commitment to accord to foreign-controlled enterprises operating in their territories treatment no less favourable than that accorded to domestic enterprises in like situations;

15 The complete Declaration is available through on the OECD website at: <http://www.oecd.org/daf/investment/>.

16 On 28 September 2000, the Slovak Republic signed an Agreement setting out the terms under which it became the thirtieth member of the OECD.

- An instrument on International Investment Incentives and Disincentives provides for efforts among member countries to improve co-operation on measures affecting international direct investment; and
- An instrument on Conflicting Requirements calls on Member countries to avoid or minimise conflicting requirements imposed on multinational enterprises by governments of different countries.

The OECD Declaration and Decisions have periodically been reviewed¹⁷ (1979, 1982, 1984, 1991). The most recent review concerned the Guidelines for Multinational Enterprises and was completed in at the OECD Ministerial meeting in June 2000. In addition to welcoming the updated Guidelines, Ministers also noted that “OECD will continue its analytical work in the field of investment policy, including work on maximising the benefits of investment liberalisation, its social and environmental dimensions and on harmful forms of policy-based competition to attract investment. OECD will encourage non-Members to adhere to the Declaration on International Investment and Multinational Enterprises”.¹⁸

The ongoing support and involvement of the business community represented by the Business and Industry Advisory committee (BIAC), labour, represented by the Trade Union Advisory Committee (TUAC) and other non-governmental organisations is crucial to the effectiveness of the Declaration and its constituent elements. The effectiveness of the Declaration also depends on the follow-up which adhering countries and social partners give to it, both nationally and within the procedures set up at the level of OECD.

Questions for discussion:

- *In what way can the balanced approach to investment issues embodied in the Declaration be of use and relevance to non-Members? Can it enhance the relationship between adhering and non-adhering economies on international investment issues? If so, how?*
- *Do participants share the objectives of the OECD Declaration as outlined in the four constituent elements? What other issues warrant attention in this dialogue?*

Session II - The OECD Guidelines for Multinational Enterprises

The results of the successful Review of the instrument at the OECD Ministerial meeting in June, 2000 are available on the OECD Guidelines website.¹⁹

17 See the Review reports: *International Investment and Multinational Enterprises: Review of the 1976 Declaration and Decisions* (OECD Paris, 1979); *Mid-Term Report on the 1976 Declaration and Decisions* (OECD Paris, 1982); *1984 Review of the 1976 Declaration and Decisions* (OECD Paris, 1984); *The OECD Declaration and Decisions on International Investment and Multinational Enterprises, 1991 Review* (OECD Paris, 1992).

18 Para. 27 of the June 2000 Ministerial Press Release “Shaping Globalisation” at: <http://www.oecd.org/media/>.

19 See both the Guidelines press release and final press release of the Ministerial Declaration on the OECD Guidelines for Multinational Enterprises website at: <http://www.oecd.org/daf/investment/guidelines/>.

In comparison with the earlier reviews the changes to the text of the Guidelines are far-reaching and reinforce the core elements – economic, social and environmental—of the sustainable development agenda²⁰. They have been developed in constructive dialogue with the business community, labour representatives and non-governmental organisations. Non-Member countries were also consulted during the Review. The revisions to the implementation procedures maintain the focus on the National Contact Points (NCPs), which are nominated by adhering governments to further the effective implementation of the Guidelines at the domestic level. The year 2000 Review, however, resulted in procedural guidance to National Contact Points in fulfilling their role and has also clarified the CIME's role.

In welcoming the updated Guidelines for Multinational Enterprises, OECD Ministers noted that “the Guidelines provide a robust set of recommendations for responsible corporate behaviour world-wide consistent with existing legislation”.²¹

The revised Guidelines have been welcomed as a timely initiative. It is widely recognised that foreign investment is important for economic growth and that multinational enterprises can contribute to economic, social and environmental progress. At the same time, public concerns remain about the impact of their activities on home and host countries. The new Guidelines represent an important step in responding to some of these concerns within the rubric of improving the climate for international investment. The basic premise of the Guidelines is that principles agreed internationally can help prevent conflict and build an atmosphere of confidence between multinational enterprises and the societies in which they operate. In addition, they complement other initiatives, including those on anti-corruption and corporate governance, that have also characterised OECD work over recent years. All these non-binding initiatives seek to improve not only the environment for enterprises, but within and among enterprises and the societies in which they operate.

The Guidelines are not a substitute for the law. They represent supplementary principles and standards of behaviour. The new text of the Guidelines contains far-reaching changes that reinforce the economic, social and environmental elements of the sustainable development agenda. Recommendations have been added on the elimination of child labour and forced labour consistent with the 1998 ILO Declaration on Fundamental Principles and Rights at Work, so they now cover all internationally recognised core labour standards.²² A recommendation on human rights has been introduced [“Enterprises should...respect the human rights of those affected by their activities consistent with the host government’s international obligations and commitments”], and new chapters on combating corruption and consumer protection have been added. The environment section now encourages multinational enterprises to raise their environmental performance through improved internal environmental management and better contingency planning for environmental impacts. The

20 With the addition of recommendations relating to the elimination of child and forced labour, all internationally recognised core labour standards are now covered by the Guidelines. The environment section now encourages enterprises to raise their environmental performance, through such measures as improved internal environmental management, stronger disclosure of environmental information, and better contingency planning for environmental impacts. A recommendation on human rights has been introduced. New chapters on combating corruption and on consumer protection have also been added. The chapter on disclosure and transparency has been updated to reflect the *OECD Principles on Corporate Governance* and to recognise and encourage progress in enhancing firms’ social and environmental accountability.

21 See para. 26 of the Ministerial press release, June 2000: <http://www.oecd.org/media/>.

22 Complementarities between ILO and OECD instruments in this area have existed since the 1970s, the ILO drafting its Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy in 1977, one year after the initial OECD MNE Guidelines.

chapter on disclosure and transparency has been updated to reflect the OECD Principles on Corporate Governance and to encourage social and environmental accountability.

Implementation procedures have been significantly improved, although it should be noted that the Guidelines were already unique as an international initiative in the area of corporate conduct with implementation procedures. While the Guidelines' recommendations are addressed to business, governments through a network of National Contact Points are responsible for promoting the Guidelines, handling enquiries and helping to resolve issues that arise in specific instances. The Review has provided considerable guidance to help National Contact Points and the Committee on International Investment and Multinational Enterprises (CIME) to carry out their duties and it has established mechanisms for promoting transparency, accountability and best practice which are outlined in the documents associated with the Guidelines available to participants, also available through the Guidelines website at: <http://www.oecd.org/daf/investment/guidelines/index.htm>. The OECD Committee on International Investment and Multinational Enterprises (CIME) remains the responsible body for clarifying the meaning of the Guidelines and overseeing their effectiveness.

Questions for discussion:

- *Which parts of the revised Guidelines are of particular interest to developing countries?*
- *What issues in the Guidelines, including chapter texts, implementation procedures, and commentaries, deserve particular attention in the dialogue between adhering and non-adhering economies?*

Session III - The OECD Instruments and non-Member Economies

The OECD has long been a focal point for co-operation among Member countries in the area of international direct investment and multinational enterprises. This co-operation is based on the 1976 Declaration (now 2000 Declaration) and associated Decisions of the OECD Council discussed above which have been strengthened in various ways over the past twenty-four years. The instruments have been regularly reviewed and strengthened over the years to keep them up to date and effective. They also provide an essential yardstick in assessing the extent to which candidates for OECD Membership adhere to standards set by these instruments.

The Declaration itself is non-binding, but governments are committed to promoting observance of principles which underlie each of the constituent elements. The OECD's Committee on International Investment and Multinational Enterprises (CIME) is responsible for overseeing the Declaration, including with respect to promoting it among non-Members. At this year's Ministerial meeting OECD Ministers again encouraged non-Members to adhere to the Declaration. Four non-Members have adhered to the Declaration: Argentina, Brazil, and Chile and the Slovak Republic.

With respect to the Guidelines, previous meetings with non-Members were held during the most recent Review -- the first as part of a conference on "The Role of International Investment in Development, Corporate Responsibility, and the OECD Guidelines for Multinational Enterprises" in September, 1999, the second at consultations with non-Members on the Guidelines Review in February 2000.²³

23 Detailed information on the September 1999 Conference is available through the OECD website at <http://www.oecd.org/daf/conference/index.htm>. The analytical summary of the discussion on corporate responsibility and the Guidelines Review [DAFFE/IME(99)23] is available on this site, and

At these meetings, it was pointed out that a number of rationales existed for applying the Guidelines in non-adhering economies, including the promotion of principles and standards that MNEs in many cases strive to apply on a world-wide basis. The non-binding principles and standards embodied in the Guidelines can also assist in benchmarking many issues, including corporate integrity, disclosure of information, employment conditions, environmental and product stewardship, and others.

The Guidelines now apply to MNE's based in adhering countries worldwide. As a result of the Review, non-Members can co-operate with the OECD on the Guidelines in several ways. First, they can adhere to the instrument itself, which has always been done in conjunction with adhering to the Declaration as a whole. Secondly, more informal co-operation can be facilitated. Indeed the CIME incorporates in its Decision on the Guidelines that it may hold exchanges of views on matters covered by the Guidelines with representatives of non-adhering countries. Suggestions for improving contact and communications with non-Members on Guidelines issues can also be considered on these occasions. Thirdly, with respect to individual issues covered by the Guidelines, or what is more specifically termed implementation of the Guidelines in specific instances in non-adhering economies, procedural guidance for NCPs has been published whereby steps will be taken to develop an understanding of the issues involved, including with respect to following the procedures for the resolution of issues that arise where relevant and practicable.

Finally, it has also been recognised that implementing the Guidelines in non-adhering countries in specific instances could raise issues that might not arise in implementing them in Members. For example, differing legal and policy environments, and the lack of a National Contact Point in non-adhering countries could be a complicating factor in obtaining access to all pertinent information.²⁴ Thus, adhering governments seek the co-operation of both enterprises and non-adhering governments to resolve problems if they occur. In addition, non-adhering countries can also contribute to resolving them -- all with a view to enhancing the investment climate in the context of non-binding recommendations to enterprises in areas of public concern.

The 12 December meeting represents the first opportunity since the Review was completed in June 2000 for adhering countries to meet with non-adhering countries on the Declaration, and exchange views on matters covered by the Guidelines. It also offers the opportunity to facilitate dialogue, including with respect to avoiding misunderstandings in the implementation of the Guidelines in non-adhering economies in specific instances. The ultimate aim in implementing the Guidelines is to improve the prospects for productive investment consistent with principles and standards outlined in the Guidelines wherever enterprises invest.

Questions for discussion:

- *Do participants share the view that the OECD Declaration can assist non-OECD Members to create a positive investment climate? What barriers exist in making the Declaration better known amongst non-Members in this regard?*

is also part of an OECD publication on the conference entitled *Foreign Direct Investment, Development and Corporate Responsibility*, available through the OECD Online Bookshop via <http://www.oecd.org/>.

Further information on the informal consultations with non-Members in February 2000 is available as an unclassified document [DAFFE/IME/(2000)9] on the OECD Documentation website at <http://www.oecd.org/products/>.

24 For a more thorough discussion of this issue, see para. 20 of the commentary to the Implementation Procedures of the Guidelines in specific instances (reproduced in Annex II of this publication).

