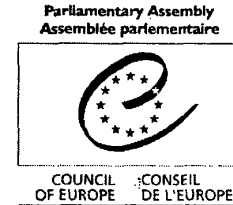


Parliamentary Assembly Assemblée parlementaire



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The OECD and the world economy

Report
Committee on Economic Affairs and Development
Rapporteur: Mr Konstantinos Vrettos, Greece, Socialist Group

I. Draft resolution

§ 1. The Enlarged Parliamentary Assembly, composed of delegations of the Organisation for Economic Co-operation and Development (OECD) and Council of Europe member states, has examined the recent activities of the OECD as they relate to the world economy, in the light of the report prepared by the Enlarged Assembly's Committee on Economic Affairs and Development and the contributions from various other committees.

§ 2. The Enlarged Assembly welcomes the overall solid growth of the world economy, thanks in particular to continued growth in the United States as well as China, India, Brazil, Russian Federation and numerous emerging economies. All of these increasingly provide the main impetus to global economic growth and the Enlarged Assembly welcomes the OECD's growing co-operation with them, making the Organisation global in outreach and influence, if not yet in membership.

§ 3. The Enlarged Assembly notes with satisfaction that inflation in the OECD area has nevertheless remained well contained, likely reflecting both rising productivity and the increased competition and richer supply of goods and services that results from rapidly increasing world trade. In the interest especially of emerging and developing economies and for the realisation of the United Nations Millennium Development Goals, it is vital to develop further an open trading and financial system that is rules-based, predictable and non-discriminatory and to set aside development assistance for the benefit of countries committed to poverty reduction - notably through the successful conclusion, under the auspices of the World Trade Organisation (WTO), of the Doha Development Agenda which also reflects the efforts to eliminate poverty, improve social conditions and raise living standards in the world economy. The enlarged Assembly asks the OECD, together with the World Trade Organisation, to identify new principles to guide world trade, in order to encourage technological investment flows to countries in particular need.

§ 4. However, a number of worrying developments cloud the horizon. Thus, the huge and steadily rising current account deficit of the United States is unsustainable over time and may lead to a painful correction by markets as the world's savings are spent to compensate for low United States domestic savings. In this context, it is important that the United States and other countries implement macroeconomic policies in an appropriate and timely manner.

§ 5. The Enlarged Assembly also hopes that countries which deliberately maintain weak national currencies vis-à-vis others will cease doing so as soon as possible and is convinced that the gradual improvement of the global imbalances should be achieved from now on by countries all over the world adopting a more flexible exchange rate regime.

§ 6. The timid growth in the eurozone is another source of concern, with Italy and Germany on the verge of recession and the twelve participating countries diverging rather than converging economically. The Enlarged Assembly joins the OECD in believing that the European Central Bank may now well have room to lower its policy-setting interest rate in order to revive economic activity. At the same time it calls on European Monetary Union (EMU) member states concerned to speed up economic reform in the spirit of the 2000 Lisbon Agenda. It is important that the will to reform not be weakened as a result of the outcome in a number of national referendums on the European Union Constitutional Treaty, since this would only aggravate an already difficult economic situation and jeopardize growth.

§ 7. High and volatile oil prices, due in particular to rapidly rising demand in the United States and in emerging economies, especially China, pose a further risk to world economic growth. The Enlarged Assembly calls on OECD member countries to make greater efforts to increase energy efficiency; reduce the dependence on fossil energy, especially oil and coal; diversify energy sources including via nuclear energy, particularly addressing the unresolved problem of the processing and storage of radioactive nuclear waste and further develop renewable energy sources and technologies. The Enlarged Assembly also invites OECD member countries to intensify efforts to promote peace and political stability in the Middle East and the Persian Gulf regions. In this context, it welcomes the Initiative on Governance and Investment for Development launched by MENA (the states of the Middle East and Northern Africa) and supported by the OECD and the United Nations Development Programme (UNDP).

§ 8. The Enlarged Assembly welcomes the OECD's extensive co-operation with Russia under its "Russia Programme", including assisting that country's accession process to the World Trade Organisation which the Enlarged Assembly hopes can be completed in the very near future, especially if Russia undertakes needed domestic structural reform and liberalization of its economy and manages to broaden the country's economic base away from oil and gas, thereby firming investor confidence.

§ 9. Given the impact of the opening up and growth of the Chinese economy, the Enlarged Assembly also welcomes the first OECD Economic Survey of the country completed in 2005, as well as the launch of the China Governance Project, and urges further development of these programmes.

§ 10. The pronounced imbalances in the world economy - as illustrated for example by the US current account deficit, the increasing divergence between eurozone economies and the preoccupying falling behind of many of the world's poorest countries - are additional sources of concern. The Enlarged Assembly in this context calls on the OECD to devote more research into hedge funds and derivatives such as swaps, options and collateralized debt obligations.

§ 11. The Enlarged Assembly rejoices in the success, one year onwards, of the European Union's 2004 enlargement to include ten new countries in central and southern Europe, as demonstrated by these countries' rapid economic and institutional development and growing integration within the wider EU. It recognises the OECD's contribution to this process via programmes such as SIGMA (Support for Improvement in Governance and Management) which are pursued also with other countries in eastern Europe and beyond.

§ 12. It is important in this respect that thought be given to the further enlargement of the OECD itself, so as to include, as soon as possible, all the countries in the world that meet the Organisation's criteria, with due attention paid to ensuring a proper balance between world regions. OECD enlargement takes on additional significance as its current membership less and

less adequately reflects the world's new economic realities and the sea-change in the distribution of its increasing wealth. The OECD's co-operation programmes with rising economies, while laudable, will no longer suffice in tackling challenges facing richer countries, including how this group may best assist the world's poorer countries, for instance in the realisation of the Millennium Development Goals.

§ 13. The Enlarged Assembly notes the growing impact of such factors as education, scientific research, social cohesion, good governance and democratic stability on the economic performance of individual states and the world economy as a whole and recommends that OECD member states pay closer attention to such factors. In this respect, it welcomes the multilateral work achieved and standards set in those areas by the OECD and the Council of Europe and calls on these organisations to intensify their co-operation and coordination in this respect.

§ 14. The Enlarged Assembly invites the OECD to carry out a comparative performance report in OECD member countries examining the role of higher education and research for developing students to their full potential, for example in meeting an increasing diversity of needs and demands associated with the knowledge society, lifelong learning, globalisation, national and regional economies, local communities, as well as social cohesion and equity.

§ 15. The Enlarged Assembly calls on the OECD and the Council of Europe to coordinate their action on mutually identified priority areas in the field of education policy.

§ 16. The Enlarged Assembly calls on the OECD to consider the non-economic aspects of agriculture. Consideration should be taken not only of the production aspect, its primary role, but also of the contribution of agriculture to the economic and social life of rural regions, the preservation and maintenance of landscapes and the protection of life's essential elements: water, air and land. Only on this condition will the balance between cities and rural areas be preserved.

§ 17. The Enlarged Assembly strongly supports the OECD's ongoing mandate to mainstream sustainable development and considers that the implementation of the objectives of OECD's Environmental Strategy for the First Decade of the 21st Century to achieve environmental sustainability should be treated as an urgent priority. In particular, urgent action is needed to implement the Kyoto Protocol and reduce greenhouse gas emissions in the post-Kyoto period, beyond 2012.

§ 18. Finally, the enlarged Assembly on the activities of the OECD decides to modify its Rules of Procedure adopted in 1992 as contained in the Appendix to this report.

