

Meeting of the OECD Council at Ministerial Level

2009

Key Information



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Les questions clés

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Preface

Dear Minister,

This 2009 OECD Ministerial Council Meeting (MCM), under the chairmanship of Han Seung-soo, Prime Minister of the Republic of Korea, will look at “The Crisis and Beyond: Building a Stronger, Cleaner, Fairer World Economy”.

In the context of the worst economic crisis in decades, the 2009 OECD MCM provides an excellent opportunity to assess the impact of the policy responses to the crisis, to discuss the options for restoring economic growth and reducing its social impact. We need coherent whole-of-government approaches, linking macroeconomic, structural and regulatory policies. The OECD is well-placed to support this effort.

The crisis underlines the need for a new impetus to international co-operation and multilateralism. A rapid and sustainable recovery requires well-designed and properly implemented co-operation among governments, international organisations, business, labour and civil society. This MCM is thus part of a broader effort in this regard, and this is reflected by the co-Chairmanship of the United Kingdom, Italy and Denmark, which are currently chairing other important international fora, respectively the G20, G8 and the UNFCCC. Korea will itself chair the G20 Summit next year.

To build a stronger and fairer economy, the discussion about the “road to recovery” will allow us to review the necessary policies, as well as the urgent need to put public finances on a sustainable track. In doing so, we will also address the two crucial issues of how to avert an impending social crisis and how to meet development challenges.

This crisis should also be an opportunity to kick-start a shift towards a cleaner economy. Green growth must be the way forward and we will review how to implement policy measures addressing the economic crisis while supporting a sustainable and environmentally friendly growth. We will also discuss the links between environmental challenges and long-term economic targets.

Meanwhile, protectionism in trade and investment threatens to undermine economic recovery and long-term growth. We will discuss how governments can best work together to prevent all forms of protectionism and keep markets open for trade and investment.

To achieve this ambitious agenda and strengthen OECD’s relevance in this turbulent period, we will examine the organisation’s role in the new global governance architecture. The OECD is already global in scope and missions, and is advancing in its goal to become a more plural and open organisation.

Global problems can only be addressed with the major emerging economies at the same table. This is the reason why I am delighted to welcome ministers from our accession and Enhanced Engagement partners, Brazil, Chile, China, Estonia, India, Indonesia, Israel, the Russian Federation, Slovenia, and South Africa. Their presence is a major breakthrough in our quest towards being more inclusive. It also provides an opportunity to develop a joint strategic response to the crisis.

I look forward to welcoming you to the OECD Week, where together, the MCM and the 2009 OECD Forum mark the highpoint of the Organisation's calendar. Collectively, we will focus on the opportunity at hand to shape a stronger, cleaner, and fairer world economy – for our generation and those that will follow.



Angel Gurría

Stronger

ECONOMIC SITUATION AND PROSPECTS

The global economy is contracting

The world economy is in the midst of its deepest and most synchronised recession in our lifetimes. The credit squeeze, wealth effects from declining house and equity prices and a generalised loss of confidence are dragging down economic activity everywhere. These factors are expected to continue to weigh heavily on output this year, before a policy-induced recovery gradually starts to build momentum. The contraction in output and the bleak economic outlook implies labour market conditions weakening throughout the world, as companies cut production, close factories and dismiss workers. Another consequence of the recession will be an exceptional degree of slack, which will push down inflation rates.

Risks and uncertainties

There are exceptionally large uncertainties associated with any forecast in the current climate, especially those related to the assumptions regarding the speed at which financial conditions improve. Moreover, the risks surrounding the outlook are higher than usual, and predominantly on the downside:

- The weakening economy could further undermine the health of financial institutions, which in turn could force a greater curtailment in lending, exacerbating the contraction in economic activity;
- The government actions in response to the crisis could prove insufficient to restore stability and confidence in financial markets;
- Some Central and Eastern European economies, as well as a growing number of developing economies may face external-payments and domestic-banking crises, intensifying the global downturn and raising the demand for external funding; and
- Against these risks is the possibility that national and international efforts to resolve problems in financial markets and the large macroeconomic stimulus recently introduced takes hold sooner and proves more effective than anticipated, advancing the start and increasing the pace of the recovery.

How should economic policy respond?

The response to the crisis requires both financial and macroeconomic policy actions. Governments and their monetary authorities have already taken unprecedented action through fiscal stimulus, monetary easing, liquidity injection, interbank loan guarantees and equity provision for troubled financial institutions. These measures have managed to avert an even more pronounced recession, and some of the effects of this policy response are now being felt. A comprehensive financial sector stabilisation plan that deals with impaired bank assets and broader concerns about bank solvency to restore credit supply and to boost confidence in financial markets remains critical, however.

It is also essential to maintain expansionary macroeconomic policies in order to effectively cushion the fall in economic activity and to prevent a deflationary downward spiral. And to have their maximal impact, conventional macroeconomic stimulus measures should be accompanied by well-designed employment and social policies that

scale up active labour market programmes and provide adequate safety nets to job losers and low-income families.

Furthermore, the remaining scope to ease monetary policy should be used fully by maintaining or bringing policy rates to near zero and committing to keep them at that level for as long as needed. At the same time, the monetary authorities should be ready to implement or expand their use of direct measures to support credit creation and enhance liquidity in markets. In the longer term, however, expansionary monetary policies and the enormous liquidity being injected risks leading to inflationary pressures if not promptly reversed once the recovery begins. Having an “exit” strategy is therefore important too. Coordination will be a desirable component of any exit strategy, as individual countries acting on their own may find it difficult to unwind in an orderly way the exceptional measures that are currently needed.

The effectiveness of fiscal policy in cushioning the economic downturn will in part depend on the design of packages. The largest short-run impact on aggregate demand is likely to come from government spending measures, but where tax cuts are implemented they are most effective if targeted at liquidity-constrained households. Choosing measures that both raise aggregate demand in the short run as well as boosting productive capacity in the long run, such as investment in infrastructure are especially desirable, provided the expected returns on projects are fully evaluated and can be swiftly implemented. The lessons from the Japanese experience with fiscal policy in the 1990s are relevant in this respect.

Policies to build a stronger and more resilient economy

In addition to these macroeconomic and financial policy actions, keeping markets open and avoiding new protectionism is crucial to strengthen prosperity throughout the world. It is imperative to avoid the risk that the economic crisis leads to a tit-for-tat escalation of barriers to trade and investment. Some features of economic emergency measures pose dangers in that respect. At the same time, there is considerable potential for both OECD and non-OECD countries to exploit further market opening. A quick, successful completion of the Doha Round would contribute to supporting world growth, boost confidence and demonstrate a commitment to competitive and open markets.

At the same time, there is a need to restore trust in globalisation, and to strengthen the functioning of not just financial markets, but labour and product markets as well. The OECD, through its analytical work and by bringing together policy experts from member and major non-member economies, is identifying across an array of policy fields good policy practices and reforms that support a better functioning market-based economy. Examples of this include OECD work on strengthening corporate governance, fighting corruption and money laundering and combating tax evasion.

FREEDOM OF INVESTMENT

So far governments have, for the most part, resisted protectionist pressures, but investment protectionism remains a threat. No recent examples have been observed of countries taking deliberate action to erect barriers to inward investment. Indeed, nearly all governments continue to welcome inward investment and some have recently taken measures to liberalise their investment policies. However, vigilance is needed and governments need to stand firm and reconfirm their commitments to open non-discriminatory policies on investment from abroad.