- *Given the principles and standards embodied in the Guidelines, affecting such issue areas as human rights, labour standards, and environmental management practices, how can the Guidelines assist in promoting investment in non-OECD Members? Do any problems arise in doing so?*
- *To what extent does the effectiveness of the Guidelines depend on a sound framework of government policy and the rule of law?*
- *How can non-adhering countries assist in responding to requests for co-operation from adhering governments in implementing the Guidelines in specific instances? What do participants think of the prospective roles of the social partners in promoting and implementing the Guidelines?*
- *Are non-Member governments interested in exploring ways of closer co-operation with the OECD on Guidelines matters? Is there interest in promoting the Guidelines in relation to their own enterprises, especially those that operate internationally?*

PARTICIPANTS

NON-MEMBER COUNTRIES

Azerbaijan:

Mr. Rovshan SULEYMANOV, Advisor, Department of Co-ordination of External Aid and Foreign Investments, Prime Minister's Office

M. I. AHMADOV, Conseiller économique, Ambassade d'Azerbaïdjan en France

Cameroon:

Mr. Pierre Emmanuel TABI, Second Counsellor, Embassy of Cameroon in Paris

Colombia:

Madame Cecilia CASTELLO, Second Secretary, Embassy of Colombia in Paris

Croatia

Mrs. Munjin WERTAG, Counsellor, Ministry of the Economy, Government of the Republic of Croatia

Ilija ZELALIC, Counsellor, Croatian Embassy in Paris

Egypt

Ms. Magda SHAHIN, Assistant Minister for International Economic Relations, Ministry of Foreign Affairs

Ms. Laila BAHA-EL-DIN, Counsellor, Embassy of Egypt in Paris

Estonia

Mr. Harri ANNUKA, Economic Counsellor, Estonian Embassy in Paris

Mr. Mati MURD, Third Secretary, Foreign Economic Policy Department, Minister of Foreign Affairs

Haïti

Mr. Ernst TOUSSAINT, Ministre Conseiller, Ambassade de Haïti à Paris

Indonesia

Mr. Tatang W. SAPUTRA, Minister Counsellor for Economic Affairs, Embassy of Indonesia

Israel

Mr. Eli LEV, Minister Counsellor, Israeli Embassy in Paris

Madame NELLIE MUNIN, Minister, Counsellor of Economic Affairs, Israel Mission to the European Union in Brussels

Jamaica

Mr Junior LODGE, Executive Director, JAMCO, UNITED KINGDOM

Kazakhstan

Mr Berlin IRISHEV, Minister Counsellor, Embassy of the Republic of Kazakhstan in France

Kenya

Mrs Purity MUHINDI, Counsellor, Kenyan Embassy in Paris

Latvia

Mr Gatis EGLITIS, Senior Expert, Department of Economic Policy, Ministry of Foreign Affairs

Mr Indulis ABELIS, Counsellor, Embassy of Latvia in Paris

Liberia

Mr. Albert AMET, Vice-Consul, Liberian Embassy in Paris

Lithuania

Mrs. Audroné RAILAITE, Director, Enterprise Economics & Management Department, Ministry of Economy

Mr. Vaidotas KARVELIS, 1st Secretary, Division for International Economic Organisations, Ministry of Foreign Affairs

Mr. Raimondas MARTINAVICIUS, Head, Economic Strategy Monitoring Division of the European Committee, Government of the Republic of Lithuania

Malaysia

Mr. Mohamed SHAHABAR, Minister Counsellor, Economic Affairs, Mission of Malaysia, Brussels

Mongolia

Mrs. R. OYUN, Second Secretary, Economic and Commercial Affairs, Embassy of Mongolia in Paris

Peru

Mr. Augusto Thornberry, Minister, Chargé d'Affaires, Embassy of Peru in France

Russia

Mr. Alexandre SHEVCHENKO, Head of Division, Economic Co-operation Department, Ministry of Foreign Affairs

Singapore

Ms Daisy GOH, Director (Europe Bilateral & Multilateral), Singapore Economic Development Board

Mr. Charles CHEW, Second Secretary, Singapore Embassy in Paris

South Africa:

Mr. Lincoln MARAIS, First Secretary, Multilateral Affairs, South African Embassy, Paris

Chinese Taipei

M. CHIANG Nailiang, Directeur de CAPEC et Conseiller Economique de Taiwan

M. LAI Tso-Sung, Christophe, Attaché Commercial, CAPEC

Tunisia

Ms. Nebiha DOGHRI, Chargée de Mission, Ministry of International Co-operation and International Investment

Mr. Tahar CHERIF, Economic Counsellor, Embassy of Tunisia

Ukraine

M. Victor LYSYTSKYI, Secretary of the Government, Office of the Cabinet of Ministers

M. Valleriy SAY, Economic Counsellor, Ukrainian Embassy

M. S. KRUGLYK, Head, Economic Commercial Mission, Ukrainian Embassy

Uzbekistan

M. Komiljen AKHMESST, Ambassade d'Ouzbekistan en France

Venezuela

Mr. Aldo PERFETTO ALEXANDROV, Third Secretary, Permanent Mission of Venezuela to the WTO

Mr. Pablo ALVAREZ, Second Secretary, Embassy of Venezuela

Vietnam

Mrs. Pham Thi Lan Huong, Senior Expert, Central Institute for Economic Management, Hanoi, Vietnam

Yugoslavia

Madame Milica UVALIC, Deputy Federal Minister of International Economic Relations, Belgrade, Yugoslavia

MEMBER COUNTRIES

Austria

*Mr Manfred SCHEKULIN, Federal Ministry of Economic Affairs and Labour,
Chairman of the Working Party on the Declaration, Former Vice-Chair of the CIME
Mr Konrad PESENDORFER, Permanent Delegation to the OECD*

Belgium

*M. R. CHARLIER, Directeur Général, Président du Point National de Contact belge,
Ministère des Affaires économiques
M. Luc RIFFLET, Conseiller, Délégation permanente auprès de l'OCDE*

Canada

*Mr Vernon MACKAY, Investment Trade Policy Division, Department of Foreign
Affairs and International Trade
Mr. Marc LEGAULT, Senior Policy Analyst, Int'l Investment and Services, Industry
Canada
Mr. Martin ROY, International Relations Officer, Trade in Services and Investment,
Finance Canada
Mr. Greg GALLO, First Secretary, Canadian Delegation to the OECD*

Czech Republic

Mr Zdenek LUKES, Ministry of Finance

Denmark

Mr. Herluf HANSEN, Ambassador, Ministry of Foreign Affairs

Finland

Mr. Jorma IMMONEN, Senior Government Secretary, Ministry of Trade and Industry

Greece

Ms. E. KARACHALIOU, Ministry of National Economy

Hungary

Mr Tibor TEJNÓRA, Senior Advisor, Ministry of Economic Affairs

Italy

Mr. Stelio VENCESLAI, Ministry of Industry

Japan

*Mr Daisuke KUROKI, Economic Affairs Bureau, Ministry of Foreign Affairs
Mr Yoichi MATSUMOTO, Second Secretary, Permanent Delegation to the OECD,
Vice-Chairman of the CIME
Mr Yoshihito YASAKI, Special Assistant (Investment, Trade, and Co-operation with
Non-Members), Permanent Delegation to the OECD*

Korea

Mr. Sang-Hwon JEON, First Secretary, Korean Delegation to the OECD

Mexico

Mr. Rogelio ARELLANO, Permanent Delegation to the OECD

Netherlands

Mr Marinus W. SIKKEL, Head of Investment Policy & International Organisations, Ministry of Economic Affairs, Chairman of the CIME, Former Chairman of the Working Party on the Guidelines

Mr Lud KROESE, Ministry of Foreign Affairs

Mrs Jeannette BALJEU, Ministry of Economic Affairs

Norway

Mr. Sten E. RUUD, Assistant Director General, Ministry of Foreign Affairs

Slovak Republic

Mr. Martin KAPKO, Director, Department of Foreign Investment, Ministry of Economy

Ms Iva PAVLOVICOVA, First Secretary, Permanent Delegation to OECD

Spain

Mrs Cristina BARRENO MALAPERT, Technical Adviser, Deputy Directorate for Foreign Investment, Ministry of the Economy

Sweden

Mr Henning ENVALL, Desk Officer, Ministry for Foreign Affairs

Switzerland

M. Rolf GERSPACHER, Secrétariat d'Etat à l'Economie, Département fédéral de l'économie

Mr. William FREI, Ministre, Représentant permanent adjoint

Turkey

Mr Isa COSKUN, Economic Counsellor, Permanent Delegation to the OECD

United Kingdom

Mr. Paul HAWKER, Head, International Investment Policy, Department of Trade and Industry

United States

Mr. Wesley SCHOLZ, Director, Office of Investment Affairs, Department of State, Vice-Chairman of the CIME

Mr Brian McFEETERS, Investment Policy Advisor, US Mission to the OECD

Mr. Benedict WOLF, Financial Economist, Bureau of Economic and Business Affairs, Department of State

Ms. Kimberly EVANS, International Economist, Department of the Treasury

EC Commission

Mme Corinne DREYFUS, DG Trade-F-2, European Commission

OBSERVERS to the CIME
(non-OECD Members adhering to the OECD Declaration, including the MNE Guidelines)

Brazil

Mr. Lauro Eduardo SOUTELLO-ALVES, First Secretary (Multilateral Economic Affairs), Embassy of Brazil in Paris

Chile

Mr. Marcelo GARCIA, Permanent Representative to the OECD, Ambassade du Chili à Paris

BUSINESS REPRESENTATIVES

Dr. Bruno LAMBORGHINI, Chairman BIAC MNEs COMMITTEE, Chairman, Olivetti Lexikon S.p.A., Italy

Dr. Kristian EHINGER, General Counsel, Foreign Holdings, Volkswagen AG, Germany

Mr. Jae-Hyun LEE, Executive Director, Korea International Trade Association (KITA), Korea

Mr. Jens BERTHELSEN, Deputy Director, Confederation of Danish Industries, Denmark

Mr. Stephen J. CANNER, Vice-President, Investment Policy, US Council for International Business, United States

Mr. Marc MAINDRAULT, Directeur des Relations Commerciales et Financières Internationales, Mouvement des Entreprises de France (MEDEF), France

Mr. Harry K. van EGMOND, Economic Advisor, Unilever NV, Netherlands

Mr. André M.A. DRIESSEN, Senior Advisor, Confederation of Netherlands Industry and Employers (VNO-NCW), Netherlands

Mr. David WOOD, Deputy Director, International Affairs, Confederation of British Industry (CBI), United Kingdom

Mr. Andrew W.A. BERKELEY, Barrister, United Kingdom

Mr. Hans EKDAHL, Senior Trade Policy Adviser, Federation of Swedish Industries, Sweden

Mr. Germain HENNET, Member of the Executive Board, Swiss Bankers' Association, Switzerland

Mr. Jan ATTESLANDER, Federation of Swiss Industrial Holding Companies, Switzerland

Mr. Bruno LINK, Issues Manager, Nestlé SA, Switzerland

Mr. Bjorn Otto SVERDRUP, International Adviser, Confederation of Norwegian Business and Industry (NHO), Norway

BIAC Secretariat

Mr. Douglas C. WORTH, Secretary-General

Ms. Nicole PRIMMER, Policy Manager

LABOUR REPRESENTATIVES

- Ms. Béatrice CULOT, Service d'Égudes, Confédération des Syndicats Chrétiens de Belgique (CSC)*
- Mr. Clovis Roberto SCHERER, Central Unica dos Trabalhadores (CUT), Brazil*
- Ms. Louise WALSH, Deputy European Representative, American Federation of Labor & Congress of Industrial Organisations (AFL-CIO), United States*
- Mr. Benoît ROBIN, Assistant - Secteur économique, Force Ouvrière (Cgt-FO), France*
- Mr. Marc DELUZET, Secrétaire confédéral, Confédération démocratique du travail (CFDT), France*
- Ms. Frédérique DUPUY, Assistante confédérale - Force Ouvrière, (Cgt-FO), France*
- Mr. G. RAJASEKARAN, General Secretary, Malaysian Trades Union Congress (MTUC), Malaysia*
- Mr. Tom ETTY, International Department, Federation of Dutch Trade Unions (FNV), Netherlands*
- Ms. Sharon JAMES, International Department, Trades Union Congress (TUC), United Kingdom*
- Mr. Donald DE MUËLENAERE, Conseller général, C.G.S.L.B., Belgium*
- Mr. Jan Erik MOREAU, Economist, Swedish Trade Unions Confederation (LO-S), Sweden*
- Ms. Veronica NILSSON, Research Officer, The Swedish Confederation of Professional Employees (TCO), Sweden*
- Mr. Jim BAKER, Director Multinationals & Organising, International Confederation of Free Trade Unions*