II. Explanatory Memorandum by Mr Vrettos, Rapporteur

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I. Introduction and background

1. The debate of the Enlarged Parliamentary Assembly on the 'The OECD and the World Economy' will be held in October 2005. The present report is based on a visit by the Rapporteur to the OECD in March 2005 and the deliberations of the Committee on Economic Affairs and Development at meetings in Antalya, Turkey, in May and at OECD headquarters in Paris in June 2005, on which occasion the attached draft Resolution was provisionally adopted. Following consultation with national delegations, it is due to be formally presented for adoption at the Enlarged Economic Committee's and the Enlarged Assembly's meetings in Strasbourg in the course of the Assembly October part-Session (3-7 October 2005).

2. In his discussions with OECD officials, the Rapporteur gained a clear and very interesting picture of their view of current economic conditions. While this report cannot hope to cover all the points discussed, it does set out provide an overview of trends and prospects for the global economy, and to examine in more detail two subjects that seem, to the Rapporteur, of particular significance:

- The reasons for today's high oil prices, and their likely future direction.
- The risks associated with the United States' trade deficit, and possible methods of reducing it.

3. In addition, the report offers an update on the OECD's own projects and activities, especially in relation to its country outreach initiatives, 'Good Governance' programmes and the development of its own membership base.

II. Prospects for the world economy

The outlook should be fairly optimistic, but diverging between regions

4. In reporting on the world's economic prospects, the Rapporteur brings an assessment that is upbeat, though rather more wary than that of his recent predecessors. In 2003, the forecast was disappointing – only 1.9% - with worldwide recovery slow to take hold. As the year

progressed, activity did begin to pick up, leading to full year growth of 2.2%. So last year began positively, with forecast growth of 3.4%; and as the year progressed, the OECD would even raise its prediction to 3.6%.

5. But even as it did so by the end of 2004, it was lowering its forecast for 2005, from 3.3% to 2.9%, and in its May 2005 "Economic Outlook" even further, to 2.6%. What has happened? As the OECD puts it, global expansion is encountering headwinds. Most markedly, the price of oil has remained higher, and more volatile, than expected – and this has directly impacted economic performance. Alongside this, and at least partly associated with it, are other decelerating factors, such as high commodity prices, a brief pause in the growth of the Chinese economy, and the peaking of property markets as consumer credit becomes less cheap. In addition, key structural challenges that the OECD has been pointing out for some years, in particular the expanding US budget deficit and sluggish demand in the Eurozone, remain at issue.

6. But all in all, the OECD holds certain hope. After a period of slower expansion during 2005, they predict a pick-up by the beginning of 2006, when OECD-wide growth is projected at 2.8%. Inflation is expected to remain relatively low, at around 1.9%. And, although growth will not be sufficient to substantially reduce unemployment or curtail deficits, it should restore OECD countries to an above-trend growth pattern, and remove much of the slack (the 'output gap') that has been evident since 2003.

7. Like all predictions, though, this picture rests on a series of assumptions – most crucially, that of the price of oil. The OECD Economic Outlook of May 2005 at any rate expects the price of Brent crude oil to decline gradually from \$55 per barrel in the second quarter of 2005 to \$48 at the end of 2006.

The foundations of the global economy have proved resilient

8. Despite its difficulties, this has been a period of strength for overall world trade - indeed 2004 is reckoned to have seen record growth of 9.4%. After slowing slightly in 2005, it is expected to repeat this figure in 2006. And it is encouraging that many former 'developing' countries, such as China, India and Brazil, have built up their trade levels, and raised their domestic standards of living - in fact, this has been the single most significant step towards meeting the United Nations Millennium Development Goals. It is worth noting, too, that many have of them have benefited from high oil and commodity prices.

9. Although headline inflation has generally risen somewhat, there has been no repeat of 1970's 'stagflation'. In fact, core inflation levels and wage demands have remained under control, and so interest rate rises have been modest. All this is seen as a tribute to the increased competitiveness and productivity of international markets, and the enhanced credibility of central banks. Nor have we seen the US dollar-driven currency crisis that many were predicting; rates have in fact been fairly stable in recent months, and the US deficit has, up to this point, been accommodated.

10. Meanwhile, stock markets have steadily regained much of the ground lost in 2001, and corporate balance sheets and profits are robust. In fact, given the low prevailing level of interest rates, there is a great deal of investment money available in the world today, looking for opportunities with good returns. Resurgent and emerging economies, such as Ukraine, have found no shortage of eager investors.

11. In short, the world economy has proved far more resilient than some had predicted, and should be poised to accelerate given reasonable conditions. The OECD points out, however, that national deficits are likely to worsen, and as interest rates continue to rise, they urge that fiscal consolidation should not be put off.

But growth will remain uneven...

12. Rather than being self-propelled, the recovery of the world economy from its slowdown in 2001 was stimulated by extremely low interest rates, and by high public and private consumption. But as those conditions fade, the deficits that were built up have remained; and the imbalances in the world's growth, more evident than ever recently, make them very hard to rectify.

13. Recent growth has had a distinctly uneven geographical character, and the gaps are only like to widen. Asia has, in general, been highly successful, with China rushing ahead and Japan beginning a long-awaited recovery. The United States has bounced back, growing well above its long-term potential, but with ever-widening deficits, and other English-speaking countries – which were only marginally affected by the previous slowdown – expanded on the back of strong consumption. Many non-OECD countries have been strong, particularly in Latin America and Eastern Europe (although much of Africa has remained difficult). Within the Eurozone, some smaller economies did well, but the overall performance has been disappointing, indeed the OECD describes Europe as 'plodding along'.

14. There are wide imbalances, even polarities, in world trade, with many different economic cycles in play. At the extreme, China and the Eurozone are now virtually counter-cyclical, with Chinese growth set to take off again, while 2004's slowdown has dampened the signs of Eurozone revival that the OECD had detected earlier in the year. Sooner or later, some rebalancing is inevitable. For all the talk of globalisation, and for all the complex interdependencies that have grown up in recent years, there is a striking lack of cohesion in the world economy.

15. The OECD Ministerial Meeting in May 2005 described the main imbalances as being "widening current account gaps, large fiscal deficits and possibly stretched valuations in some asset markets". These imbalances, they added, "may well unwind smoothly, including via some exchange rate adjustments", but "some turbulence cannot be ruled out. Persevering with structural reform, however, will help absorb any such disruption."

...and the prevailing mood is uncertainty

16. As the OECD points out, growth since 2001 has been not only geographically uneven, but also fundamentally sporadic – susceptible to sudden and unexpected losses of momentum, and proceeding by fits and starts. The traumatic events of 2001 and their protracted aftermath are certainly one explanation for this. Another is the artificially inspired nature of the recovery itself. And beyond this, the rise of many emerging economies, and corresponding decline of traditional industries in the West must have played a part in the pervasive lack of consumer confidence in OECD member countries. During 2004, for instance, a year of record trade, business confidence in the US and Europe declined to levels only just above its historical average.

17. The persistence of deficits, together with high and volatile oil prices, has only added to a mood of uncertainty that threatens to become long-term pessimism. As we shall see, this could attain the power of a self-fulfilling prophecy, and it will be a central challenge for policy-makers in the developed world to see that confidence is restored.

III. A survey of key economies

The United States

18. In 2004, growth in the **United States** came in lower than expected, though still at a remarkable 4.4%. The OECD foresees growth at 3.6% during 2005 (which is around its long-term potential level), slowing only slightly to 3.3% during 2006.

19. The principal reason for this slowdown was the level of oil prices. The US remains the world's principal oil consumer; Americans are accustomed to cheap gasoline, and much of the country's economy is founded on its availability. High prices have therefore quickly held back disposable income gains, and consumption growth has fallen back. During 2005, private consumption growth is expected to return to its 2002 level of 3.1%.