Participants in the Freedom of Investment (FOI) process hosted at the OECD reiterated their commitments to open investment policy and noted that the current context creates new challenges for investment policy makers. Many governments have adopted measures to channel public sector investment and subsidies and they often have considerable discretion in their application. Under some programmes, they attach conditions to investment and subsidies that may discourage outward investment. If such measures are not carefully designed, there is a risk of a drift toward discriminatory policies that could prejudice a return to sustainable growth.

OECD investment principles provide for flexibility as governments shape their responses to economic crises. While acknowledging that governments are currently facing exceptional circumstances and that they may need to take exceptional measures, FOI participants also stress the need to ensure that such measures do not unduly impede investment flows or distort competition. Such measures should not be maintained longer than necessary and should be designed from the outset with an “exit strategy” in mind.

Strengthened peer monitoring

Governments are aware of the risks of “new investment protectionism” and are seeking to deal with the issues it raises (for example, by coordinating responses to the crisis). FOI participants have agreed to work toward enhanced peer reviews which would include more complete and readily accessible information on policy measures, supporting analysis on new forms of investment protectionism and deeper involvement of non-members as full partners in the FOI process with equal rights and responsibilities as OECD members.

Enhancing public and private responsibility

FOI participants call on governments to work hand in hand with business to rebuild trust and confidence in international investment and to ensure that international investors conduct business with integrity and transparency.

The “Freedom of Investment” process

The “Freedom of Investment, National Security and 'Strategic Industries'” process helps governments to preserve and expand an open environment for international investment while also safeguarding essential security interests and taking action to recover from the current crisis.

Organised as Roundtables with OECD and non-member countries participating as equal partners, the FOI process provides: peer monitoring mechanisms, a multilateral forum for policy dialogue, the development of guidelines for good policy practice and a unique database on investment policy.

FOSTERING INNOVATION FOR SUSTAINABLE GROWTH

Innovation is a powerful tool for growth and one of the keys to countering the economic crisis. New and more efficient products, processes and technologies will help put countries back on a path to sustainable growth based on steady productivity gains – and deliver solutions to key environmental and social challenges. But unleashing the power of innovation requires action: financing constraints – both public and private – are constricting the innovation pipeline and threatening prospects for a durable recovery.

Fostering innovation

The economic crisis poses serious risks to investment, finance, trade, entrepreneurship and employment – the vital working parts of a country's innovation engine. R&D and new-product development are already in decline. Businesses are shifting their focus to shorter-term, lower-risk innovation and cutting back on the bolder investments that generate breakthrough technologies needed to address our economic and social ills. In response, governments are incorporating measures to preserve and strengthen innovation in their stimulus packages, including investments in long-term research, innovative start-ups and research addressing societal challenges (environment, ageing, etc.). Well-designed public-private partnerships are one way to enhance the resilience of investments in R&D over the business cycle.

Encouraging business renewal

Economic crises are times of industrial renewal: less efficient firms fail while more dynamic ones emerge and grow. This process is vital to a solid recovery and governments should not hamper it. Subsidies to support individual sectors or companies can harm the level playing field and inhibit entry of new firms. Crisis aid should be targeted and tied to long-term economic goals, notably higher productivity and the ability to respond to environmental challenges. Governments can also foster firm creation and growth by reducing administrative barriers and facilitating access to finance.

Investing in people and infrastructure

Support for education and training during times of crisis can accelerate the healthy transition to new jobs and emerging opportunities, stimulating productivity. Investment in high-speed broadband communication networks and in smart electricity grids can enhance innovation and growth if they are accompanied by regulatory frameworks which support open access to networks and competition in the market.

Greening the economy

The crisis could undercut efforts to promote a greener economy. Lower oil prices have already reduced incentives to switch to alternative energy sources – and the declining prices of raw materials are reducing pressures to use these resources more efficiently. Dealing effectively with many environmental challenges will require investment in innovative energy-efficient infrastructures as well as structural reform. Governments can accelerate the shift to a greener economy by providing a clear signal to investors by getting prices right and other measures to support environmental-friendly innovation and new technologies.

KEEPING MARKETS OPEN: AVOIDING TRADE PROTECTIONISM DURING THE CRISIS

The world has become steadily more globalised in recent decades. Employment and salaries have risen as countries import and export a greater share of their GDP and investment flows across frontiers. Trade and investment have been important ingredients in bringing about the unprecedented growth and prosperity which has meant that 4 billion people live in high growth countries or countries with OECD levels of income today, compared to just 1 billion 30 years ago. Now, however, with the global economic crisis, unemployment on the rise, and some major industries such as automobiles in trouble, the temptation is to blame those very same forces of globalisation and to advocate a retreat behind protectionist measures. This would be a grave error, the most predictable consequences of which would be to deepen and to prolong the recession.

What has been happening to trade flows?

Trade fell sharply in the last months of 2008 and during the early months of 2009. The aggregate drop is the largest that has occurred since the 1960s and is characterised by a high degree of synchronisation, in the sense that many, if not all countries, are experiencing simultaneous sharp falls in trade. Some countries and sectors are more hard hit than others. Mineral fuels and machinery and transport equipment are seeing the sharpest declines, as are the countries for which these are important sectors – notably Japan and Germany. Price falls explain some of the decline – oil and commodities prices have all come down sharply – but there are also significant volume declines. OECD is currently forecasting that the year on year fall in trade value in real terms in 2009 will be in the region of 13%.

What has caused trade to collapse?

As credit dried up so too has demand for those consumer goods that are heavily dependent on credit such as cars. Risk averse households are postponing discretionary purchases and saving more. Rising joblessness is adding to the weakness on the consumption side. Firms, big and small, have been cancelling or postponing investment decisions because they too are finding it difficult to get credit or are becoming more risk averse. Although difficult to document, the trade finance on which a very large share of trade is dependent also seems to have become increasingly difficult to obtain. The seemingly disproportionate falls in trade relative to GDP may also be explained by the complexities of modern supply chains, which assemble components and services from across the globe. Finally, although there has not been large-scale recourse to protectionist trade measures, some countries have raised tariffs or instituted import licensing and there has been a noticeable increase in the number of anti-dumping actions being initiated at the WTO. These actions also make trade more difficult.

The dangers of trade protectionism – and retaliation

The most serious threat to the international trading system could come from the dynamo effect that would be started by unilateral protectionist measures that in themselves might not be severely damaging but which are inevitable matched by other countries in retaliatory exchanges. It is generally agreed that such beggar-thy-neighbour actions

significantly exacerbated the Great Depression that began in 1929. The danger is not confined to traditional border measures such as tariffs. Sectoral initiatives that bolster specific industries may have effects similar to direct export subsidies and may also trigger competing interventions as other countries seek to level the playing field. Any measures that seek to discriminate between domestic industries and those of foreign competitors run the risk of triggering harmful retaliation. History tells us also that such measures, once taken, are extremely difficult to unravel. Their persistence would present a significant obstacle to resumed growth once the other factors necessary for recovery are in place.

What should the trading nations do?