TUAC Secretariat

- Mr. John EVANS, General Secretary, Trade Union Advisory Committee to the OECD (TUAC)*
- Mr. Roy JONES, Senior Policy Adviser, Trade Union Advisory Committee to the OECD (TUAC)*
- Mr. Rousten DARLETGUILDEER, ILO Fellow, Professor of the Kazan State University (Russia)*

NON-GOVERNMENTAL ORGANISATIONS

- Mr. Pieter VAN DER GAAG, Executive Director, Northern Alliance for Sustainability (ANPED), The Netherlands*
- Mr. Jeffrey Barber, ISF/US Citizens Network for Sustainable Development*

INTERNATIONAL ORGANISATIONS

ILO

Mr. Steven OATES, Office of the Executive Director for Fundamental Principles & Rights at Work, International Labour Office

IMF

Mr. S. Erik OPPERS, Economist, IMF Office in Europe

OAS

Ms. Maryse ROBERT, Senior Trade Specialist, OAS Trade Unit

UNEP

Cornelis Theunis VAN DER LUGT PhD, Programme Officer, UNEP Division of Technology, Industry & Economics

Ms. Laura WILLIAMSON, Programme Officer, UNEP Division of Technology, Industry & Economics

UNIDO

M. Gérard GAVEAU, Directeur du Service en France, Organisation des Nations Unies pour le Développement Industriel (ONUDI),

ANNEX II

THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES: TEXT AND IMPLEMENTATION PROCEDURES

Text

Preface

1. The *OECD Guidelines for Multinational Enterprises* (the *Guidelines*) are recommendations addressed by governments to multinational enterprises. They provide voluntary principles and standards for responsible business conduct consistent with applicable laws. The *Guidelines* aim to ensure that the operations of these enterprises are in harmony with government policies, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by multinational enterprises. The *Guidelines* are part of the *OECD Declaration on International Investment and Multinational Enterprises* the other elements of which relate to national treatment, conflicting requirements on enterprises, and international investment incentives and disincentives.
2. International business has experienced far-reaching structural change and the *Guidelines* themselves have evolved to reflect these changes. With the rise of service and knowledge-intensive industries, service and technology enterprises have entered the international marketplace. Large enterprises still account for a major share of international investment, and there is a trend toward large-scale international mergers. At the same time, foreign investment by small- and medium-sized enterprises has also increased and these enterprises now play a significant role on the international scene. Multinational enterprises, like their domestic counterparts, have evolved to encompass a broader range of business arrangements and organisational forms. Strategic alliances and closer relations with suppliers and contractors tend to blur the boundaries of the enterprise.
3. The rapid evolution in the structure of multinational enterprises is also reflected in their operations in the developing world, where foreign direct investment has grown rapidly. In developing countries, multinational enterprises have diversified beyond primary production and extractive industries into manufacturing, assembly, domestic market development and services.
4. The activities of multinational enterprises, through international trade and investment, have strengthened and deepened the ties that join OECD economies to each other and to the rest of the world. These activities bring substantial benefits to home and host countries. These benefits accrue when multinational enterprises supply the products and services that consumers want to buy at competitive prices and when they provide fair returns to suppliers of capital. Their trade and investment activities contribute to the efficient use of capital, technology and human and natural resources. They facilitate the transfer of technology among the regions of the world and the development of technologies that reflect local conditions. Through both formal training and on-the-job learning enterprises also promote the development of human capital in host countries.

5. The nature, scope and speed of economic changes have presented new strategic challenges for enterprises and their stakeholders. Multinational enterprises have the opportunity to implement best practice policies for sustainable development that seek to ensure coherence between social, economic and environmental objectives. The ability of multinational enterprises to promote sustainable development is greatly enhanced when trade and investment are conducted in a context of open, competitive and appropriately regulated markets.

6. Many multinational enterprises have demonstrated that respect for high standards of business conduct can enhance growth. Today's competitive forces are intense and multinational enterprises face a variety of legal, social and regulatory settings. In this context, some enterprises may be tempted to neglect appropriate standards and principles of conduct in an attempt to gain undue competitive advantage. Such practices by the few may call into question the reputation of the many and may give rise to public concerns.

7. Many enterprises have responded to these public concerns by developing internal programmes, guidance and management systems that underpin their commitment to good corporate citizenship, good practices and good business and employee conduct. Some of them have called upon consulting, auditing and certification services, contributing to the accumulation of expertise in these areas. These efforts have also promoted social dialogue on what constitutes good business conduct. The *Guidelines* clarify the shared expectations for business conduct of the governments adhering to them and provide a point of reference for enterprises. Thus, the *Guidelines* both complement and reinforce private efforts to define and implement responsible business conduct.

8. Governments are co-operating with each other and with other actors to strengthen the international legal and policy framework in which business is conducted. The post-war period has seen the development of this framework, starting with the adoption in 1948 of the Universal Declaration of Human Rights. Recent instruments include the ILO Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development and Agenda 21 and the Copenhagen Declaration for Social Development.

9. The OECD has also been contributing to the international policy framework. Recent developments include the adoption of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and of the OECD Principles of Corporate Governance, the OECD Guidelines for Consumer Protection in the Context of Electronic Commerce, and ongoing work on the OECD Guidelines on Transfer Pricing for Multinational Enterprises and Tax Administrations.

10. The common aim of the governments adhering to the *Guidelines* is to encourage the positive contributions that multinational enterprises can make to economic, environmental and social progress and to minimise the difficulties to which their various operations may give rise. In working towards this goal, governments find themselves in partnership with the many businesses, trade unions and other non-governmental organisations that are working in their own ways toward the same end. Governments can help by providing effective domestic policy frameworks that include stable macroeconomic policy, non-discriminatory treatment of firms, appropriate regulation and prudential supervision, an impartial system of courts and law enforcement and efficient and honest public administration. Governments can also help by maintaining and promoting appropriate standards and policies in support of sustainable development and by engaging in ongoing reforms to ensure that public sector activity is efficient and effective. Governments adhering to the *Guidelines* are committed to continual improvement of both domestic and international policies with a view to improving the welfare and living standards of all people.

I. Concepts and Principles

1. The *Guidelines* are recommendations jointly addressed by governments to multinational enterprises. They provide principles and standards of good practice consistent with applicable laws. Observance of the *Guidelines* by enterprises is voluntary and not legally enforceable.
2. Since the operations of multinational enterprises extend throughout the world, international co-operation in this field should extend to all countries. Governments adhering to the *Guidelines* encourage the enterprises operating on their territories to observe the *Guidelines* wherever they operate, while taking into account the particular circumstances of each host country.
3. A precise definition of multinational enterprises is not required for the purposes of the *Guidelines*. These usually comprise companies or other entities established in more than one country and so linked that they may co-ordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one multinational enterprise to another. Ownership may be private, state or mixed. The *Guidelines* are addressed to all the entities within the multinational enterprise (parent companies and/or local entities). According to the actual distribution of responsibilities among them, the different entities are expected to co-operate and to assist one another to facilitate observance of the *Guidelines*.
4. The *Guidelines* are not aimed at introducing differences of treatment between multinational and domestic enterprises; they reflect good practice for all. Accordingly, multinational and domestic enterprises are subject to the same expectations in respect of their conduct wherever the *Guidelines* are relevant to both.
5. Governments wish to encourage the widest possible observance of the *Guidelines*. While it is acknowledged that small- and medium-sized enterprises may not have the same capacities as larger enterprises, governments adhering to the *Guidelines* nevertheless encourage them to observe the *Guidelines* recommendations to the fullest extent possible.
6. Governments adhering to the *Guidelines* should not use them for protectionist purposes nor use them in a way that calls into question the comparative advantage of any country where multinational enterprises invest.
7. Governments have the right to prescribe the conditions under which multinational enterprises operate within their jurisdictions, subject to international law. The entities of a multinational enterprise located in various countries are subject to the laws applicable in these countries. When multinational enterprises are subject to conflicting requirements by adhering countries, the governments concerned will co-operate in good faith with a view to resolving problems that may arise.
8. Governments adhering to the *Guidelines* set them forth with the understanding that they will fulfil their responsibilities to treat enterprises equitably and in accordance with international law and with their contractual obligations.
9. The use of appropriate international dispute settlement mechanisms, including arbitration, is encouraged as a means of facilitating the resolution of legal problems arising between enterprises and host country governments.

10. Governments adhering to the *Guidelines* will promote them and encourage their use. They will establish National Contact Points that promote the *Guidelines* and act as a forum for discussion of all matters relating to the *Guidelines*. The adhering Governments will also participate in appropriate review and consultation procedures to address issues concerning interpretation of the *Guidelines* in a changing world.

II. General Policies

Enterprises should take fully into account established policies in the countries in which they operate, and consider the views of other stakeholders. In this regard, enterprises should:

1. Contribute to economic, social and environmental progress with a view to achieving sustainable development.
2. Respect the human rights of those affected by their activities consistent with the host government's international obligations and commitments.
3. Encourage local capacity building through close co-operation with the local community, including business interests, as well as developing the enterprise's activities in domestic and foreign markets, consistent with the need for sound commercial practice.
4. Encourage human capital formation, in particular by creating employment opportunities and facilitating training opportunities for employees.
5. Refrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation, financial incentives, or other issues.
6. Support and uphold good corporate governance principles and develop and apply good corporate governance practices.
7. Develop and apply effective self-regulatory practices and management systems that foster a relationship of confidence and mutual trust between enterprises and the societies in which they operate.
8. Promote employee awareness of, and compliance with, company policies through appropriate dissemination of these policies, including through training programmes.
9. Refrain from discriminatory or disciplinary action against employees who make *bona fide* reports to management or, as appropriate, to the competent public authorities, on practices that contravene the law, the *Guidelines* or the enterprise's policies.
10. Encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with the *Guidelines*.
11. Abstain from any improper involvement in local political activities.

III. Disclosure

1. Enterprises should ensure that timely, regular, reliable and relevant information is disclosed regarding their activities, structure, financial situation and performance. This information should be disclosed for the enterprise as a whole and, where appropriate, along business lines or geographic areas. Disclosure policies of enterprises should be tailored to the nature, size and location of the enterprise, with due regard taken of costs, business confidentiality and other competitive concerns.

2. Enterprises should apply high quality standards for disclosure, accounting, and audit. Enterprises are also encouraged to apply high quality standards for non-financial information including environmental and social reporting where they exist. The standards or policies under which both financial and non-financial information are compiled and published should be reported.

3. Enterprises should disclose basic information showing their name, location, and structure, the name, address and telephone number of the parent enterprise and its main affiliates, its percentage ownership, direct and indirect in these affiliates, including shareholdings between them.

4. Enterprises should also disclose material information on:

The financial and operating results of the company;

Company objectives;

Major share ownership and voting rights;

Members of the board and key executives, and their remuneration;

Material foreseeable risk factors;

Material issues regarding employees and other stakeholders;

Governance structures and policies.

5. Enterprises are encouraged to communicate additional information that could include:

a) Value statements or statements of business conduct intended for public disclosure including information on the social, ethical and environmental policies of the enterprise and other codes of conduct to which the company subscribes. In addition, the date of adoption, the countries and entities to which such statements apply and its performance in relation to these statements may be communicated;

b) Information on systems for managing risks and complying with laws, and on statements or codes of business conduct;

c) Information on relationships with employees and other stakeholders.