20. In addition, the historically low interest rates that have been maintained since 2001 are being steadily raised. In itself, this is a necessary cyclical step (especially given the inflationary threat of oil prices), but the approach has been cautious, and fiscal policy remains modestly expansionary. Current signals are that rates will continue to rise, albeit gradually, and this can only have the effect of restraining consumption. Large sectors of the auto industry have recently relied on cheap credit, for instance, and there has been a boom in house building, as well as house prices (and a concurrent boom in mortgage equity withdrawal).

21. Despite these restraints, and despite renewed worldwide demand (especially in Asia) and the advantages of a weak dollar to US exporters, the current account deficit is expected to widen further, from \$669 billion in 2004 to \$825 billion by 2006. The budget deficit, too, seems certain to remain large, given ongoing defence and security commitments and the maintenance of previous tax cuts. Federal revenues are projected to rise sufficiently for the deficit to be held at around 4% of GDP, but even this will mean overseas borrowing on an ever-increasing scale.

22. The US, it seems, has an insatiable demand for imports, and an increasing propensity for government spending. Alongside this, American consumers save very little, and there is a rising gap between domestic saving and investment, which is covered by the inflow of foreign saving. Thus, the main engine of world growth will remain indebted to an extent never before seen in history.

23. All the same, the US economy remains intrinsically strong – and despite weakening export growth, company order books are healthy. The stock market has largely regained its losses of recent years (although worries about oil and the level of government borrowing have caused it to remain anxious and volatile). Investor confidence is founded on strong profit margins at US corporations, and business investment remains high, with heavy spending on equipment and software helping to build productivity. This in turn has helped to dampen inflationary pressures, as unit labour costs have risen less than might have been expected. Unfortunately though, it has helped to prolong the 'jobless recovery', as businesses have been able to expand activity without needing to hire new workers – or to move their activity offshore. During 2004, there was at last a slight pick-up in US job creation, and this is expected to continue – but unemployment, which stood at 5.5% in 2004, is still expected to be 4.8% in 2006.

24. Under these circumstances, the OECD projects that the US will withstand inflationary pressures, with inflation limited to 2.4% in 2005, and 2.2% in 2006. And with business investment expected to keep growing, there is every chance that the US will be able to sustain above-trend growth in the medium term. But the risks are clear – and given America's role in fuelling world growth, these risks are shared by everyone.

Asian economies

25. **Japan** performed strongly in the latest recovery – more so than at any time since the 1980s. However, in 2004 growth slowed to 2.6%. The OECD expects that this slowing will continue, and that growth will be sustained at around 1.5% during 2005 and 2006 – still a notable achievement given the strength of yen against the dollar, as Japanese businesses reap the benefits of a decade of painful restructuring. In fact, this current period of expansion may, during 2006, bring an end to Japanese deflation.

26. Initially driven by exports, as so often in the past, Japanese growth has been affected by the global slowdown, particularly that in the US, and in China. In fact, China is now Japan's largest trading partner, and has accounted for more than a third of Japanese export growth during this expansionary period. The Rapporteur fervently hopes that recent political tensions between Japan and China can soon be overcome and that the increasingly close economic ties between them will help in this regard. Meanwhile, a new feature of strength in Japan has been increasing domestic demand: private consumption growth rose from 0.8% in 2003 to 1.5% in 2004.

27. Overall, this reflects increased corporate profitability and falling unemployment – which stood at 5.4% in 2002, but is expected to be only 4.1% by 2006. And although land prices are still weak, and increased labour flexibility has tended to depress wage levels, the improved health of the banking sector has helped to facilitate business investment. But consumer demand has received a very specific boost, as Japanese retirees begin to spend more of their savings.

28. Based on increased life expectancy and lower birthrates, an aging population is a common challenge for advanced economies – and the first to face this challenge has been Japan. Already, 20% of its population is over 65, and by 2050, the figure is likely to be 35%. Recently, this has had the interesting effect of lowering Japan's traditionally high rate of household savings, which has fallen from above 9% of disposable income in the 1980s to around 7% today. This is expected to continue as the demographic trend advances, which will help to bolster long-term domestic demand

29. In addition, although the budget deficit remains high, recent growth has helped to reduce it from 7.7% of GDP in 2003, the highest among OECD members, to around 5% today. If deficit reduction can be continued, and deflation brought to an end, lower saving and higher spending levels should be further encouraged. So Japan seems well on track to emerge from its long-standing structural problems and, while noting its vulnerability to external events, the OECD is upbeat about its prospects of maintaining above-potential growth.

30. **China** is an increasingly important trade partner, not only for Japan, but for all the world's major economies. Its export performance is rarely out of the headlines, and its southern coastal belt is often referred to as the 'workshop of the world'. In 2003 alone, exports rose by almost 35%, (over half of which were sales by affiliates of foreign enterprises), giving China a 6% share in world exports. China is rapidly establishing world competitiveness in a widening range of higher-value-added economic activities. This is already having a profound effect on OECD economies and this will be the case even more in the years to come.

31. But at the same time, imports were rising even faster – by 44% - so that the net contribution of foreign trade to Chinese growth was negligible. Thus, its importance to world trade is well above its export share: China has become the third-largest trading nation in the world, on a par with Japan. In 2003, China accounted for 20% of US export growth and 40% for Korea. In fact, China may have accounted for a quarter of all trade growth during that year. So from now on, any slowdown in China's expansion will have a knock-on effect on world trade, with an especial impact on more open economies.

32. A slowdown was inevitable, though, for with growth running above 9% during 2003 and into 2004, China was in danger of overheating, and was beset by shortages of power and raw materials. In the middle of the year, the authorities took steps to curb demand, by restricting bank lending and credit, reducing public infrastructure budgets and enforcing land-zoning and other investment regulations. Briefly, the economy stalled, but recovered towards the end of the year, so that full-year growth came in at 9.5%.

33. There are other factors restraining the economy, in particular rising oil, commodity and food prices: inflation has risen from 1.2% to 4% since 2003. China is the world's second largest oil consumer, and surging demand has recently made it a net oil importer for the first time. Ironically, it is booming industries in China that have helped drive up the price, not only of oil, but of products such as steel and even international shipping – and China's slowdown in growth has been nowhere near enough to reduce these prices.

34. So in 2005, the OECD expects Chinese growth to moderate, to around 9%, and to rise to 9.2% in 2006 – and there are hopes that this 'soft landing' will help to transition China to stable growth in the region of its 7-8% potential rate. Importers have already noticed tougher conditions, particularly in areas such as automobiles, which were previously financed by cheap credit (and were once expected to offer a bonanza). But with plenty of retained company earnings available for investment, incomes still rising faster than prices, and ever-increasing overseas demand, it seems reasonable to expect continued healthy growth. Indeed, as the public sector declines in its importance to the economy and higher quality domestic goods become available, it is quite likely that imports will continue their slowing trend of growth, while exports will forge ahead.

35. There is, however, the possibility of what the OECD calls 'a less benign outcome'. They point out the disruptive effect of central controls, and warn of the danger of inducing a reduction in industrial investment at a time of ever-increasing foreign exchange reserves and negative interest rates on bank deposits. In the longer run, they add, China's success will depend on the extent to which it continues to reform. There is a particular need to restructure state-owned banks and enterprises (especially in the energy and power sector), and to develop better social safety nets to ease the strains of transition on the population.

36. As the Rapporteur puts the finishing touches to his report the OECD has published its major country study on the Chinese economy, following on the heels of a similarly major study on aspects of governance in China. A few lines on this important subject seem merited, although the Rapporteur would refer the reader both to the OECD website for further study of these reports and, by early 2006, to the report at present being drawn up by the Assembly's Committee on Economic Affairs and Development (Rapporteur: Mr Wille), on the theme "Implications for Europe of the economic rise of China."