Resort to increased protectionism should be avoided. This applies equally to measures that could be taken within existing international rules and disciplines (for example raising applied tariffs to the maximum allowed bound rates) as to those that are not “WTO legal”. Initiatives that are akin to sectoral subsidies or that stimulate exports should also be avoided. In line with the pledges made already at OECD and by G20 leaders at their meeting in April, governments should do everything in their power to ensure that trade finance is available in sufficient volume to keep trade flows moving, immediately and when recovery gets under way. Finally, countries should do everything possible to bring the Doha Development Agenda negotiations to a conclusion. Locking in what is on offer would be the most effective way of guarding against the threat of a rise in protectionism and of ensuring that trade will provide needed momentum to recovery in GDP and employment, as the upturn gets under way.

What can OECD do?

OECD has joined its voice to those advocating strongly against protectionism and in favour of keeping markets open. It is undertaking analysis to decompose the steep trade declines that are occurring with a view to better understanding the causes and therefore the appropriate policy responses. The different responses being put in place by governments are being analysed to better understand their likely trade effects and to allow for a better understanding of which measures are most effective while being least trade distorting. The scope of measures being studied is broad, ranging from traditional trade instruments to NTM's, trade remedies, domestic stimulus packages and other behind the border measures. Strategies to ensure that temporary measures are ended once the economy begins to recover are being studied. The OECD's Working Party on Export credits and Credit Guarantees has been active in getting OECD and key non-OECD members and institutions to pledge to keep trade finance available. Most recently, in April 2009 it was agreed that governments and participating institutions would meet regularly in the OECD to exchange information on the measures taken by these governments and participating institutions in support of the G20 trade finance initiative and to ensure continuation of medium and long-term financing.

GLOBAL RELATIONS: ACCESSION AND ENHANCED ENGAGEMENT

At their meeting in 2007, ministers decided to launch accession negotiations with five countries (Chile, Estonia, Israel, the Russian Federation and Slovenia) and Enhanced Engagement with five others (Brazil, the People's Republic of China, India, Indonesia and South Africa), and to strengthen co-operation with regions of strategic interest, starting with Southeast Asia. This decision reflected their will to make the OECD more inclusive and thus strengthen the Organisation's relevance as a global hub for economic dialogue. It is even more important now that OECD members and non-members alike are devising ways to deal with the economic crisis. This will require the full involvement of all leading non-member economies, which the Enhanced Engagement offers an excellent opportunity to achieve. The participation in the 2009 Ministerial Council meeting (MCM) of all accession countries and Enhanced Engagement partners will help ensure that their views and interests are fully reflected in the discussions and duly taken into account in the strategic orientations for future OECD work.

Accession

The accession discussions, which were officially launched with the adoption of the Roadmaps by Council on 30 November 2007, are well underway and all candidate countries are co-operating actively with the OECD.

The Accession Roadmaps set out the terms, conditions and process for the accession of each candidate country. While there is a separate Roadmap for each candidate country, most of the elements are common to all. The Roadmaps provide for reviews of candidate countries by a number of OECD Committees which then provide formal opinions to the OECD Council on the ability and willingness of the candidate country to assume the obligations of membership and the degree of coherence between the policies of the candidate countries and those of OECD members. The obligations of membership include liberalisation commitments under the OECD investment instruments, adoption of national laws which comply with the requirements of the OECD Anti-Bribery Convention as well as commitments related to environmental policy.

Between June and September 2008, Chile, Estonia, Israel and Slovenia each submitted their Initial Memorandum, the document in which they specify their position in relation to all OECD legal instruments. The Russian Federation is aiming to submit its Initial Memorandum around the time of the MCM. The accession reviews by OECD Committees can only begin following the submission of the Memorandum.

The accession reviews of Chile, Estonia, Israel and Slovenia by Committees and their subsidiary bodies are now well underway and a number of them have completed their accession review of one or several candidate countries.

In the past months, the OECD has received a number of high-level visits from officials of the candidate countries including the President of Chile, Michelle Bachelet and the Minister of the Presidency, José-Antonio Viera-Gallo; the Chief Negotiator for Estonia, Marina Kaljurand; the Head of the Central Bank of Israel, Stanley Fisher; the Deputy Prime Minister and Minister of Finance of the Russian Federation, Alexei Kudrin; the Prime Minister of Slovenia, Borut Pahor and the Accession Co-ordinator and Minister for Development and European Affairs, Mitja Gaspari.

The Council oversees all aspects of the accession process and is regularly updated by the Secretariat on progress made. The Council is committed to continued co-operation with candidate countries and welcomes the progress made in the accession discussions.

Enhanced Engagement

Enhanced Engagement is offered to a few major economies that are potential future OECD members and whose engagement in the work of the OECD is particularly important for promoting policy convergence and global economic development. The process aims to integrate these partners into the OECD's regular work programme alongside members, rather than in separate activities that specifically address non-members.

All five countries have favourably responded to this initiative. In line with its aims, they have joined a considerable number of OECD bodies as regular observers or full participants. Enhanced Engagement partners have also adhered to OECD legal instruments, or expressed interest in doing so, and subscribed to declarations issued by the OECD such as those on the future of the Internet economy or on export credits. Efforts are underway to include the countries' economic data in the OECD statistical databases. The Enhanced Engagement partners are regular participants in OECD high-level meetings and have been invited to make contributions to the formulation of the OECD's strategic response to the financial crisis. The 2009-2010 programme of work includes a range of new activities, including an *Economic Survey* of each country as well as other peer reviews in key areas such as regulatory reform, investment or environmental policy.

The Secretary-General and Deputy Secretary-General Askey visited the Enhanced Engagement countries over the past months. In July 2008, the Secretary-General met with the Presidents and other high officials of both Indonesia and South Africa, and signed a Joint Statement on Enhanced Engagement with South Africa's Minister of Finance Trevor Manuel. In November 2008, the Secretary-General met with Brazil's President Luiz-Inácio Lula da Silva and Foreign Affairs Minister Celso Amorim. Recently, he visited China twice, meeting *i.a.* with Prime Minister Wen Jiabao, Foreign Affairs Minister Yang Jiechi and Minister of Commerce Chen Deming. Deputy Secretary-General Askey met with high-level Indian officials in Delhi, in March 2009.

The Enhanced Engagement process is overseen by the Council, principally through its External Relations Committee (ERC). The ERC has established reflection groups to allow members and the Secretariat to exchange information and discuss strategic directions on each Enhanced Engagement country.

THE OUTLOOK FOR FOOD AND AGRICULTURE

As expected in the OECD's 2008 edition of the *Agricultural Outlook*, most commodity prices are now significantly lower than their 2007-2008 record highs. Continued weakness in the general economy is expected to further dampen commodity prices over the next 2-3 years, followed by a period of strengthening prices with economic recovery. For the next ten years, real prices are still projected at, or above, the levels of the decade prior to the 2007-2008 peaks. Average crop prices are projected to be 10%-20% higher in real terms relative to the 1997-2006 average, vegetable oils 30% higher, with meats more or less unchanged.

How is agriculture faring in the economic crisis?

Despite the global financial crisis and severe economic downturn having an impact on all sectors of the economy, agriculture is expected to be more resilient coming off a period of relatively high prices and incomes and benefiting from a relatively income-inelastic demand for food. The reduction in agricultural prices, production and consumption is expected to be moderate as long as economic recovery begins within 2-3 years. Demand for more expensive beef meat is likely to be more affected by the downturn with a switch in consumption to cheaper meat types. In the medium-term, however, agriculture could be more severely affected due to credit constraints. A prolonged credit shortage would curtail both finance for normal operational expenditures, overseas trade and needed longer term investment in the sector.