IV. Employment and Industrial Relations

Enterprises should, within the framework of applicable law, regulations and prevailing labour relations and employment practices:

1.
 - a) Respect the right of their employees to be represented by trade unions and other bona fide representatives of employees, and engage in constructive negotiations, either individually or through employers' associations, with such representatives with a view to reaching agreements on employment conditions;
 - b) Contribute to the effective abolition of child labour;
 - c) Contribute to the elimination of all forms of forced or compulsory labour;
 - d) Not discriminate against their employees with respect to employment or occupation on such grounds as race, colour, sex, religion, political opinion, national extraction or social origin, unless selectivity concerning employee characteristics furthers established governmental policies which specifically promote greater equality of employment opportunity or relates to the inherent requirements of a job.
2.
 - a) Provide facilities to employee representatives as may be necessary to assist in the development of effective collective agreements;
 - b) Provide information to employee representatives which is needed for meaningful negotiations on conditions of employment;
 - c) Promote consultation and co-operation between employers and employees and their representatives on matters of mutual concern.
3. Provide information to employees and their representatives which enables them to obtain a true and fair view of the performance of the entity or, where appropriate, the enterprise as a whole.
4.
 - a) Observe standards of employment and industrial relations not less favourable than those observed by comparable employers in the host country;
 - b) Take adequate steps to ensure occupational health and safety in their operations.
5. In their operations, to the greatest extent practicable, employ local personnel and provide training with a view to improving skill levels, in co-operation with employee representatives and, where appropriate, relevant governmental authorities.
6. In considering changes in their operations which would have major effects upon the livelihood of their employees, in particular in the case of the closure of an entity involving collective lay-offs or dismissals, provide reasonable notice of such changes to representatives of their employees, and, where appropriate, to the relevant governmental authorities, and co-operate with the employee representatives and appropriate governmental authorities so as to mitigate to the maximum extent practicable adverse effects. In light of the specific circumstances of each case, it would be appropriate if management were able to give such notice prior to the final decision being taken. Other means may also be employed to provide meaningful co-operation to mitigate the effects of such decisions.

7. In the context of bona fide negotiations with representatives of employees on conditions of employment, or while employees are exercising a right to organise, not threaten to transfer the whole or part of an operating unit from the country concerned nor transfer employees from the enterprises' component entities in other countries in order to influence unfairly those negotiations or to hinder the exercise of a right to organise.
8. Enable authorised representatives of their employees to negotiate on collective bargaining or labour-management relations issues and allow the parties to consult on matters of mutual concern with representatives of management who are authorised to take decisions on these matters.

V. Environment

Enterprises should, within the framework of laws, regulations and administrative practices in the countries in which they operate, and in consideration of relevant international agreements, principles, objectives, and standards, take due account of the need to protect the environment, public health and safety, and generally to conduct their activities in a manner contributing to the wider goal of sustainable development. In particular, enterprises should:

1. Establish and maintain a system of environmental management appropriate to the enterprise, including:
 - a) Collection and evaluation of adequate and timely information regarding the environmental, health, and safety impacts of their activities;
 - b) Establishment of measurable objectives and, where appropriate, targets for improved environmental performance, including periodically reviewing the continuing relevance of these objectives; and
 - c) Regular monitoring and verification of progress toward environmental, health, and safety objectives or targets.
2. Taking into account concerns about cost, business confidentiality, and the protection of intellectual property rights:
 - a) Provide the public and employees with adequate and timely information on the potential environment, health and safety impacts of the activities of the enterprise, which could include reporting on progress in improving environmental performance; and
 - b) Engage in adequate and timely communication and consultation with the communities directly affected by the environmental, health and safety policies of the enterprise and by their implementation.
3. Assess, and address in decision-making, the foreseeable environmental, health, and safety-related impacts associated with the processes, goods and services of the enterprise over their full life cycle. Where these proposed activities may have significant environmental, health, or safety impacts, and where they are subject to a decision of a competent authority, prepare an appropriate environmental impact assessment.

4. Consistent with the scientific and technical understanding of the risks, where there are threats of serious damage to the environment, taking also into account human health and safety, not use the lack of full scientific certainty as a reason for postponing cost-effective measures to prevent or minimise such damage.
5. Maintain contingency plans for preventing, mitigating, and controlling serious environmental and health damage from their operations, including accidents and emergencies; and mechanisms for immediate reporting to the competent authorities.
6. Continually seek to improve corporate environmental performance, by encouraging, where appropriate, such activities as:
 - a) Adoption of technologies and operating procedures in all parts of the enterprise that reflect standards concerning environmental performance in the best performing part of the enterprise;
 - b) Development and provision of products or services that have no undue environmental impacts; are safe in their intended use; are efficient in their consumption of energy and natural resources; can be reused, recycled, or disposed of safely;
 - c) Promoting higher levels of awareness among customers of the environmental implications of using the products and services of the enterprise; and
 - d) Research on ways of improving the environmental performance of the enterprise over the longer term.
7. Provide adequate education and training to employees in environmental health and safety matters, including the handling of hazardous materials and the prevention of environmental accidents, as well as more general environmental management areas, such as environmental impact assessment procedures, public relations, and environmental technologies.
8. Contribute to the development of environmentally meaningful and economically efficient public policy, for example, by means of partnerships or initiatives that will enhance environmental awareness and protection.

VI. Combating Bribery

Enterprises should not, directly or indirectly, offer, promise, give, or demand a bribe or other undue advantage to obtain or retain business or other improper advantage. Nor should enterprises be solicited or expected to render a bribe or other undue advantage. In particular, enterprises should:

1. Not offer, nor give in to demands, to pay public officials or the employees of business partners any portion of a contract payment. They should not use subcontracts, purchase orders or consulting agreements as means of channelling payments to public officials, to employees of business partners or to their relatives or business associates.
2. Ensure that remuneration of agents is appropriate and for legitimate services only. Where relevant, a list of agents employed in connection with transactions with public bodies and state-owned enterprises should be kept and made available to competent authorities.

3. Enhance the transparency of their activities in the fight against bribery and extortion. Measures could include making public commitments against bribery and extortion and disclosing the management systems the company has adopted in order to honour these commitments. The enterprise should also foster openness and dialogue with the public so as to promote its awareness of and co-operation with the fight against bribery and extortion.
4. Promote employee awareness of and compliance with company policies against bribery and extortion through appropriate dissemination of these policies and through training programmes and disciplinary procedures.
5. Adopt management control systems that discourage bribery and corrupt practices, and adopt financial and tax accounting and auditing practices that prevent the establishment of “off the books” or secret accounts or the creation of documents which do not properly and fairly record the transactions to which they relate.
6. Not make illegal contributions to candidates for public office or to political parties or to other political organisations. Contributions should fully comply with public disclosure requirements and should be reported to senior management.

VII. Consumer Interests

When dealing with consumers, enterprises should act in accordance with fair business, marketing and advertising practices and should take all reasonable steps to ensure the safety and quality of the goods or services they provide. In particular, they should:

1. Ensure that the goods or services they provide meet all agreed or legally required standards for consumer health and safety, including health warnings and product safety and information labels.
2. As appropriate to the goods or services, provide accurate and clear information regarding their content, safe use, maintenance, storage, and disposal sufficient to enable consumers to make informed decisions.
3. Provide transparent and effective procedures that address consumer complaints and contribute to fair and timely resolution of consumer disputes without undue cost or burden.
4. Not make representations or omissions, nor engage in any other practices, that are deceptive, misleading, fraudulent, or unfair.
5. Respect consumer privacy and provide protection for personal data.
6. Co-operate fully and in a transparent manner with public authorities in the prevention or removal of serious threats to public health and safety deriving from the consumption or use of their products.

VIII. Science and Technology

Enterprises should:

1. Endeavour to ensure that their activities are compatible with the science and technology (S&T) policies and plans of the countries in which they operate and as appropriate contribute to the development of local and national innovative capacity.
2. Adopt, where practicable in the course of their business activities, practices that permit the transfer and rapid diffusion of technologies and know-how, with due regard to the protection of intellectual property rights.
3. When appropriate, perform science and technology development work in host countries to address local market needs, as well as employ host country personnel in an S&T capacity and encourage their training, taking into account commercial needs.
4. When granting licenses for the use of intellectual property rights or when otherwise transferring technology, do so on reasonable terms and conditions and in a manner that contributes to the long term development prospects of the host country.
5. Where relevant to commercial objectives, develop ties with local universities, public research institutions, and participate in co-operative research projects with local industry or industry associations.

IX. Competition

Enterprises should, within the framework of applicable laws and regulations, conduct their activities in a competitive manner. In particular, enterprises should:

1. Refrain from entering into or carrying out anti-competitive agreements among competitors:
 - a) To fix prices;
 - b) To make rigged bids (collusive tenders);
 - c) To establish output restrictions or quotas; or
 - d) To share or divide markets by allocating customers, suppliers, territories or lines of commerce.
2. Conduct all of their activities in a manner consistent with all applicable competition laws, taking into account the applicability of the competition laws of jurisdictions whose economies would be likely to be harmed by anti-competitive activity on their part.
3. Co-operate with the competition authorities of such jurisdictions by, among other things and subject to applicable law and appropriate safeguards, providing as prompt and complete responses as practicable to requests for information.
4. Promote employee awareness of the importance of compliance with all applicable competition laws and policies.

X. Taxation

It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with the tax laws and regulations in all countries in which they operate and should exert every effort to act in accordance with both the letter and spirit of those laws and regulations. This would include such measures as providing to the relevant authorities the information necessary for the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle.

*Commentary on the Text*²⁵

Commentary on General Policies

1. The General Policies chapter of the *Guidelines* is the first to contain specific recommendations to enterprises. As such it is important for setting the tone and establishing common fundamental principles for the specific recommendations in subsequent chapters.

2. Obeying domestic law is the first obligation of business. The *Guidelines* are not a substitute for nor should they be considered to override local law and regulation. They represent supplementary principles and standards of behaviour of a non-legal character, particularly concerning the international operations of these enterprises. While the *Guidelines* extend beyond the law in many cases, they should not and are not intended to place an enterprise in a situation where it faces conflicting requirements.

3. Enterprises are encouraged to co-operate with governments in the development and implementation of policies and laws. Considering the views of other stakeholders in society, which includes the local community as well as business interests, can enrich this process. It is also recognised that governments should be transparent in their dealings with enterprises, and consult with business on these same issues. Enterprises should be viewed as partners with government in the development and use of both voluntary and regulatory approaches (of which the *Guidelines* are one element) to policies affecting them.

4. There should not be any contradiction between the activity of multinational enterprises (MNEs) and sustainable development, and the *Guidelines* are meant to foster complementarities in this regard. Indeed, links among economic, social, and environmental progress are a key means for furthering the goal of sustainable development.²⁶ On a related issue, while promoting and upholding

25. *Note by the Secretariat:* This commentary has been prepared by the Committee on International Investment and Multinational Enterprises to provide information on and explanation of the *Guidelines*. It is not part of the Declaration on International Investment and Multinational Enterprises or of the Council Decision on the *Guidelines for Multinational Enterprises*.

26. One of the most broadly accepted definitions of sustainable development is in the 1987 World Commission on Environment and Development (the Brundtland Commission): "Development that meets the needs of the present without compromising the ability of future generations to meet their own needs".

human rights is primarily the responsibility of governments, where corporate conduct and human rights intersect enterprises do play a role, and thus MNEs are encouraged to respect human rights, not only in their dealings with employees, but also with respect to others affected by their activities, in a manner that is consistent with host governments' international obligations and commitments. The Universal Declaration of Human Rights and other human rights obligations of the government concerned are of particular relevance in this regard.

5. The *Guidelines* also acknowledge and encourage the contribution that MNEs can make to local capacity building as a result of their activities in local communities. Similarly, the recommendation on human capital formation is an explicit and forward-looking recognition of the contribution to individual human development that MNEs can offer their employees, and encompasses not only hiring practices, but training and other employee development as well. Human capital formation also incorporates the notion of non-discrimination in hiring practices as well as promotion practices, life-long learning and other on-the-job training.

6. Governments recommend that, in general, enterprises avoid efforts to secure exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation and financial incentives among other issues, without infringing on an enterprise's right to seek changes in the statutory or regulatory framework. The words "or accepting" also draw attention to the role of the state in offering these exemptions. While this sort of provision has been traditionally directed at governments, it is also of direct relevance to MNEs. Importantly, however, there are instances where specific exemptions from laws or other policies can be consistent with these laws for legitimate public policy reasons. The environment and competition policy chapters are examples.

7. The paragraph devoted to the role of MNEs in corporate governance gives further impetus to the recently adopted OECD Principles of Corporate Governance. Although primary responsibility for improving the legal and institutional regulatory framework lies with governments, enterprises also have an interest in good governance.

8. An increasing network of non-governmental self-regulatory instruments and actions address aspects of corporate behaviour and the relationships between business and society. Enterprises recognise that their activities often have social and environmental implications. The institution of self-regulatory practices and management systems by enterprises sensitive to reaching these goals - thereby contributing to sustainable development - is an illustration of this. In turn, developing such practices can further constructive relationships between enterprises and the societies in which they operate.