37. In its economic study the OECD generally commends China on its impressive growth in recent years. The report emphasises that not only the rich, dynamic regions and population strata have benefited from this development, but also millions of poorer people in less developed provinces. At the same time the OECD points out, however, that even the most developed regions in the country have only reached income levels comparable to those attained by other south-east Asian countries already decades ago. This in turn illustrates China's still largely untapped potential as a future consuming and trading nation. The OECD also has praise for the country's fiscal policy and overall balance in its finances. This gives it considerable latitude in shaping its future economic policies, also as regards taxes.

38. The report expresses some concern, however, over the sustainability of China's social policies. Thus, the pensions system is deemed insufficient to cope with the rising number of elderly people, especially as the consequences of China's decades-long "one child" policy are beginning to show. Here, the OECD calls for a greater role for capital markets and a liberalised insurance sector in helping to remedy the situation.

39. There is also some concern over the extent of bad loans, especially those awarded over many years to underperforming state-owned companies. Finally, the report takes up rather briefly China's environmental challenges, including the rapid deterioration of the water supply in many regions, the continuing loss of valuable farmland and bottlenecks in the energy supply. (An OECD review on environmental policies in China is foreseen for 2006.)

40. Any crisis in China will affect the world economy, but most of all it threatens Asia. The rapid expansion of intra-regional trade amongst Asian countries has been a feature of recent years, helping to strengthen their autonomous contribution to world trade and growth. **Korea** is a good example; its exports, about a third of which go to China, have helped to sustain growth during a period of weak domestic demand, in the aftermath of the country's credit bubble. This was caused by a sudden drop in savings, and a boom in cheap credit – which left nearly a fifth of the workforce in debt arrears, the situation exacerbated by slow wage growth and falling property prices.

41. Korea's growth is expected to remain between 4% and 5% this year and next, with domestic demand reviving to offset a slowdown in exports. With a lower contribution from external demand expected, the current account surplus is likely to narrow to around 1.7% next year. Growth prospects appear healthy, unless there is a continuing slowdown in external demand.

The eurozone

42. Activity in the Eurozone accelerated in the first part of 2004, but slowed as the year went on, so that full-year growth was 1.9%. The OECD expects this to weaken to 1.25% in 2005, before advancing to around 2% in 2006. As several previous Rapporteurs have described, Eurozone economies face a daunting array of challenges, to which should be added the psychological blow of the negative outcome in the French and Dutch referendums on the EU Constitutional Treaty in May and June 2005, respectively.

43. **Europe** is less exposed than most regions to the increase in oil prices, because of economic efficiency and dollar pricing. While last year's oil-price hike was crucial in suppressing signs of recovery, Europe should be well placed to adapt if prices remain high. And although there has been some inflationary impact in Europe, medium-term inflation prospects seem modest, allowing interest rates to remain fairly low.

44. Also, growth in the Eurozone is particularly reliant on exports; and while the weak dollar has been a considerable challenge, it has, contrary to many expectations, stabilised and even strengthened slightly in recent months. Meanwhile, currency considerations have prompted Eurozone manufacturers to reduce costs and to develop other markets. Germany, for so long the motor of European growth, has begun to adopt less rigid working practices and, despite its overall domestic woes, has recently established itself as the world's largest exporter. The booming economies of central and eastern Europe offer great scope, both for exports and for sourcing lower-cost labour and materials so as to remain globally competitive. And although migration is a sensitive issue – as the recent protests in especially France over the so-called "Bolkestein draft directive" on services have shown - there are signs that industrial relocation is already underway. German firms have been in forefront of this, but both Renault and Peugeot have recently announced projects in eastern Europe, for instance (in Peugeot's case, involving joint development with Toyota). If world demand picks up, as expected, during 2006, European exporters should have a renewed opportunity.

45. These factors may cushion the Eurozone; but if its long-awaited recovery is truly to advance, the key challenge will be to stimulate and support domestic demand. Among the larger economies, France and Spain are on track for reasonable growth this year (2% and 2.7% respectively), with domestic demand contributing most to GDP in both cases. Germany and the Netherlands, by contrast, continue to rely on exports, and have seen very little growth (1.4% and 1.2%). As can be seen all over the world, a vibrant export trade is not enough to finance, and generate employment for, a modern economy.

46. Persistently high unemployment is the clearest symptom of the problem – and perhaps the leading cause of public pessimism in the Eurozone. From an average level of 8.9% in 2004, it is projected to rise to 9% in 2005 and then come down to 8.7% in 2006. But even these figures do not show the full scale of the problem: workforce participation rates are low and becoming lower

in Europe (particularly in France), with many older people effectively subsidised to leave the workforce, in an attempt to create new jobs. Unfortunately, this has not prevented high levels of youth unemployment. And Europe will soon face similar demographic challenges to those of Japan, with 31% of the population expect to be over 65 years of age by 2040. The Rapporteur in this context refers to the Assembly's recently adopted Resolution 1423 (2005) on "What solutions to Europe's unemployment?" (Rapporteur: Mr Högmark; Doc. 10359), which well illustrated the scope of the challenge ahead of us.¹

47. In these conditions, with governments managing structurally high public deficits and high unemployment, it is not at all surprising that households lack confidence. Despite low interest rates, household saving rates remain at a high level – some 11% of disposable income, compared with less than 2% in the US – and in Germany they are even increasing.

48. In some Eurozone economies, such as Spain and Ireland house prices have recently increased markedly – but this has been less true in the largest economies: in Italy, price growth has slowed down in recent years, and in Germany prices have actually been falling. There is an opportunity here since, the OECD believes, sustained movement in housing wealth can have long-term benefits for consumption. And the strength of this effect is significantly boosted if households can borrow against their equity.

49. Mortgage markets in the eurozone tend to be fairly small, with a less competitive range of products and less flexible borrowing conditions than are seen elsewhere (the Netherlands being a notable exception). Equity withdrawal is uncommon, for instance, and in Germany and France very rare. Housing transaction costs tend to be high, too – over 20% of the total price in Belgium, for instance, compared to less than 10% in the US. So it is easy to see how the housing market might be stimulated, and in the major economies there is plenty of scope for growth without running the risk of an unsustainable boom.

50. In fact, to break the vicious circle of low confidence and low demand, the OECD sees an urgent need for structural reform on many fronts. While praising the efforts of some countries, particularly Germany, to tackle deficits and improve flexibility, it urges that these be continued and deepened within a coherent framework of change. Competition and investment needs to be encouraged, tax and subsidy levels restrained, and there should be deregulation so as to encourage entrepreneurs and develop the small business and service sectors that can generate new jobs quickly, and can target the skills of a well-educated workforce to meet changing consumer habits - all policy measures highlighted in the abovementioned report by our colleague Mr Högmark.

51. The May 2005 OECD Ministerial Meeting, presumably eyeing Europe in particular, pointed to the service sector as having "large untapped potential to increase employment, productivity and innovation. Reforming the service sector is essential to improve the foundations for future performance of OECD economies." At a time when especially Europe is losing many services to outsourcing, this message deserves particular attention from governments.

52. So far, in the OECD's view, the closer integration that monetary union was intended to bring has not created any additional growth, or economic vigour. And as we have seen, economic conditions and circumstances still vary widely within the zone itself. The ambitious targets set at Lisbon – intended to make Europe the world's most competitive economy by 2010 - seem as far from fulfilment as ever. Progress is becoming ever more urgent, if the Eurozone is to maintain its social programmes as the population ages. Rather than being 'pulled along' by the next global upswing, says the OECD, the Eurozone needs to achieve 'autonomous momentum'. The importance of reaching such momentum has if anything increased following the referendum setbacks on the EU constitutional treaty in France and The Netherlands in the summer of 2005.