The role of biofuels

Biofuel prospects increasingly depend on mandated use and prospects remain uncertain due to such unpredictable factors as crude oil prices, new policy interventions and developments in second-generation technology. Biofuels will struggle to compete with the current low fuel prices, although government support policies underpin ethanol and biodiesel production and prices. A projected rapid expansion of biofuel production to meet mandated use standards will continue to inflate prices for such feedstocks as wheat, maize, oilseeds and sugar.

Beyond the crisis

Once economic recovery begins the fastest growth in agricultural production and consumption will continue to come from developing countries. This is particularly evident for livestock products where the primary drivers are income, population growth, and urbanisation, which explain the trend towards western diets high in animal protein.

Population and income projections suggest food production needs to increase 50% by 2030 and to double by 2050. There is substantial additional land available for use in agriculture but bringing more marginal land into production can involve considerable investment and lower yields, while possibly incurring increased social and environmental costs. To capitalise on the potential to improve productivity growth, in particular in developing country agriculture, requires development, adaptation and adoption of appropriate technologies and infrastructures, to even diffuse existing technologies more widely, but growth in public agricultural research expenditures is slowing. Research investment today determines productivity gains a decade from now. This is thus an area requiring urgent attention.

FINANCING SMEs DURING THE CRISIS

SMEs and entrepreneurs are key players in all economies, generating an important share of income and employment and driving innovation and growth. They also face significant challenges, however, and access to financing is one of the most important. Innovative business and entrepreneurs are most badly hit by this lack of finance and the situation is being exacerbated by the most severe global, financial and economic crisis in decades.

The double shock of the crisis: a sharp decline in sales and cut backs in credit by banks

SMEs are facing a clear downturn, if not a slump, in demand for their products and services. This, added to the reported increases in payment delays to SMEs, is having a significant impact on their working capital and is generating an increase in defaults, insolvencies and bankruptcies in many countries. To deal with this situation, SMEs are reducing their credit demand, mainly for investment purposes, while banks are tightening their credit conditions and increasing their spreads (despite the general fall in interest rates). In terms of venture capital (an important source of financing for entrepreneurship and innovative SMEs), the crisis is reducing exit opportunities and fundraising activities while invested capital is stagnating or starting to decline.

How are governments responding?

Governments are undertaking three types of measures: 1) Supporting sales, cashflows and working capital through tax-related measures (*e.g.* cutting, deferring, refunding taxes, etc.), shortening payment delays to SMEs and export facilitation (export credit lines, credit insurance, etc.); 2) Enhancing SME access to liquidity, mainly to credit through bank recapitalisation and creation or expansion of loan and credit guarantee schemes and by mediating and monitoring bank lending to SMEs; and 3) Helping SMEs maintain their investment levels and respond to a possible surge in demand in the near future, through investment grants and credits, accelerated depreciation, and R&D financing. Although most of those measures are very recent and have not been evaluated, some policy implications can be drawn.

Policy implications and possible future actions

Guarantee schemes, accompanied with credit mediation and monitoring to increase their effectiveness, and other measures such as tax cuts and deferrals and shortening payment delays to SMEs, can help to resolve the insufficiency of working capital. This is the most urgent issue for SMEs financing at the current time. Innovative and high growth SMEs should be supported by the provision of risk capital through co-investments and the reduction/elimination of taxes on capital gains for investments in SMEs by venture capital funds. Policy recommendations for further action include fostering more competition in and increasing monitoring on SME and entrepreneur banking, more timely data gathering on SMEs, a more balanced use of “relationship banking” and advanced automatic credit evaluation systems; and enhancing SMEs’ credit and investment readiness.

INVESTING IN INFRASTRUCTURES – A VIEW BEYOND THE ECONOMIC CRISIS

An important feature of OECD and emerging economy stimulus packages in recent months has been investment in infrastructures. Governments have been seeking rapid impact on jobs and incomes, and so the additional spending has focused on so-called “shovel-ready” projects which can be brought on stream quickly, *i.e.* mainly maintenance, repairs and upgrades to roads, rail and buildings, and investment in IT. In a recession, however, there is a temptation to lose sight of the longer-term role of infrastructures in fostering economic and social development. Indeed, cutting back or putting on hold key infrastructural projects in energy and transport may significantly impede economic recovery as supply bottlenecks build up and unnecessary price jumps occur.

Looking beyond the current recession, demand for infrastructure is expected to continue to expand significantly in the next few decades, driven largely by growing populations in the developing world and the eventual recovery in world economic growth. Globally, the amount of infrastructure spending that is likely to be needed is considerable. Through to 2030 it is estimated that investment requirements for telecommunications, road, rail, water, and electricity transmission and distribution collectively will require about USD 2 trillion a year. That equates to about 2.5% of annual world GDP. If electricity generation and other energy related infrastructure investments in oil, gas and coal are included, the annual share of world GDP rises to around 3.5%.

Many parts of infrastructure systems in OECD countries are ageing rapidly so that a larger effort will need to be directed towards maintaining and upgrading existing infrastructures and to getting infrastructures to work more efficiently. But in many OECD countries public finances are becoming increasingly tight. This was already becoming apparent before the economic crisis, and the situation has further deteriorated since its onset.

As a result, a gap is opening in OECD countries between the future infrastructure investment required and the capacity of the public sector to meet those requirements from traditional funding sources. Bridging the looming “infrastructure gap” will require more efficient and more intelligent use of infrastructure assets through new technologies, demand management strategies, regulatory changes and improved planning.

But it will also demand innovative approaches to find new sources of funding. More diverse forms of public finance will need to be sought. This will include making more and better use of user-fees, creating mechanisms for securing long-term financing for infrastructure, such as long-term infrastructure funds or 50-year bonds, exploring the possibilities offered by land value capture – *i.e.* enabling governments to make use of the value of the land they hold – and promoting innovative variations on traditional financing mechanisms. Also, greater recourse to private sector funding seems inevitable. Especially in light of the current economic situation, this will entail a fresh look at PPPs (public-private partnerships) and exploring possibilities for a more active participation of pension funds and other large institutional investors.

THE IMPACT OF THE CRISIS ON REGIONAL ECONOMIES

In most OECD countries, sub-national governments account for the majority of public investment. Yet, the crisis is hitting regional and local government budgets hard at a time of difficult access to credit. There is a clear risk that some regional and local governments may have to reduce their public investments, running counter to national governments' efforts to stimulate the economy. Better co-ordination of public investment across all levels of government, as well as internationally, is imperative to make the most of scarce public resources.

This crisis is global, but it affects different regions in different ways. Early labour market and output data confirm that some regions are being harder hit than others. The impact of the recession is being felt by people where they live, and they expect governments to take visible steps to maintain and create employment locally. In doing this, governments should avoid the temptation to give subsidies to specific enterprises or sectors, as this may create distortions and lead to trade friction.

The most effective way to help regions is by investing in ways that lead to sustainable productivity growth. In other words, governments need to maximise the long-term impact of short-term stimulus packages. Regional policies have an important role to play in the design and implementation of long-term development policies. Because different regions have specific strengths, policies that build upon those strengths, rather than imposing a "one size fits all" approach, will lead to higher growth.