9. Following from effective self-regulatory practices, as a matter of course, enterprises are expected to promote employee awareness of company policies. Safeguards to protect *bona fide* "whistle-blowing" activities are also recommended, including protection of employees who, in the absence of timely remedial action or in the face of reasonable risk of negative employment action, report practices that contravene the law to the competent public authorities. While of particular relevance to anti-bribery and environmental initiatives, such protection is also relevant to other recommendations in the *Guidelines*.

10. Encouraging, where practicable, compatible principles of corporate responsibility among business partners serves to combine a re-affirmation of the standards and principles embodied in the *Guidelines* with an acknowledgement of their importance to suppliers, contractors, subcontractors, licensees and other entities with which MNEs enjoy a working relationship. It is recognised that there are practical limitations to the ability of enterprises to influence the conduct of their business partners. The extent of these limitations depends on sectoral, enterprise and product characteristics such as the number of suppliers or other business partners, the structure and complexity of the supply chain and the market position of the enterprise vis-à-vis its suppliers or other business partners. The influence

enterprises may have on their suppliers or business partners is normally restricted to the category of products or services they are sourcing, rather than to the full range of activities of suppliers or business partners. Thus, the scope for influencing business partners and the supply chain is greater in some instances than in others. Established or direct business relationships are the major object of this recommendation rather than all individual or ad hoc contracts or transactions that are based solely on open market operations or client relationships. In cases where direct influence of business partners is not possible, the objective could be met by means of dissemination of general policy statements of the enterprise or membership in business federations that encourage business partners to apply principles of corporate conduct compatible with the Guidelines.

11. Finally, it is important to note that self-regulation and other initiatives in a similar vein, including the *Guidelines*, should not unlawfully restrict competition, nor should they be considered a substitute for effective law and regulation by governments. It is understood that MNEs should avoid potential trade or investment distorting effects of codes and self-regulatory practices when they are being developed.

Commentary on Disclosure

12. The purpose of this chapter is to encourage improved understanding of the operations of multinational enterprises. Clear and complete information on enterprises is important to a variety of users ranging from shareholders and the financial community to other constituencies such as employees, local communities, special interest groups, governments and society at large. To improve public understanding of enterprises and their interaction with society and the environment, enterprises should be transparent in their operations and responsive to the public's increasingly sophisticated demands for information. The information highlighted in this chapter may be a supplement to disclosure required under the national laws of the countries in which the enterprise operates.

13. This chapter addresses disclosure in two areas. The first set of disclosure recommendations is identical to disclosure items outlined in the *OECD Principles of Corporate Governance*. The *Principles* call for timely and accurate disclosure on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. Companies are also expected to disclose sufficient information on the remuneration of board members and key executives (either individually or in the aggregate) for investors to properly assess the costs and benefits of remuneration plans and the contribution of incentive schemes, such as stock option schemes, to performance. The *Principles* contain annotations that provide further guidance on the required disclosures and the recommendations in the *Guidelines* should be construed in relation to these annotations. They focus on publicly traded companies. To the extent that they are deemed applicable, they should also be a useful tool to improve corporate governance in non-traded enterprises; for example, privately held and state owned enterprises.

14. The *Guidelines* also encourage a second set of disclosure or communication practices in areas where reporting standards are still emerging such as, for example, social, environmental, and risk reporting. Many enterprises provide information on a broader set of topics than financial performance and consider disclosure of such information a method by which they can demonstrate a commitment to socially acceptable practices. In some cases, this second type of disclosure -- or communication with the public and with other parties directly affected by the firms' activities -- may pertain to entities that extend beyond those covered in the enterprises' financial accounts. For example, it may also cover information on the activities of subcontractors and suppliers or of joint venture partners.

15. Many enterprises have adopted measures designed to help them comply with the law and standards of business conduct, and to enhance the transparency of their operations. A growing number

of firms have issued voluntary codes of corporate conduct, which are expressions of commitments to ethical values in such areas as environment, labour standards or consumer protection. Specialised management systems are being developed with the aim of helping them respect these commitments -- these involve information systems, operating procedures and training requirements. Enterprises are co-operating with NGOs and intergovernmental organisations in developing reporting standards that enhance enterprises' ability to communicate how their activities influence sustainable development outcomes (e.g. the Global Reporting Initiative).

16. The *OECD Principles of Corporate Governance* support the development of high quality internationally recognised standards of accounting, financial and non-financial disclosure, and audit, which can serve to improve the comparability of information among countries. Financial audits conducted by independent auditors provide external and objective assurance on the way in which financial statements have been prepared and presented. The transparency and effectiveness of non-financial disclosure may be enhanced by independent verification. Techniques for independent verification of non-financial disclosure are emerging.

17. Enterprises are encouraged to provide easy and economical access to published information and to consider making use of information technologies to meet this goal. Information that is made available to users in home markets should also be available to all interested users. Enterprises may take special steps to make information available to communities that do not have access to printed media (e.g. poorer communities that are directly affected by the enterprise's activities).

18. Disclosure requirements are not expected to place unreasonable administrative or cost burdens on enterprises. Nor are enterprises expected to disclose information that may endanger their competitive position unless disclosure is necessary to fully inform the investment decision and to avoid misleading the investor.

Commentary on Employment and Industrial Relations

19. This chapter opens with a chapeau that includes a reference to "applicable" law and regulations, which is meant to acknowledge the fact that multinational enterprises, while operating within the jurisdiction of particular countries, may be subject to *national*, *sub-national*, as well as *supra-national* levels of regulation of employment and industrial relations matters. The terms "prevailing labour relations" and "employment practices" are sufficiently broad to permit a variety of interpretations in light of different national circumstances - for example, different bargaining options provided for employees under national laws and regulations.

20. The International Labour Organisation (ILO) is the competent body to set and deal with international labour standards, and to promote fundamental rights at work as recognised in its 1998 Declaration on Fundamental Principles and Rights at Work. The *Guidelines*, as a non-binding instrument, have a role to play in promoting observance of these standards and principles among multinational enterprises. The provisions of the *Guidelines* chapter echo relevant provisions of the 1998 Declaration, as well as the ILO's 1977 Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. The Tripartite Declaration sets out principles in the fields of employment, training, working conditions, and industrial relations, while the OECD Guidelines cover all major aspects of corporate behaviour. The OECD Guidelines and the ILO Tripartite Declaration refer to the behaviour expected from enterprises and are intended to parallel and not conflict with each other. The ILO Tripartite Declaration can therefore be of use in understanding the *Guidelines* to the extent that it is of a greater degree of elaboration. However, the responsibilities for the follow-up procedures under the Tripartite Declaration and the *Guidelines* are institutionally separate.

21. The first paragraph of this chapter is designed to echo all four fundamental principles and rights at work which are contained in the ILO's 1998 Declaration, namely the freedom of association and right to collective bargaining, the effective abolition of child labour, the elimination of all forms of forced or compulsory labour, and non-discrimination in employment and occupation. These principles and rights have been developed in the form of specific rights and obligations in ILO Conventions recognised as fundamental.

22. The chapter recommends that multinational enterprises contribute to the effective abolition of child labour in the sense of the ILO 1998 Declaration and ILO Convention 182 concerning the worst forms of child labour. Long-standing ILO instruments on child labour are Convention 138 and Recommendation 146 (both adopted in 1973) concerning minimum ages for employment. Through their labour management practices, their creation of high quality, well paid jobs and their contribution to economic growth, multinational enterprises can play a positive role in helping to address the root causes of poverty in general and of child labour in particular. It is important to acknowledge and encourage the role of multinational enterprises in contributing to the search for a lasting solution to the problem of child labour. In this regard, raising the standards of education of children living in host countries is especially noteworthy.

23. The chapter also recommends that enterprises contribute to the elimination of all forms of compulsory labour, another principle derived from the 1998 ILO Declaration. The reference to this core labour right is based on the ILO Conventions 29 of 1930 and 105 of 1957. C. 29 requests that governments "suppress the use of forced or compulsory labour in all its forms within the shortest possible period", while C. 105 requests of them to "suppress and not to make use of any form of forced or compulsory labour" for certain enumerated purposes (e.g. as a means of political coercion or labour discipline), and "to take effective measures to secure [its] immediate and complete abolition". At the same time, it is understood that the ILO is the competent body to deal with the difficult issue of prison labour, in particular when it comes to the hiring-out of prisoners to (or their placing at the disposal of) private individuals, companies or associations.

24. The principle of non-discrimination with respect to employment and occupation is considered to apply to such terms and conditions as hiring, discharge, pay, promotion, training and retirement. The list of non-permissible grounds for discrimination which is taken from ILO Convention 111 of 1958 considers that any distinction, exclusion or preference on these grounds is in violation of the Convention. At the same time, the text makes clear that the terms do not constitute an exhaustive list. Consistent with the provisions in paragraph 1d), enterprises are expected to promote equal opportunities for women and men with special emphasis on equal criteria for selection, remuneration, and promotion, and equal application of those criteria, and prevent discrimination or dismissals on the grounds of marriage, pregnancy or parenthood.

25. The reference to consultative forms of employee participation in paragraph two of the *Guidelines* is taken from ILO Recommendation 94 of 1952 concerning Consultation and Co-operation between Employers and Workers at the Level of the Undertaking. It also conforms to a provision contained in the 1977 ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. Such consultative arrangements should not substitute for employees' right to bargain over terms and conditions of employment. A recommendation on consultative arrangements with respect to employment arrangements is also part of paragraph eight.

26. In paragraph three of this chapter, information provided by companies to their employees is expected to provide a "true and fair view" of performance. It relates to the following: the structure of the enterprise, its economic and financial situation and prospects, employment trends, and expected substantial changes in operations, taking into account legitimate requirements of business

confidentiality. Considerations of business confidentiality may mean that information on certain points may not be provided, or may not be provided without safeguards.

27. In paragraph four, employment and industrial relations standards are understood to include compensation and working-time arrangements. The reference to occupational health and safety implies that MNEs are expected to follow prevailing regulatory standards and industry norms to minimise the risk of accidents and injury to health arising out of, linked with, or occurring in, the course of employment. This encourages enterprises to work to raise the level of performance with respect to occupational health and safety in all parts of their operation even where this may not be formally required by existing regulations in countries in which they operate. It also encourages enterprises to respect employees' ability to remove themselves from a work situation when there is reasonable justification to believe that it presents an imminent and serious risk to health or safety. Reflecting their importance and complementarities among related recommendations, health and safety concerns are echoed elsewhere in the *Guidelines*, most notably in chapters on Consumer Interests and the Environment.

28. The recommendation in paragraph five of the chapter encourages MNEs to recruit an adequate workforce share locally, including managerial personnel, and to provide training to them. Language in this paragraph on training and skill levels complements the text in paragraph four of the General Policies chapter on encouraging human capital formation. The reference to local personnel complements the text encouraging local capacity building in paragraph three of the General Policies chapter.

29. Paragraph six recommends that enterprises provide reasonable notice to the representatives of employees and relevant government authorities, of changes in their operations which would have major effects upon the livelihood of their employees, in particular the closure of an entity involving collective layoffs or dismissals. As stated therein, the purpose of this provision is to afford an opportunity for co-operation to mitigate the effects of such changes. This is an important principle that is widely reflected in the industrial relations laws and practices of adhering countries, although the approaches taken to ensuring an opportunity for meaningful co-operation are not identical in all adhering countries. The paragraph also notes that it would be appropriate if, in light of specific circumstances, management were able to give such notice prior to the final decision. Indeed, notice prior to the final decision is a feature of industrial relations laws and practices in a number of adhering countries. However, it is not the only means to ensure an opportunity for meaningful co-operation to mitigate the effects of such decisions, and the laws and practices of other adhering countries provide for other means such as defined periods during which consultations must be undertaken before decisions may be implemented.

Commentary on the Environment

30. The text of the Environment Chapter broadly reflects the *principles* and objectives contained in the Rio Declaration on Environment and Development, in Agenda 21 (within the Rio Declaration). It also takes into account the (Aarhus) Convention on Access to Information, Public Participation in Decision-making, and Access to Justice in Environmental Matters and reflects *standards* contained in such instruments as the ISO Standard on Environmental Management Systems.