¹ See <http://assembly.coe.int/Main.asp?link=http://assembly.coe.int/Documents/WorkingDocs/Doc04/EDOC10359.htm>

IV. Oil prices: at their peak, or the beginning of a 'permanent shock'?

69. High oil prices are routinely identified as a major risk factor for the world economy, if not *the* major risk. As we've seen, current prices have already impacted on growth – and, as the Rapporteur heard, the OECD's published assumption of a steadily falling price level has not begun to be fulfilled. It is first worth asking, then, why are prices so high?

- Increasing demand has been a factor, of course, driven by record trade levels; total demand has risen by 15% since 1995, and the US and China – who are the world's leading oil consumers – have together accounted for nearly half of that increase. Demand is expected to rise by another two-thirds over the next thirty years (with the US and China still dominant), and this would be consistent with a real price rise of around \$8 per barrel. Such increases are foreseen, and with proven reserves thought to be adequate to demand over the next few decades, might be expected to take place gradually. But crucially, says the OECD, the recent price-hike was preceded by a widespread underestimation of short-term Chinese demand (which was exacerbated by China's need to use oil to make up its deficit in electricity generation).
- Political uncertainty in key producing regions continues to be important. There are specific concerns about the Persian Gulf, where viable oil reserves are increasingly concentrated, both in terms of civil stability and the capacity to expand production (given that investment is not necessarily allocated according to market forces).
- There have been logistical difficulties as the geographical pattern of demand changes, with pressure on tanker fleets, terminal facilities and refineries. Paralleling this, there have also been regional mismatches between the type of oil demanded and supplied, with a premium being added to the low-sulphur grades required in the West.
- Some have suggested that speculators, such as hedge funds, are buying into oil and other commodities to an extent that is raising prices. The OECD has investigated this idea and, while it thinks it unlikely that such buying is affecting the oil price level, it thinks this may have increased the market's volatility.

70. Together, these factors could substantially explain last year's price spike, which was both unexpected and rapid (Brent Crude prices rose from \$32 in mid-2004 to \$50 by year-end). Since the 1980's, oil prices have tended to be more volatile than other commodities – and while one would expect high commodity prices during a period of trade expansion, it was the speed of oil's price rise that caught markets unaware. But why has such an aggressive price hike not had a more dramatic impact on the world economy?

- Firstly, the increase has been much more limited than the oil shocks of the 1970s (in real terms, the peak price at that time was nearly \$90).
- Moreover, oil demand has been decelerated over the last 30 years. The dependence of OECD economies on oil (measured by the amount used per unit of GDP) has almost halved. This has been particularly true in Europe, and in Japan (which, while being the world's third largest oil consumer, is one of the most energy-efficient countries in the world). The key steps to this have been greater fuel efficiency, changes in their industrial composition, and diversification to other energy sources. At the same time, the dollar pricing of oil has tended to shield economies whose currencies are (otherwise uncomfortably) strong – interestingly, international oil revenues are increasingly being invested in Euros, contributing to its continuing strength.

- Another important factor is the current rise in oil prices is taking place against a backdrop of low and stable inflation, and low interest rates. Higher prices have so far impacted on headline inflation, while core inflation (that is, the rate of inflation excluding certain sectors whose prices are most volatile, specifically food and energy) and wages have hardly changed. We are well placed to avoid the inflationary spiral of the 1970s.

71. It might be, then, that the recent price rise was no more than a spike, which had a less fundamental impact than might have been expected, and is likely to be reduced soon. But is this true?

72. Perhaps not. The IMF and Goldman Sachs are among those who, in recent months, have warned of a 'permanent oil shock', with prices even higher than now – perhaps as high as \$100 per barrel. It is possible that, just as Chinese demand was underestimated before, we are underestimating future demand. World trade is forecast to continue its strong growth, driven by the less energy-efficient USA and China, and entailing the rapid rise of many emerging economies, with huge pent-up potential for energy consumption. And meanwhile, geopolitical anxiety is growing, rather than diminishing, especially in relation to oil-producing regions.

73. This is plausible – and that plausibility has already made it damaging. For in the OECD's view, perhaps the most serious effect of the current price level – and, crucially, its volatility – has been increasing uncertainty and damaging confidence. In an increasingly forward-looking world, OECD says, perceptions may have a greater impact than real month-to-month price changes.

74. It is certainly true that the oil price has increased far more than is implied by the currently established fundamentals, and carries a substantial 'risk premium'. One may argue that reserves are good, that steadily increasing prices will make new reserves commercially viable, and that it is in the interests of OPEC to avoid price shocks. But with the rise of former developing countries high structural demand may be here to stay, and more quickly than had been expected. Demand from emerging economies will definitely play an increasing role in determining prices – both because of their increasing contribution to world growth, and the energy intensity of their activity.

75. In response, there is a need to make further progress in energy efficiency, first and foremost in the United States, and find means to encourage this in emerging markets (the OECD points out that higher energy taxes tend to reduce the impact of oil price hikes). Alongside this, there is a need to diversify to new energy sources (as Japan has successfully done). As was pointed out in last year's report, sustainable development is a priority in an era of high growth.

76. The OECD finds it particularly interesting that countries have overcome the oil shock with different degrees of ease. In the United States, United Kingdom and Canada and, outside the OECD, China, the oil shock has been overcome at a limited cost. By contrast, Germany, Italy and Japan have languished in the face of the oil shock, in part because they were more dependent on external demand, at a time when world trade was negatively affected by the oil shock. This different degree of resilience in the face of external shocks is an important feature in the current heterogeneous pattern of growth across the OECD.

77. The need for adaptation is urgent, for previous OECD studies have suggested that every \$10 added to oil prices subtract around 0.5% from world GDP. And while no one, not even the speculators, can be sure of oil's future direction there is, as the Rapporteur heard in his meetings, no imminent sign that prices will fall. It seems that the world is coming to terms with the uncertain and finite nature of its most important commodity – and pricing it accordingly. The Rapporteur recalls the Parliamentary Assembly's debate at the end of April 2005 on "Europe's growing energy vulnerability" in which this issue was amply described.

V. More recent developments: the "Katrina" hurricane, further oil price rises and EU-China textile frictions

78. This past summer has been overshadowed economically by two events: firstly the rapid and relentless further rise in oil prices, to reach well over 60 dollars per barrel and with no let-up in sight; and secondly the hurricane "Katrina" that hit Louisiana, Mississippi and adjacent American States in August, causing the entire inner New Orleans to be flooded with hundreds of dead and thousands of homeless and evacuees. The total cost of the hurricane could amount to over 40 billion dollars, according to the insurance company Swiss Re. A second hurricane of about the same magnitude hit mainly Texas in late September, causing additional damage.

79. In the OECD's interim report on the economic situation in the OECD area, published in early September, the organisation was able to only partly incorporate these two events into its economic forecast. It is clear, however, that the organisation sees this new 'oil shock' as in many ways as significant as that of 1973. It sees one difference, however, as lying in the considerably improved energy efficiency in the OECD member states reached since then. Another difference is that this time the price rise is due to steadily rising and seemingly unstoppable demand from more and more countries in the world, whereas in 1973 the OPEC oil rise was ordained by that institution rather than dictated by market forces. Whatever, the OECD says it is too early to try to predict the longer term consequences of the price rise (or indeed how long it will last), except that the resulting uncertainty is likely to impair both investment and private consumption.

80. Whereas Katrina will mainly affect the US economy (with knock-on consequences for the world's insurance sector), the oil price rise, so the OECD says, will influence different countries differently. Generally speaking, countries and regions with currently stronger growth, such as the US, will be less affected, while Japan and above all parts of the eurozone will suffer more. Higher energy prices may further dampen consumption in more vulnerable economies and thereby drag core inflation (that is, excluding energy) down further as people spend more on especially petrol and less on other items.