The new generation of regional policies focuses on expanding economic opportunities by investing in public goods and services conducive to strengthening competitiveness. This approach recognises that investment in infrastructure has a stronger impact on productivity growth if supported by investment in "soft" infrastructures such as human capital and networks of knowledge.

The key is creating the right conditions in which innovation flourishes in all types of region. Public policy also needs to address regions that may not be science leaders, but that can be innovative in other ways. Such regions need a different kind of policy that focuses on improving products and processes by capitalising on local knowledge.

Regional policy responses to the crisis can also foster a "green" recovery. Several fiscal stimulus packages have a green edge. Japan's Greening Cities policy includes the building of "eco-model cities". Korea's New Deal programme focuses on green homes, public transit, high-speed railways and the cleaning up of the major rivers. The German "Social City" programme combines social and energy efficiency goals. Rural regions can also play a major role in achieving more efficient production processes including through new investments in renewable energy. Investment in wind power and biomass can boost sustainable growth in the long term by helping achieve carbon reduction targets while building new economic opportunities in rural areas.

Cleaner

GREEN GROWTH AND ECONOMICS OF CLIMATE CHANGE MITIGATION

Tackling climate change should not be delayed

Ambitious action to reduce greenhouse gas (GHG) emissions is economically rational. The ongoing economic crisis provides no room for complacency. At most, it might reduce global emissions marginally and temporarily, after which an upward trend will resume. Delaying action on climate change would only necessitate larger cuts later.

Ambitious mitigation goals should be achieved through a policy mix, with an emphasis on price-based instruments

To build support for action, countries need to use least cost policies to achieve significant emission cuts. To keep the costs low, the policy mix should put a strong emphasis on putting a price on GHG emissions, *e.g.* through cap-and-trade schemes, to discourage the behaviour that generates them and encourage emitters to find abatement options where they are cheapest. But no single instrument will be sufficient to tackle the wide-ranging sources and sectors emitting GHGs. Given market and information barriers, price instruments will need to be complemented by standards (*e.g.* building codes, electric appliance standards) and measures to boost the innovation and adoption of cleaner technologies.

The economic crisis opens up new opportunities

The stimulus packages rolled out by many governments are opportunities for greening our economy. Many include direct public spending and tax incentives to support “green” investments in areas such as intelligent infrastructure, energy efficiency, alternative energy supply and “smart” grids, public transport, water supply and sanitation and pollution control. Investments in energy production, buildings and transport infrastructure stay for decades, so it is important to ensure that they do not lock-in polluting energy technologies and dirty modes of production and consumption, but instead promote clean alternatives.

The economic crisis also provides an incentive to improve efficiency in the use of energy and materials, and an opportunity to push through reforms for a greener world economy. For example, removing environmentally harmful subsidies to fossil fuel production and consumption would benefit both the environment and the economy. New OECD analysis estimates that removing fossil fuel subsidies in emerging and developing economies could reduce their greenhouse gas emissions by almost one-third in 2050.

We need to move now towards a green economy

Countries are even more aware now of the costs of policy action, making OECD recommendations on least-cost policies ever more relevant. Dealing effectively and efficiently with environmental problems will require “getting the prices right” through the use of economic instruments, such as environmental taxes or cap-and-trade schemes with auctioned permits. These measures have the added benefit, in a situation where public finances are over-extended, of bringing in revenues which could be used to cut other taxes that create economic distortions or to raise revenues to help pay for the stimulus packages.

Green innovation requires both R&D investments and getting the prices right

In the long-term, we will need new breakthrough technologies to address environmental problems. Pricing carbon or other pollution provides an essential incentive for the development and diffusion of greener technologies. Investors need a clear and credible price signal now to make the appropriate investment decisions for a greener future. New technologies, such as carbon capture and storage, will not be aggressively deployed without a significant carbon price. It is not a choice between better pricing or stimulation of technological innovation: better pricing will likely be one of the best triggers for such innovation. According to OECD calculations, a carbon price path consistent with a 550 ppm CO_{2-eq} stabilisation scenario could lead to a four-fold increase in world energy R&D spending by 2050.

All countries and all sectors need to take action

All large emitters will need to participate in mitigation action. Achieving even the moderate climate targets will be impossible through action in developed countries alone. Also, most of the cheaper emission abatement opportunities are located in developing countries, so their participation will be essential to keep the global costs of action manageable. But where action is taken, it needs to be decoupled from who pays for that action. Financing will be essential to support mitigation action in developing countries.

Similarly, all sectors will need to participate. The costs of incomplete industry or gas coverage of GHG policies would be high. For instance, exempting energy-intensive industries from carbon pricing would raise the cost by over 50% in 2050 to achieve stabilisation of GHG concentration at 550 ppm CO_{2-eq}.

Concerns about carbon leakage and competitiveness impacts are often exaggerated

Unless only a very few countries take action against climate change, carbon leakage rates and competitiveness effects of climate policies are very small. A scenario of only the EU taking action shows that about 20% of the emission reductions in the EU would be offset by emission increases in other countries. However, once all Annex I countries take action, this leakage rate would be reduced to 9% of emissions. Border tax adjustments or grandfathering domestic emission permits can reduce carbon leakage, but at a cost overall to the economy. Sector-wide agreements covering energy-intensive industries may offer a cheaper and more constructive alternative to mitigate fears of leakage.

RESPONDING TO THE CORPORATE GOVERNANCE LESSONS

There is broad agreement that weak corporate governance contributed to the financial crisis. When corporate governance arrangements at financial institutions were put to the test, in numerous cases, they failed to provide the checks and balances needed for sound business practices. Weaknesses have been identified in four key corporate governance areas. Remuneration structures encouraged excessive risk both in securities trading and at senior executive level. Risk management appears to have been partial and not enterprise-based and the information flow to boards was inadequate. Boards failed to oversee risk management systems and strategy so that independent objective oversight of management did not take place. Finally, shareholders failed to ensure board accountability and indeed in some cases they approved what turned out to be highly risky, short-term oriented decisions by management.

These four problem areas are, in fact, not unique to financial service companies indicating the need for a general policy response both by the authorities as well as the OECD as the global standard setter for corporate governance. Executive remuneration has been a long running problem in the corporate sector as have questions about effective board accountability and the exercise of shareholder rights. Risk management failures have also taken place in large non-financial companies.

Identifying problem areas is relatively easy compared to developing efficient policy measures. As a starting point, the financial crisis instigated an examination of the comprehensiveness of the OECD Corporate Governance Principles. Extensive research and consultations have revealed that the Principles remain relevant to examining the present situation but that their implementation has lagged. More needs to be done both by companies themselves and by the authorities. The OECD will take the lead, reviewing progress in the key areas and examining efficiency against the benchmark of regulatory impact analysis.

Immediate policy actions in the banking sector are required. To improve board capacity, prudential regulators have the tools to consider whether board members are competent to exercise independent, objective judgement. Better risk management practices such as ensuring direct access of the management function to the board can also be demanded by regulators. The Financial Stability Board took up the challenge of addressing weaknesses in remuneration policies by developing a “Code of Conduct” for institutions subject to prudential regulation. The Code will be implemented by bank regulators who have the powers to raise capital requirements if the remuneration system appears to increase risks. No such policy options are available for the corporate sector more generally, but clearly there is a need to improve outcomes. At the end of the day, shareholders, especially institutions, must assume a greater role, raising unanswered questions about their own governance and incentive structures.