31. Sound environmental management is an important part of sustainable development, and is increasingly being seen as both a business responsibility and a business *opportunity*. Multinational enterprises have a role to play in both respects. Managers of these enterprises should therefore give appropriate attention to environmental issues within their business strategies. Improving environmental performance requires a commitment to a systematic approach and to continual

improvement of the system. An environmental management system provides the internal framework necessary to control an enterprise's environmental impacts and to integrate environmental considerations into business operations. Having such a system in place should help to assure stockholders, employees and the community that the enterprise is actively working to protect the environment from the impacts of its activities.

32. In addition to improving environmental performance, instituting an environmental management system can provide economic benefits to companies through reduced operating and insurance costs, improved energy and resource conservation, reduced compliance and liability charges, improved access to capital, improved customer satisfaction, and improved community and public relations.

33. In the context of these *Guidelines*, "sound environmental management" should be interpreted in its broadest sense, embodying activities aimed at controlling both direct and indirect environmental impacts of enterprise activities over the long-term, and involving both pollution control and resource management elements.

34. In most enterprises, an internal control system is needed to manage the enterprise's activities. The environmental part of this system may include such elements as targets for improved performance and regular monitoring of progress towards these targets.

35. Information about the activities of enterprises and associated environmental impacts is an important vehicle for building confidence with the public. This vehicle is most effective when information is provided in a transparent manner and when it encourages active consultation with stakeholders such as employees, customers, suppliers, contractors, local communities and with the public-at-large so as to promote a climate of long-term trust and understanding on environmental issues of mutual interest

36. Normal business activity can involve the ex ante assessment of the potential environmental impacts associated with the enterprise's activities. Enterprises often carry out appropriate environmental impact assessments, even if they are not required by law. Environmental assessments made by the enterprise may contain a broad and forward-looking view of the potential impacts of an enterprise's activities, addressing relevant impacts and examining alternatives and mitigation measures to avoid or redress adverse impacts. The *Guidelines* also recognise that multinational enterprises have certain responsibilities in other parts of the product life cycle.

37. Several instruments already adopted by countries adhering to the *Guidelines*, including Principle 15 of the Rio Declaration on Environment and Development, enunciate a "precautionary approach". None of these instruments is explicitly addressed to enterprises, although enterprise contributions are implicit in all of them.

38. The basic premise of the *Guidelines* is that enterprises should act as soon as possible, and in a proactive way, to avoid, for instance, serious or irreversible environmental damages resulting from their activities. However, the fact that the *Guidelines* are addressed to enterprises means that no existing instrument is completely adequate for expressing this recommendation. The *Guidelines* therefore draw upon, but do not completely mirror, any existing instrument.

39. The *Guidelines* are not intended to reinterpret any existing instruments or to create new commitments or precedents on the part of governments -- they are intended only to recommend how the precautionary approach should be implemented at the level of enterprises. Given the early stage of this process, it is recognised that some flexibility is needed in its application, based on the specific context in which it is carried out. It is also recognised that governments determine the basic

framework in this field, and have the responsibility to periodically consult with stakeholders on the most appropriate ways forward.

40. The *Guidelines* also encourage enterprises to work to raise the level of environmental performance in all parts of their operations, even where this may not be formally required by existing practice in the countries in which they operate.

41. For example, multinational enterprises often have access to technologies or operating procedures which could, if applied, help raise environmental performance overall. Multinational enterprises are frequently regarded as leaders in their respective fields, so the potential for a “demonstration effect” on other enterprises should not be overlooked. Ensuring that the environment of the countries in which multinational enterprises operate also benefits from available technologies is an important way of building support for international investment activities more generally.

42. Enterprises have an important role to play in the training and education of their employees with regard to environmental matters. They are encouraged to discharge this responsibility in as broad a manner as possible, especially in areas directly related to human health and safety.

Commentary on Combating Bribery

43. Bribery and corruption are not only damaging to democratic institutions and the governance of corporations, but they also impede efforts to reduce poverty. In particular, the diversion of funds through corrupt practices undermines attempts by citizens to achieve higher levels of economic, social and environmental welfare. Enterprises have an important role to play in combating these practices.

44. Progress in improving the policy framework and in heightening enterprises’ awareness of bribery as a management issue has been significant. The OECD *Convention of Combating Bribery of Foreign Public Officials* (the *Convention*) has been signed by 34 countries and entered into force on 15 February 1999. The *Convention*, along with the 1997 revised *Recommendation on Combating Bribery in International Business Transactions* and the 1996 *Recommendation on the Tax Deductibility of Bribes to Foreign Public Officials*, are the core instruments through which members of the anti bribery group co-operate to stop the flow of bribes for the purpose of obtaining or retaining international business. The three instruments target the offering side of the bribery transaction. They aim to eliminate the “supply” of bribes to foreign public officials, with each country taking responsibility for the activities of its companies and what happens on its own territory²⁷. A monitoring programme has been established to assure effective and consistent implementation and enforcement of the *Convention*.

27. For the purposes of the *Convention*, a “bribe” is defined as an “...offer, promise, or giv(ing) of any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.” The Commentaries to the *Convention* (paragraph 9) clarify that “(s)mall ‘facilitation’ payments do not constitute payments made ‘to obtain or retain business or other improper advantage’ within the meaning of paragraph 1 and, accordingly, are also not an offence. Such payments, which, in some countries, are made to induce public officials to perform their functions, such as issuing licenses or permits, are generally illegal in the foreign country concerned. Other countries can and should address this corrosive phenomenon by such means as support for programmes of good governance.”

45. To address the demand side of bribery, good governance practices are important elements to prevent companies from being asked to pay bribes. In addition, governments should assist companies confronted with solicitation of bribes.

46. Another important development has been the International Chamber of Commerce's recent update of its *Report on Extortion and Bribery in Business Transactions*. The *Report* contains recommendations to governments and international organisations on combating extortion and bribery as well as a code of conduct for enterprises that focuses on these issues.

47. Transparency in both the public and private domains is a key concept in the fight against bribery and extortion. The business community, non-governmental organisations and governments and inter-governmental organisations have all co-operated to strengthen public support for anti-corruption measures and to enhance transparency and public awareness of the problems of corruption and bribery. The adoption of appropriate corporate governance practices is a complementary element in fostering a culture of ethics within the enterprise.

Commentary on Consumer Interests

48. A brief reference to "consumer interests" was first introduced into the *Guidelines* in 1984, to reflect increasingly international aspects of consumer policies and the impact that the expansion of international trade, product packaging, marketing and sales and product safety can have on those policies. Since that time, the development of electronic commerce and the increased globalisation of the marketplace have substantially increased the reach of MNEs and consumer access to their goods and services. In recognition of the increasing importance of consumer issues, a substantial percentage of enterprises, in their management systems and codes of conduct include references to consumer interests and protections.

49. In light of these changes, and with an eye to helping enhance consumer safety and health, a chapter on *consumer interests* has been added to the *Guidelines* as a result of the current Review. Language in this chapter draws on the work of the OECD Committee on Consumer Policy, as well as that embodied in various individual and international corporate codes (such as those of the ICC), the UN Guidelines on Consumer Policy, and the OECD Guidelines for Consumer Protection in the Context of Electronic Commerce.

50. A variety of consumer protection laws exist that govern business practices. The emerging framework is intended to both protect consumer interests and foster economic growth and places a growing emphasis on the use of self-regulatory mechanisms. As noted, many existing national and international corporate codes of conduct include a reference to some aspect of consumer protection and amplify the commitment of industry to help protect health and safety and build consumer confidence in the marketplace. Ensuring that these sorts of practices provide consumers with effective and transparent protection is essential to help build trust that encourages consumer participation and market growth.

51. The emphasis on alternative dispute resolution in paragraph 3 of the chapter is an attempt to focus on what may in many cases be a more practicable solution to complaints than legal action which can be expensive, difficult and time consuming for everyone involved. It is particularly important that complaints relating to the consumption or use of a particular product that results in serious risks or damages to public health should be resolved in a fair and timely manner without undue cost or burden to the consumer.

52. Regarding paragraph 5, enterprises could look to the OECD Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data as a helpful basis for protecting personal data.

Commentary on Science and Technology

53. In a knowledge-based and globalised economy where national borders matter less, even for small or domestically oriented enterprises, the ability to access and utilise technology and know-how is essential for improving firm performance. Such access is also important for the realisation of the economy-wide effects of technological progress, including productivity growth and job creation, within the context of sustainable development. Multinational enterprises are the main conduit of technology transfer across borders. They contribute to the national innovative capacity of their host countries by generating, diffusing, and even enabling the use of new technologies by domestic enterprises and institutions. The R&D activities of MNEs, when well connected to the national innovation system, can help enhance the economic and social progress in their host countries. In turn, the development of a dynamic innovation system in the host country expands commercial opportunities for MNEs.

54. The chapter thus aims to promote, within the limits of economic feasibility, competitiveness concerns and other considerations, the diffusion by multinational enterprises of the fruits of research and development activities among the countries where they operate, contributing thereby to the innovative capacities of host countries. In this regard, fostering technology diffusion can include the commercialisation of products which imbed new technologies, licensing of process innovations, hiring and training of S&T personnel and development of R&D co-operative ventures. When selling or licensing technologies, not only should the terms and conditions negotiated be reasonable, but MNEs may want to consider the long-term developmental, environmental and other impacts of technologies for the home and host country. In their activities, multinational enterprises can establish and improve the innovative capacity of their international subsidiaries and subcontractors. In addition, MNEs can call attention to the importance of local scientific and technological infrastructure, both physical and institutional. In this regard, MNEs can usefully contribute to the formulation by host country governments of policy frameworks conducive to the development of dynamic innovation systems.

Commentary on Competition

55. These *Guidelines* are intended to emphasise the importance of competition laws and policies to the efficient operation of both domestic and international markets, to reaffirm the importance of compliance with those laws and policies by domestic and multinational enterprises, and to ensure that all enterprises are aware of developments concerning the number, scope, and severity of competition laws and in the extent of co-operation among competition authorities. The term “competition” law is used to refer to laws, including both “antitrust” and “antimonopoly” laws, that prohibit collective or unilateral action to (a) abuse market power or dominance, (b) acquire market power or dominance by means other than efficient performance, or (c) engage in anti-competitive agreements.

56. In general, competition laws and policies prohibit (a) hard core cartels; (b) other agreements that are deemed to be anti-competitive; (c) conduct that exploits or extends market dominance or market power; and (d) anti-competitive mergers and acquisitions. Under the 1998 Recommendation of the OECD Council Concerning Effective Action Against Hard Core Cartels, C(98)35/Final, the anti-competitive agreements referred to in sub (a) constitute hard core cartels, but the Recommendation incorporates differences in Member countries’ laws, including differences in the laws’ exemptions or provisions allowing for an exception or authorisation for activity that might

otherwise be prohibited. These guidelines should not be interpreted as suggesting that enterprises should not avail themselves of such exemptions or provisions. The categories sub (b) and (c) are more general because the effects of other kinds of agreements and of unilateral conduct are more ambiguous, and there is less consensus on what should be considered anti-competitive.

57. The goal of competition policy is to contribute to overall social welfare and economic growth by creating and maintaining market conditions in which the nature, quality, and price of goods and services are determined by market forces except to the extent a jurisdiction considers necessary to achieve other goals. In addition to benefiting consumers and a jurisdiction's economy as a whole, such a competitive environment rewards enterprises that respond efficiently to consumer demand, and enterprises should provide information and advice when governments are considering laws and policies that might reduce their efficiency or otherwise affect the competitiveness of markets. .

58. Enterprises should be aware that competition laws are being enacted in a rapidly increasing number of jurisdictions, and that it is increasingly common for those laws to prohibit anti-competitive activities that occur abroad if they have a harmful impact on domestic consumers. Moreover, the growth of cross-border trade and investment makes it more likely that anti-competitive conduct taking place in one jurisdiction will have harmful effects in other jurisdictions. As a result, anti-competitive unilateral or concerted conduct that is or may be legal where it occurs is increasingly likely to be illegal in another jurisdiction. Enterprises should therefore take into account both the law of the country in which they are operating and the laws of all countries in which the effects of their conduct are likely to be felt.