81. The OECD even talks about a risk of deflation and, in what amounts to a softening from its recommendation of May 2005, contents itself with recommending to the European Central Bank that it at least not increase its policy-setting interest rate. It also advises the US Federal Reserve to consider making a pause in its successive interest rate rises, lest a recession take hold.

82. Finally, the OECD regrets that only slow progress is being made in Europe and Japan when it comes to reducing fiscal imbalances. While recognising that fiscal income in the US has improved following recent strong growth, the OECD remains uncertain as to whether this will lead to a sustained improvement in the countries' fiscal situation.

83. The divided stance of the member states of the European Union as regards globalisation and more open trade became evident during the summer. Urged on by a number of EU member states – essentially France and a number of Mediterranean members – the European Commission blocked imports of a large quantity of garments from China, despite the lifting of quota restrictions as from the beginning of 2005 in accordance with a WTO agreement. This resulted in huge quantities of pullovers and other clothing being temporarily stored in warehouses at various import points, and large numbers of highly discontented EU retailers who were now unable to fill their stores in time for the autumn season. In the end an agreement between the EU and China was reached in September 2005, signifying that around half of the blocked garments would be let in and the other half counted against shipments foreseen for 2006. The internal EU division on textile imports highlighted both the vulnerability of the textile sector in many member states (and of textile exporting countries nearby, such as in North Africa) and the dependence of European retailers and the consuming public on price-worthy imports.

VI. The US current account deficit: uncharted territory

84. Among developed countries, the **United States** is not unusual in running a current account deficit, and it has done so fairly consistently since the early 1980s; but never has the world's leading economy been so heavily indebted. The US deficit is at its highest recorded level, and likely to worsen from 4.5% of GDP in 2003 to 6.25% by 2006, with no path to reduction in sight. Its course will affect the entire world economy.

85. Some think the deficit sustainable. The US achieves healthy growth rates, of course, and expressed as a share of GDP, still has a relatively low level of net foreign liability, around 25% (although in 1980 it enjoyed foreign net assets of 13%). As a comparison, Australia, with a long-standing deficit, has liabilities approaching 60%. And at present, there seems to be little overt stress involved in servicing the debt. US interest rates have remained low, while demand for debt securities has been strong, and although the dollar is weak, it has not collapsed. In fact, the willingness of overseas lenders, particularly Asian central banks to continue buying dollars has been one of the key factors in stabilizing the currency.

86. And that may be precisely the problem. While many countries routinely operate large deficits, it is the scale of the funding required by the US that makes it, in the OECD's view, unsustainable. And the financial markets fear that this is true. A recent hint by the Korea's national bank that it would transfer out of dollars was enough to send the US stock market, and the dollar, into free fall (their intentions, it was quickly explained, had been misunderstood).

87. And of course, each new deficit adds to the foreign liability level, which will – were the deficit were to proceed at 5% while GDP growth were also at 5% - pass 50% within a decade, and eventually reach 100%. This process will, therefore, substantially increase the perceived risk of investing in the US. And in addition, prolonged imbalances encourage demands for trade protectionism, a trend already in evidence in the United States.

88. A deficit of this size inevitably absorbs a significant proportion of the world's total savings, and implies an increasing share of dollar assets in investor's portfolios. While the US is an attractive investment destination, there must be a risk that investors will find more profitable returns elsewhere – as previously noted, there is currently a large amount of investment cash chasing good opportunities worldwide. If that happens, Asia's authorities – who have a clear vested interest in the US economy – will become more and more crucial. Yet there must be a limit to their ability to take on foreign debt.

89. If that limit were reached, the incident with Korea's national bank suggests what might well follow: the dollar and the markets would crash, interest rates would rise sharply, and the US would be plunged into recession, quickly followed by the rest of the world. Protectionism would be all too likely. Some think that it is precisely because of the awful consequences that this simply will not be allowed to happen. But the OECD continues to urge that action be taken, sooner rather than later.

90. Even if there is no crash, US incomes and demand will become increasingly decoupled from production, as the share of foreign assets rises, which will prove dangerously destabilising for the economy, and make solving the problem even harder in the future.

91. Of course, any narrowing of the deficit will have implications not only for the United States, but also for its trading partners. The OECD has examined several routes by which this might be achieved in the near term – via changes in exchange rates, a change in national savings levels, or non-price export competitiveness

92. The first foresees a further decline in the currency, the traditional means to correct trade imbalances. The OECD calculates that, to achieve an improvement worth 2% of GDP over 6 years, an overall decline of 22% in the dollar would be needed (spread around all currencies). This would have a huge shock effect on trading partners, particularly Japan; it would also push up inflation, and therefore interest rates (and therefore would increase US debt repayments).

93. The second possible solution would involve raising the level of national public savings, via a reduction in the government deficit: but to achieve the same 2% fall in the trade deficit, they calculate that a 6% reduction in the government deficit would be required. Not only is this highly ambitious, it would also impact heavily on the domestic economy. Interest rates would need to fall, which would very likely lead to a fall in private savings levels. If the reduction in private savings were to cancel out the increase in public savings, the whole measure would fail. And the economic effects would certainly be severe.

94. The third, and most interesting, considers a structural improvement in US exporting. An important explanation for the present remorseless deterioration in the deficit is the greater appetite of Americans for imports, relative to overseas demand for their goods. While this 'elasticity' lasts, the deficit will continue to get worse even if the economies of trading partners are growing at the same rate as their own economy – so stimulation in the rest of the world will do little to narrow the US deficit. In fact, this is a key reason why other models for deficit reduction seem to require such stringent measures to achieve so little impact.

95. There are several explanations for this import elasticity. Compared to other developed countries, the US has a youthful population profile – and the young tend to be attracted to a wide variety of modern, fashionable goods that are not made domestically (they also need fewer domestic services, such as healthcare). The US is closely linked to the world's most dynamic and new economies, which by nature tend to be export-driven, and which have positioned themselves to produce just the variety and quality of goods demanded. In addition, the US has a relatively high immigrant population, with less loyalty to domestic products.

96. This situation has been exacerbated by the competitiveness of the US economy, where offshoring and relocation have become common, and the distinction between 'domestic' and 'imported' is blurred (to the increasingly Hispanic population of the western US, products made in Mexico may be seen as domestic). If all these factors are accounted for, the OECD finds that the US is not much more 'elastic' in its import demands than other developed countries. And in fact, this elasticity is reversed in the provision of services, where the US has a strong competitive advantage.

97. So the United States needs to secure a more liberal environment for world trade in services, and at the same time needs to emulate newer economies, by producing a wider variety of modern products for export. It should be well placed to do this, given its exceptional technology base, good productivity and flexible labour force. In their analysis, the OECD found that a 2% of GDP improvement in the deficit could be achieved if the US share of world imports rose by 2% per year over 6 years. This performance would distinguish it amongst the major economies, but is not implausible in the context of recent examples of 'catch-up' growth. Ireland has recently achieved something very similar.

98. Of the three routes examined, this is also least costly and disruptive option for other countries; but all the same, protectionism could prove a sizeable obstacle, as the recent difficulties in trade liberalisation talks have demonstrated. Nonetheless, it might though be in the interests of the world not only to allow the US to follow this route, but to help them to achieve it! And perhaps the OECD's analysis offers insights for other developed countries wrestling with a persistent trade deficit.

99. The external deficit of the United States has as its counterpart external surpluses elsewhere. The unwinding of global imbalances could be facilitated by macroeconomic policies that reduce national savings in surplus countries, such as Germany. In this latter group of countries, what is needed are macroeconomic policies helping to switch the growth pattern in favour of domestic demand, including accommodative monetary policies. Combined efforts to reduce global imbalances would reduce the potential for disorderly adjustment. Similarly, a move towards more flexible exchange rate regime, especially in China, would also help to avert too sudden a reduction in imbalances.