FIGHTING CORRUPTION

Ten years after its entry into force, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions is the leading international instrument addressing the “supply side” of bribery.

The global economic crisis may lead to increased competitive pressures on companies to potentially engage in corrupt acts. A “Declaration on Bribery in International Business Transactions”, which reaffirms the OECD’s commitment to strong anti-bribery principles, will be brought to ministers for their consideration during the Ministerial meeting.

The Declaration states that the fight against transnational bribery remains a high priority, and that all countries must take responsibility to ensure that they are successfully implementing the Convention. It emphasises the importance of keeping foreign bribery investigations and prosecutions free of political and economic considerations. It calls on major exporting countries that are not parties to the Convention to meet its tough standards, and encourages companies to put in place effective measures to deter and detect bribery of foreign public officials.

The OECD Convention focuses on the person or entity that offers, promises or gives a bribe. Countries which sign the Convention are required to adopt and implement national laws that make it a crime for both individuals and companies to engage in bribery of foreign public officials.

To date, 38 countries – the 30 OECD members plus Argentina, Brazil, Bulgaria, Chile, Estonia, Israel, Slovenia, South Africa – have joined the Convention. It creates a strong foundation supporting countries’ actions to fight foreign bribery, and establishes tough and effective standards to guide these efforts. Its impact is clear. Countries are implementing laws, moving forward with prosecutions, and sanctioning foreign bribery offences.

The unique strength of the Convention is its rigorous, peer-driven review mechanism. The Working Group on Bribery oversees this mutual evaluation process, motivating countries to promote integrity, prevent corruption, and investigate and prosecute cases. It also allows sharing of ideas and good practices.

OECD countries, major emerging economies and developing countries alike are joining forces to prevent and punish corruption at home and abroad. However, increased connectivity allows corruption’s damaging effects to spread far beyond where the corrupt act is committed, throughout the global economy and society.

At this critical juncture, the OECD supports countries around the world in their efforts to curb foreign bribery and improve governance in both the public and private sectors. The OECD Working Group on Bribery is leading the global movement to eliminate bribery of foreign public officials from international business, ensure fair competition and support economic development.

COUNTERING INTERNATIONAL TAX EVASION

Tax evasion through tax havens and other non-transparent jurisdictions deprives governments of developed and developing countries of revenues needed for hospitals, schools and roads, forcing honest taxpayers to pick up the tab. It also prevents them from lowering taxes for all. **The OECD's work on harmful tax practices** has highlighted the harmful effects that result from lack of transparency, reliance on strict bank secrecy, or lack of effective exchange of information, all of which create opportunities for taxpayers to evade tax due in their home countries. The recent Liechtenstein tax scandal shows how a small tax haven can have a worldwide impact. The scale of the problem is significant. Experts' estimates of the value of assets held offshore range from USD 1.7 trillion to USD 11.5 trillion.

Standards of transparency and information exchange

The OECD, working with non-OECD countries through its Global Forum, has developed standards of transparency and exchange of information which have also been endorsed by the G7, the G20 and the UN. The implementation of these standards will allow countries to improve taxation of their own residents' income not only in respect of undeclared foreign assets, but also domestic assets, since they reduce the attraction of shifting assets abroad. The implementation of these standards is not only relevant for tax havens. All countries should implement these standards so that tax evasion activities do not simply shift to other less transparent and less cooperative jurisdictions.

Progress in implementing the standard

Major progress has been made since last year as all 84 jurisdictions participating in the Global Forum have now committed to the standards, which have now been universally accepted. The pace of implementation is also increasing, with a growing number of conventions including Article 26 of the OECD Model Tax Convention and nearly 50 tax information exchange agreements having been signed since the start of 2008.

Next steps

These policy changes represent a very significant step toward minimising opportunities for offshore tax evasion. However, these must now be followed up with swift implementation, which the OECD will closely monitor. The OECD will continue to pursue this work through its Global Forum, including by strengthening the review process and expanding the participation in its work. The OECD will also review how best to ensure that developing countries benefit from this progress.

THE FINANCIAL AND ECONOMIC CRISIS AND WATER

The financial and economic crisis poses both challenges and opportunities for improving access to water and sanitation for all. Accessing finance for infrastructure maintenance and upgrades is now more difficult for water utilities and municipalities, while it becomes politically difficult to raise water tariffs.

But the crisis could provide impetus to advance water sector reforms and mobilise the political will needed to implement them. If the efficiency and governance of the water sector is improved, it could better attract funds from financial markets. Economically and politically, it makes sense: the water sector is a mature sector that can provide a steady, stable rate of return that makes it attractive to risk-averse investors; and increased competition for access to water calls for better management of this increasingly strategic resource. Economic stimulus packages also present opportunities for job-creating and “shovel ready” investments in the water sector, particularly for water saving and network rehabilitation which require shorter planning periods compared to other types of infrastructure.

The OECD work on water aims to help countries better manage this vital resource, and to strengthen financing arrangements for improved water supply and sanitation services in both OECD and developing countries. It highlights the need to communicate better the significant economic benefits of investment in water supply and sanitation services – positive social returns between 4 and 12 in health benefits alone. Lack of awareness among policy makers, and the fact that these benefits accrue to society rather than the immediate investor, impede investment in this sector.

The water sector needs to enhance its creditworthiness and minimise investment risks if it is to attract investment capital. This requires utilities to become more efficient, *e.g.* by reducing leakages both from pipes and coffers. In addition, strategic finance planning is crucial for the sector. The current economic climate requires smarter financing plans for water infrastructure investments. A balance needs to be found between the basic sources of revenue – the “3Ts”: taxes, tariffs and transfers (Overseas Development Assistance) – and repayable sources of finance like loans or bonds that can be leveraged by the 3Ts.

NUCLEAR ENERGY AND CLIMATE CHANGE

Electricity generation is by far the largest contributor to anthropogenic CO₂ emissions, representing nearly 30% of the total, twice the next largest sector (road transport) and growing at more than double the latter's rate. Electricity from nuclear power is nearly carbon-free, even on a full life cycle basis (i.e. including construction, uranium mining, etc.). Its carbon emissions are between one and two orders of magnitude below those of fossil-fuel chains. It contributes 16% of world electricity generation and in OECD countries this share reaches 22%. Its share could be much larger.

Analyses by the United Nations Intergovernmental Panel on Climate Change (IPCC) conclude that annual CO₂ emissions must be halved from 2005 levels if the consequences of climate change are to be contained at a tolerable level. Emissions have to be cut to around 13 GT/yr by 2050. Assessments suggest that emissions will be around 60 GT/yr in 2050 unless serious ameliorative actions are taken.

Nuclear energy is the only virtually carbon-free technology with a proven track record on the scale required. In the Nuclear Energy Agency's (NEA) low and high scenario projections, CO₂ emissions would be reduced by between 4 and 12 GT/yr in 2050 if nuclear were used instead of coal, which is significant in terms of the 13 GT/yr target level that the IPCC recommends.

Governments wishing to make use of nuclear energy in future sustainable energy mixes have clear responsibilities. These include, among others, maintaining continued, effective safety regulation; ensuring the maintenance of the skills base, fostering progress on facilities for waste disposal; maintaining and reinforcing international non-proliferation arrangements; and providing the regulatory, policy and fiscal stability that investors require.