59. Finally, enterprises should understand that competition authorities are engaging in more and deeper co-operation in investigating and challenging anti-competitive activity. *See generally:* Recommendation of the Council Concerning Co-operation between Member Countries on Anticompetitive Practices Affecting International Trade, C(95)130/Final; *Making International Markets More Efficient Through "Positive Comity" in Competition Law Enforcement*, Report of the OECD Committee on Competition Law and Policy, DAF/CLP(99)19. When the competition authorities of various jurisdictions are reviewing the same conduct, enterprises' facilitation of co-operation among the authorities promotes consistent and sound decision-making while also permitting cost savings for governments and enterprises.

Commentary on Taxation

60. Corporate citizenship in the area of taxation implies that enterprises should comply with the taxation laws and regulations in all countries in which they operate, co-operate with authorities and make certain kinds of information available to them. However, this commitment to provide information is not without limitation. In particular, the *Guidelines* make a link between the information that should be provided and its relevance to the enforcement of applicable tax laws. This recognises the need to balance the burden on business in complying with applicable tax laws and the need for tax authorities to have the complete, timely and accurate information to enable them to enforce their tax laws.

61. A member of an MNE group in one country may have extensive economic relationships with members of the same MNE group in other countries. Such relationships may affect the tax liability of each of the parties. Accordingly, tax authorities may need information from outside their jurisdiction in order to be able to evaluate those relationships and determine the tax liability of the member of the MNE group in their jurisdiction. Again, the information to be provided is limited to that which is relevant to the proposed evaluation of those economic relationships for the purpose of determining the

correct tax liability of the member of the MNE group. MNEs should co-operate in providing that information.

62. Transfer pricing is another important issue for corporate citizenship and taxation. The dramatic increase in global trade and cross-border direct investment (and the important role played in such trade and investment by MNEs) has meant that transfer pricing tends now to be a significant determinant of the tax liabilities of members of an MNE group. It is recognised that determining whether transfer pricing respects the arm's length standard (or principle) is often difficult both for MNEs and for tax administrations.

63. The Committee on Fiscal Affairs (CFA) of the OECD undertakes ongoing work to develop recommendations for ensuring transfer pricing reflects the arm's length principle. Its work resulted in the publication in 1995 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Transfer Pricing Guidelines) which was the subject of the Recommendation of the OECD Council on the Determination of Transfer Pricing between Associated Enterprises (members of an MNE group would normally fall within the definition of Associated Enterprises).

64. The OECD Transfer Pricing Guidelines focus on the application of the arm's length principle to evaluate the transfer pricing of associated enterprises. The Transfer Pricing Guidelines aim to help tax administrations (of both OECD Member countries and non-Member countries) and MNEs by indicating mutually satisfactory solutions to transfer pricing cases, thereby minimising conflict among tax administrations and between tax administrations and MNEs and avoiding costly litigation. MNEs are encouraged to follow the guidance in the OECD Transfer Pricing Guidelines, as amended and supplemented, in order to ensure that their transfer prices reflect the arm's length principle.

Implementation Procedures

Decision of the OECD Council on the OECD Guidelines for Multinational Enterprises

June 2000

THE COUNCIL,

Having regard to the Convention on the Organisation for Economic Co-operation and Development of 14th December 1960;

Having regard to the OECD Declaration on International Investment and Multinational Enterprises (the “Declaration”), in which the Governments of adhering countries (“adhering countries”) jointly recommend to multinational enterprises operating in or from their territories the observance of Guidelines for Multinational Enterprises (the “Guidelines”);

Recognising that, since operations of multinational enterprises extend throughout the world, international co-operation on issues relating to the Declaration should extend to all countries;

Having regard to the Terms of Reference of the Committee on International Investment and Multinational Enterprises, in particular with respect to its responsibilities for the Declaration [C(84)171(Final), renewed in C/M(95)21];

Considering the Report on the First Review of the 1976 Declaration [C(79)102(Final)], the Report on the Second Review of the Declaration [C/MIN(84)5(Final)], the Report on the 1991 Review of the Declaration [DAFFE/IME(91)23], and the Report on the 2000 Review of the Guidelines [C(2000)96];

Having regard to the Second Revised Decision of the Council of June 1984 [C(84)90], amended June 1991 [C/MIN(91)7/ANN1];

Considering it desirable to enhance procedures by which consultations may take place on matters covered by these Guidelines and to promote the effectiveness of the Guidelines;

On the proposal of the Committee on International Investment and Multinational Enterprises:

DECIDES:

To repeal the Second Revised Decision of the Council of June 1984 [C(84)90], amended June 1991 [C/MIN(91)7/ANN1], and replace it with the following:

I. National Contact Points

1. Adhering countries shall set up National Contact Points for undertaking promotional activities, handling inquiries and for discussions with the parties concerned on all matters covered by the Guidelines so that they can contribute to the solution of problems which may arise in this connection, taking due account of the attached procedural guidance. The business community, employee organisations, and other interested parties shall be informed of the availability of such facilities.
2. National Contact Points in different countries shall co-operate if such need arises, on any matter related to the Guidelines relevant to their activities. As a general procedure, discussions at the national level should be initiated before contacts with other National Contact Points are undertaken.
3. National Contact Points shall meet annually to share experiences and report to the Committee on International Investment and Multinational Enterprises.

II. The Committee on International Investment and Multinational Enterprises

1. The Committee on International Investment and Multinational Enterprises (“CIME” or “the Committee”) shall periodically or at the request of an adhering country hold exchanges of views on matters covered by the Guidelines and the experience gained in their application.
2. The Committee shall periodically invite the Business and Industry Advisory Committee to the OECD (BIAC), and the Trade Union Advisory Committee to the OECD (TUAC) (the “advisory bodies”), as well as other non-governmental organisations to express their views on matters covered by the Guidelines. In addition, exchanges of views with the advisory bodies on these matters may be held at their request.
3. The Committee may decide to hold exchanges of views on matters covered by the Guidelines with representatives of non-adhering countries.
4. The Committee shall be responsible for clarification of the Guidelines. Clarification will be provided as required. If it so wishes, an individual enterprise will be given the opportunity to express its views either orally or in writing on issues concerning the Guidelines involving its interests. The Committee shall not reach conclusions on the conduct of individual enterprises.
5. The Committee shall hold exchanges of views on the activities of National Contact Points with a view to enhancing the effectiveness of the Guidelines.
6. In fulfilling its responsibilities for the effective functioning of the Guidelines, the Committee shall take due account of the attached procedural guidance.
7. The Committee shall periodically report to the Council on matters covered by the Guidelines. In its reports, the Committee shall take account of reports by National Contact Points, the views

expressed by the advisory bodies, and the views of other non-governmental organisations and non-adhering countries as appropriate.

III. Review of the Decision

This Decision shall be periodically reviewed. The Committee shall make proposals for this purpose.

* * *

Procedural Guidance

I. National Contact Points

The role of National Contact Points (NCP) is to further the effectiveness of the Guidelines. NCPs will operate in accordance with core criteria of visibility, accessibility, transparency and accountability to further the objective of functional equivalence.

A. Institutional Arrangements

Consistent with the objective of functional equivalence, adhering countries have flexibility in organising their NCPs, seeking the active support of social partners, including the business community, employee organisations, and other interested parties, which includes non-governmental organisations.

Accordingly, the National Contact Point:

1. May be a senior government official or a government office headed by a senior official. Alternatively, the National Contact Point may be organised as a co-operative body, including representatives of other government agencies. Representatives of the business community, employee organisations and other interested parties may also be included.
2. Will develop and maintain relations with representatives of the business community, employee organisations and other interested parties that are able to contribute to the effective functioning of the Guidelines.

B. Information and Promotion

National Contact Points will:

1. Make the Guidelines known and available by appropriate means, including through on-line information, and in national languages. Prospective investors (inward and outward) should be informed about the Guidelines, as appropriate.
2. Raise awareness of the Guidelines, including through co-operation, as appropriate, with the business community, employee organisations, other non-governmental organisations, and the interested public.

3. Respond to enquiries about the Guidelines from:
 - (a) Other National Contact Points;
 - (b) The business community, employee organisations, other non-governmental organisations and the public; and
 - (c) Governments of non-adhering countries.

C Implementation in Specific Instances

The NCP will contribute to the resolution of issues that arise relating to implementation of the Guidelines in specific instances. The NCP will offer a forum for discussion and assist the business community, employee organisations and other parties concerned to deal with the issues raised in an efficient and timely manner and in accordance with applicable law. In providing this assistance, the NCP will:

1. Make an initial assessment of whether the issues raised merit further examination and respond to the party or parties raising them.
2. Where the issues raised merit further examination, offer good offices to help the parties involved to resolve the issues. For this purpose, the NCP will consult with these parties and where relevant:
 - (a) Seek advice from relevant authorities, and/or representatives of the business community, employee organisations, other non-governmental organisations, and relevant experts;
 - (b) Consult the National Contact Point in the other country or countries concerned;
 - (c) Seek the guidance of the CIME if it has doubt about the interpretation of the Guidelines in particular circumstances;
 - (d) Offer, and with the agreement of the parties involved, facilitate access to consensual and non-adversarial means, such as conciliation or mediation, to assist in dealing with the issues.
3. If the parties involved do not reach agreement on the issues raised, issue a statement, and make recommendations as appropriate, on the implementation of the Guidelines.
4.
 - (a) In order to facilitate resolution of the issues raised, take appropriate steps to protect sensitive business and other information. While the procedures under paragraph 2 are underway, confidentiality of the proceedings will be maintained. At the conclusion of the procedures, if the parties involved have not agreed on a resolution of the issues raised, they are free to communicate about and discuss these issues. However, information and views provided during the proceedings by another party involved will remain confidential, unless that other party agrees to their disclosure.
 - (b) After consultation with the parties involved, make publicly available the results of these procedures unless preserving confidentiality would be in the best interests of effective implementation of the Guidelines.

5. If issues arise in non-adhering countries, take steps to develop an understanding of the issues involved, and follow these procedures where relevant and practicable.

D. Reporting

1. Each National Contact Point will report annually to the Committee.
2. Reports should contain information on the nature and results of the activities of the National Contact Point, including implementation activities in specific instances.

II. Committee on International Investment and Multinational Enterprises

1. The Committee will discharge its responsibilities in an efficient and timely manner.
2. The Committee will consider requests from NCPs for assistance in carrying out their activities, including in the event of doubt about the interpretation of the Guidelines in particular circumstances.
3. The Committee will:
 - (a) Consider the reports of NCPs.
 - (b) Consider a substantiated submission by an adhering country or an advisory body on whether an NCP is fulfilling its responsibilities with regard to its handling of specific instances.
 - (c) Consider issuing a clarification where an adhering country or an advisory body makes a substantiated submission on whether an NCP has correctly interpreted the Guidelines in specific instances.
 - (d) Make recommendations, as necessary, to improve the functioning of NCPs and the effective implementation of the Guidelines.
4. The Committee may seek and consider advice from experts on any matters covered by the Guidelines. For this purpose, the Committee will decide on suitable procedures.

*Commentary on the Implementation Procedures*²⁸

1. The Council Decision represents the commitment of adhering countries to further the implementation of the recommendations contained in the text of the *Guidelines*. Procedural guidance for both NCPs and the CIME is attached to the Council Decision.

2. The Council Decision sets out key adhering country responsibilities for the *Guidelines* with respect to NCPs, summarised as follows:

- Setting up NCPs (which will take due account of the procedural guidance attached to the Decision), and informing interested parties of the availability of *Guidelines*-related facilities.
- NCPs in different countries to co-operate with each other as necessary.
- NCPs to meet annually and report to the CIME.