VII. The OECD: outreach and expansion

100. Founded in 1961, the OECD grew out of the post-war mechanism to manage reconstruction under the Marshall Plan. Today it has 30 members, who together represent around 20% of the world's population and 75% of the world's trade. Over time, the organisation has developed a range of cooperation and outreach programmes, so that today 22 non-member countries are either full participants or regular observers in various OECD Committees and Working Groups.

101. The overall aim of these programmes is to assist economic integration by making the OECD's expertise more widely available, and by providing a forum where members and non-members can share each other's insights and points of view. At a global level, there are nine OECD Global Forums: trade, governance, taxation, competition, sustainable development, agriculture, the knowledge economy and international investment and education.

102. With the geopolitical changes of the last 15 years, improving the quality of governance in emerging economies has become a special focus of OECD activity. And recent corporate scandals show that the issue is alive and well in developed countries, too. As last years report described, the OECD has recently revised its Principles of Corporate Governance, and these have been adopted – in member countries and beyond - as a benchmark of good practice. Five regional Roundtables have been established to promote and support their implementation. Encouraging investment for development has also become a key area of activity, as the world struggles to put the Millennium Development goals into action. This year, we will look at some of the 'field' programmes underway, which help put such principles into practice.

Country Programmes

103. Three specific country programmes are in place, designed to assist the development of major non-member economies. In each case, the OECD produces specific country reports, and individual support for policy development.

- Beginning in 1998, the **Brazil Programme** has been highly successful, with recent joint conferences held on public debt management, pension reform, and curbing conflicts of interest in the public service. The OECD has invited Brazil to take part in a study of agricultural liberalisation in the context of the WTO's Doha negotiations, and acted as advisers to the current President's transition team. They are now working with the government on a restructuring of competition policy. A first OECD Economic Survey of Brazil was published in 2004.

- The **Russia programme** has focussed on a review of regulatory reform, and measures to assist with Russia's accession process to the WTO (due to be completed at the end of this year). Five economic surveys have now been compiled, the most recent addressing macroeconomic developments, especially the role of financial intermediaries and corporate governance. A series of local workshops on Environmental Compliance Indicators is also underway.

- As part of the **China programme**, events have recently been organised to support the development of intellectual property rights, and in early 2005, China joined an OECD/ADB anti-corruption initiative. Work in progress has also included agriculture reform, a **policy-dialogue** on corporate governance, education programmes, and mechanisms for improving the distribution of investment across the country. Last year saw the launch of the China Governance Project, designed to encourage local policymakers to address key governance issues. This year the OECD has for the first time carried out an Economic Survey on China. There has also been a focus on encouraging high-quality Foreign Direct Investment; the OECD is encouraged by the progress already made in establishing laws and regulations that are conducive to this. Finally, China participates as an observer in the OECD's Committee on Scientific and Technological Policy, to which should be added many contacts with Chinese government officials in other domains.

Regional Programmes

104. The South East Europe Compact for Reform, Investment, Integrity and Growth ('The Investment Compact') was established in 2000 and is currently co-chaired by the OECD, Austria and Bulgaria. It is part of the Stability Pact for South Eastern Europe² and supports the improvement of the business environment through structural policy reform. The Investment Compact, which is underpinned by a group of OECD donor countries, offers a pragmatic approach stressing the responsibility of the region for its own future, capacity building, partnership and support from the international community and private sector, peer review and sharing of experience within the region and with OECD countries to maintain the momentum of change.

105. In 1992, a joint venture with the EU, another regional project was established to improve governance and management in the transition economies of central and eastern Europe. Known as **SIGMA (Support for Improvement in Governance and Management)**, it has focussed on modernising systems of public governance, such as the judiciary, audit and expenditure management and public procurement. In particular, SIGMA has advised EU candidate countries on institution building and the creation of legal frameworks that are aligned with EU legislation. SIGMA also focuses on civil service systems and policy making and co-ordination as important elements in any modernisation agenda.

106. Over the last 3 years, in fact, a range of regional **programmes and initiatives** have been established:

- The launch of **NEPAD (the New Partnership for Africa Development)** has enabled a strengthening of links with Africa. 2003 saw an OECD/NEPAD African Investment Roundtable in Johannesburg, resulting in a joint initiative to create a positive investment environment, with the OECD helping to create the local peer review mechanism that is a crucial part of the NEPAD concept. In addition, the OECD provides assistance to West Africa through the Sahel and West Africa Club, an informal dialogue grouping, with a particular aim of helping the region to meet the Millennium Development Goals

- There have also been fast-developing links with Asia and Latin America. After the first OECD/India workshop took place in Delhi, dealing with privatisation and governance of state-owned assets, India went on to host the OECD's 2004 Global Forum on International Investment. An Asian Roundtable on Corporate Governance is now in its third year; having previously focussed on enforcement and implementation, this year it will assess achievements so far, and set out remaining challenges. The Regional Programme for Latin America covers areas such as competition, corporate governance, taxation and the environment. It is carried out in cooperation with the UN Economic Commission for Latin America and the Caribbean (ECLAC).

² See www.stabilitypact.org and www.investmentcompact.org

- The newest such regional example is the ***Initiative on Governance and Investment for Development***, undertaken by **MENA (the states of the Middle East and North Africa)**, supported by the OECD to promote reforms to enhance investment, modernise governance structures and operations, strengthen regional partnerships and promote sustainable economic growth.

107. The MENA initiative has two components, 'Good Governance for Development', also supported by the OECD and the 'Investment Programme'. It has been designed as a regional effort, originated and led by the countries themselves, and has involved establishing a unique structure of working groups with access to experts and policy networks from OECD countries.

108. Each component will focus on concrete actions with specific delivery dates, combined with an ongoing monitoring and support system. There is a three-year plan cycle 2005-2007, covering assessment, implementation and reform evaluation. The key element of the OECD's work will be to support the creation of action plans, and to monitor their implementation through dialogue and group learning. The initiative also hopes to develop specific and costed development proposals, which could then be supported by donor countries and agencies, increasing the range and impact of bilateral programmes in the region.

109. The extent of the OECD's "outreach" strategy became abundantly clear during a most interesting OECD Forum 2005 held in Paris in May under the heading "Fuelling the Future – Security, Stability, and Development". The aim of the conference was to examine how globalisation should be shaped so that all countries may profit from it and at the same time make the necessary structural adjustments, including in the services sector. Among the aspects highlighted were the consequences of globalisation for the development of the economies of the OECD's member countries, their structural adaptation to meet the rising competition from increasingly important emerging economies, the obligations of industrialised countries in realising the United Nations Millennium Development Goals and the Monterrey Declaration, and finally the possibilities to speed up the negotiations on the Doha Development Agenda, for instance as regards the opening of domestic markets, the liberalisation of agriculture and the elimination of exports subsidies.

110. This ever-widening range of activity raises an interesting question: to what extent should the OECD itself be a 'club' of developed countries, lending its expertise and facilitating development, and to what extent should it expand to include the world's many emerging economies?

111. The OECD is well aware of the question – and in fact, the 1990's saw the largest wave of accessions since the organisation was founded. Mexico, Hungary, the Czech Republic, Poland, Korea and the Slovak Republic all gained membership between 1994 and 2000. And last year, the OECD issued a report on internal reform, which revised, and went some way toward clarifying, the basis on which new accessions would be considered and the process by which they would be confirmed (although no new candidates were specifically mentioned).