Stable national energy policies with clear commitments on climate change and carbon emission reduction are a prerequisite to providing incentives for the long-term investment associated with capital-intensive nuclear energy projects. The environmental cost of carbon emissions, supported by society until very recently, should be borne by producers and consumers of carbon-emitting technologies and products. This will have the added effect of enhancing the competitive margin of renewables and nuclear energy as compared with fossil-fuelled electricity.

Stable regulatory regimes are essential in order to provide investors with guarantees that a nuclear energy project can be completed to a reasonable and predictable schedule. Governments have a major role to play in streamlining licensing processes for nuclear power plants and fuel cycle facilities while ensuring the health and environmental protection required for societal acceptability.

Finally, nuclear energy's vast potential should also be recognised in any international arrangements for the development of climate friendly technologies, particularly in developing economies with rapidly growing electricity demand. In this context, it seems crucial to allow nuclear energy to be included in any flexibility mechanisms in the follow-on to the Kyoto Protocol.

Fairer

THE JOBS CRISIS

Labour market conditions are weakening throughout the world. The latest OECD projections indicate that the unemployment rate in the OECD area could approach 10% by 2010 compared with 5.6% in 2007. This implies that the crisis could swell the ranks of the unemployed in the OECD area by about 25 million people, by far the largest and most rapid increase in OECD unemployment in the post-war period.

The most disadvantaged labour-market groups – youth, low-skilled, immigrants and temporary workers – are bearing the brunt of the rapidly rising unemployment. They are the first to lose their jobs and often have only limited access to social safety nets. And since they also face serious difficulty in finding a new job, they are at high risk of becoming long-term unemployed or discouraged.

Extra resources are needed to scale up labour market programmes

Appropriate employment and social policies are an essential component of a successful strategy to bring the OECD countries back on a growth track, while preventing the financial crisis from developing into a full-blown social crisis. Most fiscal stimulus packages that OECD countries have introduced to kick-start a recovery include funds for labour market and social policy measures, but these additional funds are rather limited in many cases. This seems a missed opportunity since effective labour market policies can make a real difference and there is a lot of knowledge about what works and what does not.

Promoting labour demand and avoid unnecessary layoffs

A number of OECD countries have introduced or scaled-up subsidies that encourage firms to retain or hire workers (e.g. short-time working schemes, hiring subsidies, etc.). These subsidies can have a role in supporting labour demand provided they are well-designed and implemented. In order to minimise the negative side-effects, these schemes should be temporary, and well-targeted to firms for whom the demand is only depressed temporarily, and to workers who may find it particularly difficult to regain employment if made redundant.

Maintaining “the activation stance”...

One of the main labour policy reforms in the OECD over the past decade has been the implementation of *activation/mutual obligation* strategies, which combine effective re-employment services with strong job-search incentives, enforced by the threat of moderate benefit sanctions. Expanding the arsenal of effective active labour market programmes would be important to maintain the activation stance in a recession when job vacancies are declining. This expanded arsenal should include well-designed training programmes and public sector job creation schemes targeted to the most disadvantaged job-seekers.

...while also providing effective safety nets

While unemployment benefits will automatically step in to sustain the incomes of many job losers, coverage of such benefits is weak in some OECD countries and, in a number of cases, efforts have been made to extend the coverage and, in some cases, the maximum duration of benefits to provide a more effective safety net. Moves in these directions should be combined with a reinforced activation stance in order to minimise any adverse effects on work incentives which could prove costly once the recovery sets in.

EDUCATION AND THE CRISIS

Education is feeling the impact of the crisis

In some countries, public school expenditure is vulnerable while education and training systems face compromises on quality. Public funding for higher education has been cut in several countries and many universities have seen their endowments hit. Furthermore, firms hit by the recession find it harder to finance training while apprenticeship offers are declining due to bankruptcy and overall decline in business activity.

A sustainable recovery will need increased investment in education

Indeed, this is what some countries are doing. Economic stimulus plans have included support for education and training that enables people to make smooth transition to new jobs and seize emerging opportunities. In Australia, Austria, Canada, Germany and Norway stimulus plans have included provisions for improving existing education facilities as well as building new schools and universities. The United States stimulus package proposes new funding for local school districts, a new School Modernisation and Repair Programme, an Education Technology Programme to improve higher education and expand fellowships for science teachers. Several countries have taken the crisis as an opportunity to review and reinvent their reform plans. Examples include Spain's creation of school places for children under three years of age and the University Strategy 2015, Portugal's reform of higher education institutions, and Hungary's allocation of EUR 70 million for new training programmes for teachers. In England the higher education sector is mobilising to help business through the downturn.

The OECD is monitoring the impact of the crisis on policies and planning for educational infrastructure (through the Centre for Effective Learning Environments) and has organised a conference on higher education and the crisis to take place at the end of June (through the Programme on Institutional Management in Higher Education in co-operation with the Danish authorities). Soon, the OECD will develop a more systematic response by developing a clearing house for innovations and exchange of experiences.

Recommendations

The current crisis will accelerate changes, new work organisations will be introduced under new rules and regulations; new skills will be needed, while the demand for others will abate. Vocational education and training is in the spotlight and entrepreneurial skills and attitudes, creativity and adaptability will be crucial competencies in the post-crisis economy. They will need to be nurtured by more adaptive and innovative education and training systems addressing in particular the needs of youth who leave school with few or no qualifications and are the hardest hit.

Educational infrastructure can be an important element of public investments to support economic recovery. It is therefore crucial that this opportunity be used to renovate the educational infrastructure itself (e.g. ecologically sustainable schools) and to create better and more innovative learning environments (including investments in technology).

Some measure of support to individuals' investment in education could also be considered. In particular, the backing of student loans might be necessary to prevent a drop in enrolment in higher education and ensure equity of access.

THE CREDIT CRUNCH AND DEVELOPMENT FINANCE

Consequences on development finance flows

Developing countries, even those relying on subsistence agriculture and without sophisticated financial systems, may be among the most severely affected by the current crisis. This is because of their dependence on financial inflows: remittances, official development assistance (ODA) and foreign direct investment (FDI).

For Sub-Saharan Africa, remittances in 2008 are estimated to have totalled USD 19 billion. This is more than inflows from either FDI or country-programmable ODA. For migrant-sending countries, the likely reduction in remittances and its impact on the current account and household incomes may be an important dimension to the crisis.

Whilst ODA flows have in the past displayed a certain resilience to business-cycle fluctuations in donor countries, concern is warranted, given the severity of the crisis. Though flows of ODA are not expected to suffer major cuts in 2009, the prospects for 2010 and beyond are not encouraging: ODA budgets are expected to come under severe pressure as donor governments struggle to keep public finances under control.

FDI now constitutes a major form of capital inflow for many developing countries. With capital set to remain scarce, multinational corporations may scale back their overseas investments. These inflows are also rendered vulnerable through their strong dependence on local growth as a “pull factor”.

Can South-South linkages compensate for the economic slowdown in the North?

In recent years there has been a sharp intensification of South-South economic links, principally through FDI and trade. For instance, China-Africa trade increased by 45% in 2008, to USD 107 billion. How well low-income countries will withstand the crisis is increasingly more contingent on the fortunes of the rest of the developing world than it is on those of the OECD area. The OECD currently estimates that real GDP growth for China and India for 2009 will be 6.3% and 4.3% respectively.