3. The Council Decision also establishes CIME's responsibilities for the *Guidelines*, including:

- Organising exchanges of views on matters relating to the *Guidelines*
- Issuing clarifications as necessary
- Holding exchanges of views on the activities of NCPs
- Reporting to the OECD Council on the *Guidelines*

4. CIME is the OECD body responsible for overseeing the functioning of the *Guidelines*. This responsibility applies not only to the *Guidelines*, but to all elements of the Declaration (National Treatment Instrument, and the instruments on International Investment Incentives and Disincentives, and Conflicting Requirements). In the Declaration, CIME seeks to ensure that each element is respected and understood, and that they all complement and operate in harmony with each other.

5. Reflecting the increasing relevance of the *Guidelines* to countries outside the OECD, the Decision provides for consultations with non-adhering countries on matters covered by the *Guidelines*. This provision allows CIME to arrange periodic meetings with groups of countries interested in *Guidelines* issues, or to arrange contacts with individual countries if the need arises. These meetings and contacts could deal with experiences in the overall functioning of the *Guidelines* or with specific issues. Further guidance concerning CIME and NCP interaction with non-adhering countries is provided in the Procedural Guidance attached to the Decision.

I. Procedural Guidance for NCPs

6. National Contact Points have an important role in enhancing the profile and effectiveness of the *Guidelines*. While it is enterprises that are responsible for observing the *Guidelines* in their day-to-day behaviour, governments can contribute to improving the effectiveness of the implementation

28. *Note by the Secretariat:* This commentary has been prepared by the Committee on International Investment and Multinational Enterprises to provide information on and explanation of the *Guidelines*. It is not part of the Declaration on International Investment and Multinational Enterprises or of the Council Decision on the *Guidelines for Multinational Enterprises*.

procedures. To this end, they have agreed that better guidance for the conduct and activities of NCPs is warranted, including through annual meetings and CIME oversight.

7. Many of the functions in the Procedural Guidance of the Decision are not new, but reflect experience and recommendations developed over the years (e.g. the 1984 Review Report C/MIN(84)5(Final)). By making them explicit the expected functioning of the implementation mechanisms of the *Guidelines* is made more transparent. All functions are now outlined in four parts of the Procedural Guidance pertaining to NCPs: institutional arrangements, information and promotion, implementation in specific instances, and reporting.

8. These four parts are preceded by an introductory paragraph that sets out the basic purpose of NCPs, together with core criteria to promote the concept of “functional equivalence”. Since governments are accorded flexibility in the way they organise NCPs, NCPs should function in a visible, accessible, transparent, and accountable manner. These criteria will guide NCPs in carrying out their activities and will also assist the CIME in discussing the conduct of NCPs.

Core Criteria for Functional Equivalence in the Activities of NCPs

Visibility. In conformity with the Decision, adhering governments agree to nominate National Contact Points, and also to inform the business community, employee organisations and other interested parties, including NGOs, about the availability of facilities associated with NCPs in the implementation of the *Guidelines*. Governments are expected to publish information about their contact points and to take an active role in promoting the *Guidelines*, which could include hosting seminars and meetings on the instrument. These events could be arranged in co-operation with business, labour, NGOs, and other interested parties, though not necessarily with all groups on each occasion.

Accessibility. Easy access to NCPs is important to their effective functioning. This includes facilitating access by business, labour, NGOs, and other members of the public. Electronic communications can also assist in this regard. NCPs would respond to all legitimate requests for information, and also undertake to deal with specific issues raised by parties concerned in an efficient and timely manner.

Transparency. Transparency is an important criterion with respect to its contribution to the accountability of the NCP and in gaining the confidence of the general public. Thus most of the activities of the NCP will be transparent. Nonetheless when the NCP offers its “good offices” in implementing the *Guidelines* in specific instances, it will be in the interests of their effectiveness to take appropriate steps to establish confidentiality of the proceedings. Outcomes will be transparent unless preserving confidentiality is in the best interests of effective implementation of the *Guidelines*.

Accountability. A more active role with respect to enhancing the profile of the *Guidelines* -- and their potential to aid in the management of difficult issues between enterprises and the societies in which they operate -- will also put the activities of NCPs in the public eye. Nationally, parliaments could have a role to play. Annual reports and annual meetings of NCPs will provide an opportunity to share experiences and encourage “best practices” with respect to NCPs. CIME will also hold exchanges of views, where experiences would be exchanged and the effectiveness of the activities of NCPs could be assessed.

Institutional Arrangements

9. The composition of NCPs should be such that they provide an effective basis for dealing with the broad range of issues covered by the *Guidelines*. Different forms of organisation (e.g. representatives from one Ministry, an interagency group, or one that contained representatives from non-governmental bodies) are possible. It may be helpful for the NCP to be headed by a senior official. NCP leadership should be such that it retains the confidence of social partners and fosters the public profile of the *Guidelines*. NCPs, whatever their composition, are expected to develop and maintain relations with representatives of the business community, employee organisations, and other interested parties.

Information and Promotion

10. The NCP functions associated with information and promotion are fundamentally important to enhancing the profile of the *Guidelines*. These functions also help to put an accent on “pro-active” responsibilities of NCPs.

11. NCPs are required to make the *Guidelines* better known and available by appropriate means, including in national languages. On-line information may be a cost-effective means of doing this, although it should be noted that universal access to this means of information delivery cannot be assured. English and French language versions will be available from the OECD, and website links to the OECD *Guidelines* website are encouraged. As appropriate, NCPs will also provide prospective investors, both inward and outward, with information about the *Guidelines*. A separate provision also stipulates that in their efforts to raise awareness of the *Guidelines*, NCPs will co-operate with a wide variety of organisations and individuals, including, as appropriate, the business community, employee organisations, other non-governmental organisations, and the interested public.

12. Another basic activity expected of NCPs is responding to legitimate enquiries. Three groups have been singled out for attention in this regard: (i) other National Contact Points (reflecting a provision in the Decision); (ii) the business community, employee organisations, other non-governmental organisations and the public; and (iii) governments of non-adhering countries.

Implementation in Specific Instances

13. When issues arise relating to implementation of the *Guidelines* in specific instances, the NCP is expected to help resolve them. Generally, issues will be dealt with by the NCP in whose country the issue has arisen. Among adhering countries, such issues will first be discussed on the national level and, where appropriate, pursued at the bilateral level. This section of the Procedural Guidance provides guidance to NCPs on how to handle such situations. The NCP may also take other steps to further the effective implementation of the *Guidelines*.

14. In making an initial assessment of whether the issue raised merits further examination, the NCP will need to determine whether the issue is *bona fide* and relevant to the implementation of the *Guidelines*. In this context, the NCP will take into account:

- the identity of the party concerned and its interest in the matter;
- whether the issue is material and substantiated;
- the relevance of applicable law and procedures;
- how similar issues have been, or are being, treated in other domestic or international proceedings;

- whether the consideration of the specific issue would contribute to the purposes and effectiveness of the *Guidelines*.

15. Following its initial assessment, the NCP is expected to respond to the party or parties having raised the issue. If the NCP decides that the issue does not merit further consideration, it will give reasons for its decision.

16. Where the issues raised merit further consideration, the NCP would discuss the issue further with parties involved and offer “good offices” in an effort to contribute informally to the resolution of issues. Where relevant, NCPs will follow the procedures set out in paragraph 2a) through 2d). This could include seeking the advice of relevant authorities, as well as representatives of the business community, labour organisations, other non-governmental organisations, and experts. Consultations with NCPs in other countries, or seeking guidance on issues related to the interpretation of the *Guidelines* may also help to resolve the issue.

17. As part of making available good offices, and where relevant to the issues at hand, NCPs will offer, or facilitate access to, consensual and non-adversarial procedures, such as conciliation or mediation, to assist in dealing with the issues at hand, such as conciliation or mediation. In common with accepted practices on conciliation and mediation procedures, these procedures would be used only upon agreement of the parties concerned.

18. If the parties involved fail to reach agreement on the issues raised, the NCP will issue a statement, and make recommendations as appropriate, on the implementation of the *Guidelines*. This procedure makes it clear that an NCP will issue a statement, even when it feels that a specific recommendation is not called for.

19. Transparency is recognised as a general principle for the conduct of NCPs in their dealings with the public (see para. 8 in “Core Criteria” section, above). However, paragraph C-4 recognises that there are specific circumstances where confidentiality is important. The NCP will take appropriate steps to protect sensitive business information. Equally, other information, such as the identity of individuals involved in the procedures, should be kept confidential in the interests of the effective implementation of the *Guidelines*. It is understood that proceedings include the facts and arguments brought forward by the parties. Nonetheless, it remains important to strike a balance between transparency and confidentiality in order to build confidence in the *Guidelines* procedures and to promote their effective implementation. Thus, while para. C-4 broadly outlines that the proceedings associated with implementation will normally be confidential, the results will normally be transparent.

20. As noted in para. 2 of the “Concepts and Principles” chapter, enterprises are encouraged to observe the *Guidelines* wherever they operate, taking into account the particular circumstances of each host country.

- In the event *Guidelines*-related issues arise in a non-adhering country, NCPs will take steps to develop an understanding of the issues involved. While it may not always be practicable to obtain access to all pertinent information, or to bring all the parties involved together, the NCP may still be in a position to pursue enquiries and engage in other fact finding activities. Examples of such steps could include contacting the management of the firm in the home country, and, as appropriate, government officials in the non-adhering country.
- Conflicts with host country laws, regulations, rules and policies may make effective implementation of the *Guidelines* in specific instances more difficult than in adhering

countries. As noted in the commentary to the General Policies chapter, while the *Guidelines* extend beyond the law in many cases, they should not and are not intended to place an enterprise in a situation where it faces conflicting requirements.

- The parties involved will have to be advised of the limitations inherent in implementing the *Guidelines* in non-adhering countries.
- Issues relating to the *Guidelines* in non-adhering countries could also be discussed at NCP annual meetings with a view to building expertise in handling issues arising in non-adhering countries.

Reporting

21. Reporting would be an important responsibility of NCPs that would also help to build up a knowledge base and core competencies in furthering the effectiveness of the *Guidelines*. In reporting on implementation activities in specific instances, NCPs will comply with transparency and confidentiality considerations as set out in para. C-4.

II. Procedural Guidance for the CIME

22. The Procedural Guidance to the Council Decision provides additional guidance to the Committee in carrying out its responsibilities, including:

- Discharging its responsibilities in an efficient and timely manner
- Considering requests from NCPs for assistance
- Holding exchanges of views on the activities of NCPs
- Providing for the possibility of seeking advice from experts

23. The non-binding nature of the *Guidelines* precludes the Committee from acting as a judicial or quasi-judicial body. Nor should the findings and statements made by the NCP (other than interpretations of the *Guidelines*) be questioned by a referral to CIME. The provision that CIME shall not reach conclusions on the conduct of individual enterprises has been maintained in the Decision itself.

24. CIME will consider requests from NCPs for assistance, including in the event of doubt about the interpretation of the *Guidelines* in particular circumstances. This paragraph reflects paragraph C-2c) of the Procedural Guidance to the Council Decision pertaining to NCPs, where NCPs are invited to seek the guidance of the CIME if they have doubt about the interpretation of the *Guidelines* in these circumstances.

25. When discussing NCP activities, it is not intended that CIME conduct annual reviews of each individual NCP, although the CIME will make recommendations, as necessary, to improve their functioning, including with respect to the effective implementation of the *Guidelines*.

26. A substantiated submission by an adhering country or an advisory body that an NCP was not fulfilling its procedural responsibilities in the implementation of the *Guidelines* in specific instances will also be considered by the CIME. This complements provisions in the section of the Procedural Guidance pertaining to NCPs reporting on their activities.

27. Clarifications of the meaning of the *Guidelines* at the multilateral level would remain a key responsibility of the CIME to ensure that the meaning of the *Guidelines* would not vary from country to country. A substantiated submission by an adhering country or advisory body with respect to

whether an NCP interpretation of the *Guidelines* is consistent with CIME interpretations will also be considered. This may not be needed very often, but would provide a vehicle to ensure consistent interpretation of the *Guidelines*.

28. Finally, the Committee may wish to call on experts to address and report on broader issues (e.g. child labour, human rights) or individual issues, or to improve the effectiveness of procedures. For this purpose, CIME could call on OECD in-house expertise, international organisations, the advisory bodies, NGOs, academics, and others. It is understood that this will not become a panel to settle individual issues.