112. As set out in the report, any new member must be committed to pluralistic democracy and a market economy. In addition, and more subjectively, they should be regarded as 'like-minded', and as a 'significant player' – and the report frankly states that new accessions must be 'ultimately and fundamentally a political decision' by the OECD's governing council. It is hard to disagree with any of this, and we look forward to seeing the new candidates that it is hoped will emerge via this revised process. For it is notable, when reading the OECD's own (highly authoritative) reports, that membership's share of world exports and imports has been in decline for some years. The challenge for the organisation will be to maintain its enviable reputation, by expanding neither too quickly nor too slowly, and by achieving a constituent balance that reflects the world's trade, without sacrificing its membership ideals.

VIII. Concluding comments

113. A survey of the world economy as brief as this one can draw only broad conclusions, but several are evident.

114. The prospects for growth in world trade are good, in fact it is quite possible that new records will be set in the next few years. There are, however, sizeable risks.

115. For the foreseeable future, the price of oil will have a huge effect on economic performance. And while it is possible that we will face even higher prices, it is all but certain that prices will be higher than we have been accustomed to. The world's response to this challenge, in improving efficiency and diversification, will do much to determine our long-term growth potential. Yesterday's environmental issues are becoming today's economic issues.

116. It is also clear that the pattern of world trade has changed for good. This is good news for those who live in the world's emerging economies, and can expect a better standard of living for their children. It has also done much to fuel higher living standards in the developed countries, although the structural challenges evident in each reflect the climate of uncertainty that has also been created. Many seem to fear that, when world trade does at last rebalance, they will find that they have been the losers.

117. Those developed countries that have adapted best have done so by encouraging domestic demand, often by encouraging property ownership. In the best cases, these changes mirror social developments and aspirations. Various approaches can be seen, but in each case they are leading to the creation of sophisticated consumer-driven societies, that can capitalise on their high levels of productivity and skills. The Committee on Economic Affairs and Development was treated to a very interesting presentation at its June 2005 meeting in Paris on how more open trade by countries can in fact ease the pain of globalization, especially if coupled with liberalization of services. Indeed, the bulk of the most advanced and wealthy economies are now overwhelmingly in services as opposed to production, meaning that services can benefit from the cheaper goods and brisker consumption that results from liberalized trade, and that services can themselves become more competitive as a result of liberalization in the services sector, including in the exports of services to other countries.

118. The complexity of world trade, and the expansion of domestic wealth, will now challenge developed countries to manage their finances with skill. The OECD has long urged its member countries to correct their deficits – and never more so than this year. Developed countries have weak public finances, they point out, at the very time when demographic changes are on course to put them under the most pressure. The key challenge will be to balance saving and spending needs – so as to avoid, in the future, the dilemma of US consumers today, who are personally in debt and whose government is in debt. The question, as highlighted by the current debate about Social Security funding, is who will pay their pensions?

119. It is with these concluding questions that your Rapporteur submits his provisional report to his colleagues on the Enlarged Parliamentary Assembly and the similarly Enlarged Committee on Economic Affairs and Development, in the hope that they will add many valuable comments and amendments in time for its final adoption.

Appendix

Modification of the Rules of Procedure for enlarged debates of the Parliamentary Assembly on the activities of the OECD

1. The Rules of Procedure for the enlarged debates of the Parliamentary Assembly on the activities of the OECD were adopted in 1992 and amended in 1994. They appear on pages 150 – 158 of the 2005 version of the Rules of Procedure of the Assembly.
2. Over these years, the Rules of Procedure of the Parliamentary Assembly of the Council of Europe have been modified to reflect changing circumstances, such as the Council's enlarged membership now counting 46 member states plus observers.
3. In line with the above, the Rules of Procedure for the enlarged Assembly are modified as follows:
 - Part III.1, add "or a Vice-President" after "the President";
 - Part III.1, delete the second sentence;
 - Part V. 5, align speaking times with those in the Assembly, i.e. persons speaking on behalf of committees 3 minutes;
 - Part VI. 3, add at the end "Sub-amendments must be tabled at least one hour before the end of the previous sitting of the same part-Session preceding that in which the debate begins", same rule as for the Assembly;
 - Part VI. 5, 1 minute instead of 3 minutes;
 - Part VIII. 2, change "ten members" to "thirty members" and "three parliamentary delegations" to "five parliamentary delegations";
 - Part IX. 6, replace "three minutes" by "one minute".

Please note that on page 154 of the Rules, at the end of Part VI. 3, it should read (in English only) "... and, as regards amendments, by 7 pm on the eve of the debate".

Reporting committee: Committee on Economic Affairs and Development

Reference to committee: Standing mandate

Draft resolution unanimously adopted by the Enlarged Committee on Economic Affairs and Development on 4 October 2005.

Members of the Committee: Mr Evgeni **Kirilov** (Chairperson), Mrs Antigoni **Pericleous Papadopoulos** (Vice-Chairperson), Mr Márton Braun (Vice-Chairperson), Mr Konstantinos **Vrettos** (Vice-Chairperson), MM. Ruhi Açıkgöz, Ulrich Adam, Hans Ager, Abdülkadir Ateş, Radu-Mircea Berceanu, Akhmed Bilalov, Jaime Blanco (alternate: Mme Elvira **Cortajarena**), Patrick Breen, Milos Budin, Erol Aslan Cebeci, Mrs Ingrida Circene, MM. Ignacio Cosidó, Giovanni Crema, Øystein Djupedal, Ioannis **Dragassakis**, Iván **Farkas**, Joan Albert Farré Santuré, Relu Fenechiu, Mrs Siv **Fridleifsdóttir**, MM. Carles Gasóliba, Francis Grignon, Alfred Gusenbauer (alternate: Mrs Christine **Muttonen**), Nick Harvey, Norbert **Haupt**, Anders G. **Högmark**, I. **Ivanov**, Klaus Werner Jonas, Ms Verica Kalanović MM. Karen Karapetyan, Orest **Klympush**, Anatoliy **Korobeynikov** (alternate: Umar **Dzhabrailov**), Rudolf Kraus, Zoran Krstevski, Jean-Marie Le Guen, Harald Leibrecht, Rune **Lund**, Gadzhy Makhachev (alternate: Mrs Liudmila **Pirozhnikova**), Jean-Pierre Masseret, Miloš Melčák, José Mendes Bota, Mrs Ljiljana **Miličević**, MM. Neven Mimica (alternate: Mr Petr **Lachnit**), Gebhard **Negele**, Conny **Öhman**, Oliveira Martins, Mart **Opmann**, Bogdan Podgórski, Jakob **Presečnik**, Jeffrey Pullicino Orlando, Luigi Ramponi, Maurizio Rattini, Maximilian Reimann, Dario Rivolta, Volodymyr Rybak, Kimmo **Sasi**, Bernard **Schreiner** (alternate: Mme Josette **Durrieu**), Samad Seyidov (alternate: Aydin **Mirzazada**), Leonid Slutsky, Ms Geraldine Smith, Mrs Aynur Sofiyeva, MM. Christophe **Spiliotis-Saquet**, Qazim Tepshi, Frans Timmermans (alternate: Tiny **Kox**), Dragan Todorović, Mrs Ágnes Vadai, Mr Luc Van den Brande, Mrs Jelleke Veenendaal, Mrs Biruté Vésaitė, MM. Oldřich Vojtš, Varujan **Vosganian**, Robert **Walter** (alternate: David **Marshall**), Andrzej **Wielowieyski**, Marek Wikiński (alternate: Ms Grażyna **Ciemniak**), Paul **Wille**, Mrs Rosmarie Zapfl-Helbling, Mr Kostyantyn Zhevago.

Canada: Mrs **Milne**, Mr **Tilson**, Mrs **Lalonde**, Mr **Lee**, Mr **Rivest**
Japan: Mr **Seko**, Mrs **Murata**, Mr **Kazama**
Mexico: Mr **Margain**

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

Head of Secretariat: Mr Torbiörn

Secretaries to the committee: Ms Ramanauskaite and Mr de Buyer