The crisis as an opportunity for reforms

Reduced financial inflows can be expected to give additional impetus to reforms at four levels:

- enhancing aid effectiveness, as spelled out in the Paris Declaration and the Accra Agenda for Action;
- encouraging favourable conditions to FDI;
- reducing the financial and institutional impediments to the transfer of remittances; and,
- enlarging domestic tax bases and promoting the improved mobilisation of domestic resources.

AID COMMITMENTS IN A CRISIS ENVIRONMENT

The human impact of the financial crisis in the poorest countries is huge – tens of millions are falling back into poverty as economic growth slows or goes into reverse. Decisive and urgent action must be taken to prevent the financial crisis from becoming a development crisis.

Hitting hard on many fronts

The impact of the crisis varies by country, yet there are four main mechanisms that must be dealt with:

- **Household earnings are falling** and unemployment rates are rising.
- **Capital flows are drying up;** declining foreign direct investment is affecting three-quarters of low-income countries, especially in Africa and central Asia.
- **Export earnings and government revenues are falling.** Many of the lowest-income countries have been hit hard by the current contraction in world trade, and by the fall of 38% in non-oil commodity prices between July and December 2008.
- **The economic impact is having severe human and social consequences.** World Bank estimates indicate that there may be an additional 46 million people in poverty in 2009; well over one-half of those worst affected are women and girls. Furthermore, some states are becoming more fragile and social disorder is increasing.

What can be done?

The priority is to provide short-term protection against the effects of the crisis in developing countries, and to minimise the long-term consequences. Core social and infrastructure spending must be expanded, including safety nets and job creation programmes, as well as support to private companies. The speed and scale of this response are essential if the worst impacts of the crisis on human welfare and on economic performance are to be minimised and the recovery of growth accelerated.

Quality of aid is critical

The OECD countries have pledged to abstain from trade protectionism and reaffirmed their commitments to provide aid to developing countries. As the OECD-DAC recently reported, aid flows in 2008 were the highest ever. At the G20 Summit in London, new funds were committed to international institutions, some of which will be available for the poorest countries.

Yet alongside raising the volume of aid, improving its quality is critical. The Accra Agenda for Action (AAA) – endorsed in September 2008 – maps out what must be done by developing and developed countries to make aid more effective and ensure a global co-ordinated response to the crisis.

The AAA sets out three broad challenges for donors and partners alike: strengthening country ownership over development; building more effective and inclusive partnerships; and delivering and accounting for development results. As progress is made on these undertakings, three things must be prioritised: removing barriers that hinder rapid disbursement; increasing the predictability of aid; and addressing excessive fragmentation of aid.

STRESS-TESTING MIGRATION AND INTEGRATION POLICIES

The unfolding economic crisis has been disrupting OECD labour markets more rapidly and significantly than initially expected. As ever, certain labour market groups are particularly hard hit by the economic downturn. Immigrants are one such prominent group because they tend to be concentrated in industries which are more sensitive to cyclical fluctuations and they have, on average, less secure contractual arrangements in their jobs.

Against this backdrop, the perception grows that immigrants are competing for scarce jobs with native-born unemployed. Hence, calls grow for a major tightening in controls on inflows and for unemployed immigrants to be encouraged to return home.

Adjusting labour migration policies

The principal brake on labour migration is a fall in demand from employers. Many OECD countries, however, reinforce this trend by making it more difficult to recruit foreign workers. The upshot of all this is that the limited data available to date point to a decline in migration flows to OECD countries in 2008 and early 2009, especially among temporary foreign workers. It should be noted, however, that in many OECD countries, many inflows are *non-discretionary*; that is, movements cannot be restricted directly. This is the case within free mobility areas for example, but also for family reunification or humanitarian migrations.

Strengthening integration policies

The impact on immigrant labour market outcomes is much more visible in countries where the crisis began earlier, but also where immigrant labour has played a key role as a growth engine in the pre-crisis period. In the case of Spain for example, after at least ten years of rapid growth, the labour market situation of immigrants suddenly deteriorated. In the fourth quarter of 2008, the unemployment rate of immigrants reached 20.3%.

In order to ensure that unemployed immigrants do not drift into long-term unemployment or inactivity, integration programmes need to be maintained, if not strengthened, during an economic downturn. They should pay particular attention to the needs of recent immigrants, at high risk of long-term scarring effects during and after a steep cyclical downturn. Furthermore, governments need to watch out for increasing xenophobic reactions and worsening discriminatory practices in hiring and firing.

Looking ahead

The current financial crisis and economic slowdown have certainly shifted priorities from the management of increased labour migration to a focus on tighter regulation of the flows. But the phenomenon of population ageing in OECD countries will not go away. Economic recovery will reveal whether labour needs will be as prevalent generally as they have been in a number of OECD countries over the past decade. To play a greater role in supporting economic growth, labour migration would then need to be better managed, to reduce or redirect irregular movements into legal channels but also to avoid in the future the kinds of integration problems which have appeared in the past among immigrants, both low- and high-skilled, and their children.

MEASURING THE PROGRESS OF SOCIETIES

The crisis is affecting the lives of millions and behind the unemployment figures and bankruptcy rates lies the human reality. But the crisis is also an opportunity to rethink existing paradigms and build stronger, more inclusive visions to improve people's lives over the long-run. The crisis has challenged mainstream economic models, as well as commonly used measures to assess the success of a society. For 60 years Gross Domestic Product (GDP) has been the dominant way in which the world has measured and understood progress, yet GDP does not capture many factors that impact on people's lives, or the elements that are key to ensuring the sustainability of our societies.

When the OECD organised its first World Forum on "Statistics, Knowledge and Policy", few could have predicted the interest the event would inspire. After the creation in 2007 of the "Istanbul Declaration", signed by the OECD and other international and national organisations, a growing movement has emerged to better understand and measure societal progress. Initiatives to measure progress now range from community-based projects in developed and developing countries to the high-level Commission established by French President Nicolas Sarkozy (led by Nobel-Prize winners Joseph Stiglitz and Amartya Sen) and the World Economic Forum's Global Council on "Benchmarking Progress in Society".

The Global Project and the 3rd OECD World Forum

The OECD-hosted Global Project on "Measuring the progress of societies", officially established in July 2008, is shaping the development of an international network of organisations from all sectors. The Project is the first systematic global effort to go "beyond GDP" by enabling and promoting new ways to measure societal progress. It is encouraging and assisting societies to debate what progress means to them, and is developing new measures of progress along with the ICT tools needed to make these measures meaningful to citizens.

A milestone in the Project will be the 3rd OECD World Forum (Busan, Korea 27-30 October 2009), where 1 500 participants are expected from across the world, including policy makers, Nobel-Prize winners, opinion leaders, chief statisticians and academics. Questions for debate will include: Can we move from measures of success largely based on short-term maximisation of income towards a more comprehensive paradigm of progress, where environmental and social aspects play a greater role? What measurement frameworks do we need to sustain this effort? What types of data and methodologies are needed to move from rhetoric to credible statistical measures? How do we get from measures to actions that will improve people's lives? Can shared measures of progress help build greater accountability, more effective policies and rebuild trust in our institutions? And how can political leaders benefit from these efforts to build new visions and deliver true prosperity?

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