Parliamentary Assembly
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COUNCIL OF EUROPE
CONSEIL DE L'EUROPE

Doc. 12340
15 July 2010

The activities of the Organisation for Economic Co-operation and Development (OECD) in 2009-2010

Report[1]
Committee on Economic Affairs and Development
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1. The report is distributed in conformity with the Rules of Procedure for enlarged debates of the Assembly on the activities of the OECD.

A. Draft resolution[2]

1. For the purpose of debating the activities of the Organisation for Economic Co-operation and Development (OECD), the Parliamentary Assembly of the Council of Europe meets annually in an enlarged forum including delegations from the non-European member states of the OECD and the European Parliament. The enlarged Parliamentary Assembly has reviewed the activities of the OECD in 2009-2010 in the light of the OECD's latest annual report, the report submitted by the Assembly's Committee on Economic Affairs and Development and the contributions of other Assembly committees in the fields of health, social policy, the environment, agriculture, migration, education and science.

OECD enlargement

2. The enlarged Assembly welcomes the three new members of the organisation (Chile, Israel and Slovenia) and notes that Estonia is likely to become a member by the end of 2010. In this respect it decides that 7 seats and votes will be allocated to the Chilean delegation to participate in the debates of the enlarged Assembly. It also welcomes the progress made by the Russian Federation. The enlarged Assembly also looks forward to the further participation of Brazil, China, India, Indonesia and South Africa in the substantive work of the OECD under the "Enhanced Engagement" programmes leading up to accession talks, as well as to further co-operation between the OECD and South-East Asia as a priority region. The enlarged Assembly reiterates its belief that full respect for democracy, human rights and the rule of law, including international law, should constitute an essential criterion for judging whether a candidate country should be invited to join the OECD. The enlarged Assembly encourages the OECD to continue further enlargement and to invite countries meeting membership criteria to accession negotiations

Global economy

3. The enlarged Assembly welcomes the OECD's assessment that, after having contracted by 3.3% overall last year, GDP in OECD countries is projected to rise by 2.7% this year, well ahead of the 1.9% forecast last November. Steady, if unspectacular, growth of 2.8% is expected in 2011 as the effects of government stimulus and industrial restocking fade. Amongst the major OECD economies, the United States will lead the way, with growth of 3.2% expected during this year and next. Overall, in its latest economic outlook, the OECD describes the current situation as "relatively auspicious". Strong growth in emerging market economies is contributing significantly. However, the strength of the recovery greatly differs across OECD areas and it is the weakest and the most erratic in the euro area.

4. It should be noted that the key reason for this rapid recovery is the rebound of world trade. After shrinking by 11% in 2009 (its first annual decline since 1982), a global trade growth of 10.6% is expected this year, with 8.4% expected in 2011, thereby returning to pre-crisis levels. This dynamism is very much driven by the larger non-OECD economies and particularly China, India and Brazil. Accordingly, global output growth is expected to be around 4.5% during this year and the next. One impact of the crisis has therefore been to hasten the decline in weight of the major developed countries within the world economy, their share of global trade volumes having fallen by around 2%, and of global industrial output by around 4.6%.

5. In this context, the enlarged Assembly underlines the necessity for a successful completion of the Doha Round trade negotiations, not least in a spirit of solidarity with the least developed countries. It welcomes the promising results of the OECD's co-operation with the World Trade Organization in promoting assistance for the low-income countries with a view to increasing their trading capacity, notably through the Aid for Trade initiative. The enlarged Assembly also notes the importance of investment as a major driver of trade flows and job creation, and encourages the OECD to continue to play the central role in promoting best practices with respect to international investment. In this regard, it welcomes the launch of the update of the OECD Guidelines for Multinational Enterprises.

6. The enlarged Assembly is concerned that government stimulus programmes and rescue packages have led to a sharp deterioration of public finances. Governments will therefore have to address the consequences of exceptional stimulus spending and the rescue of debt-stricken institutions. More than €1 000 billion was injected into OECD countries under fiscal stimulus packages in 2009, and although broadly successful, these interventions have increased deficits, leaving some governments carrying levels of debt unprecedented in peacetime, while social costs (such as unemployment benefit) have increased and revenue expectations have been slashed. Those countries with serious fiscal challenges need to accelerate the pace of consolidation so as to avoid the threat of a sovereign debt crisis. The enlarged Assembly welcomes the

2. Draft resolution adopted by the enlarged Committee on Economic Affairs and Development on 5 October 2010.

recent announcements made by some countries of their intention to drastically reduce their deficits in 2010 and strengthen their fiscal frameworks and institutions. The key challenge is to strike the right balance between policies aiming at achieving fiscal consolidation while at the same time supporting the recovery by efforts to boost competitiveness as well as economic growth and job creation.

7. The enlarged Assembly notes with concern that the euro area budget deficit rose from 2% of GDP in 2008 to 6.3% in 2009 and, while there is substantial variation between members, a determined process of fiscal consolidation is clearly needed (given that this average is more than double the Maastricht criteria of 3%). Moreover, as the instability has continued, the markets have raised broader concerns about the perceived internal contradictions of the currency, and even cast doubt upon its long-term viability. The enlarged Assembly fully supports the conclusions of the OECD that such concerns will need to be directly addressed by strengthening the area's financial regulatory and supervisory architecture and a firmer adherence to rules. There is certainly a need for stronger oversight of domestic policies, taking into account issues of competitiveness. Consideration should also be given to external auditing and even to the possibility of more effective sanctions for non-compliance.

8. The financial, economic and social crisis has called into question a number of assumptions which have underpinned the member states' economic policies over the last decades, such as deregulation, the primacy of economic criteria in all areas of life, as well as an overemphasis on profit and growth. Confidence in the globalised free market economic model of capitalism has been undermined. The enlarged Assembly fears that our financial system no longer does the basic job required of it – to underpin the productive economy and the fundamental operating systems upon which we all depend. Finance should be a means, not an end, and support society's vital operating systems: the core economy of family, neighbourhood and community, and the environment.

9. The enlarged Assembly therefore deems it crucial that the OECD's "Strategic Response to the Crisis", designed to counter the effects of the crisis in a range of areas, be put into practice (notably in improving tax transparency, aligning financial sector regulations and incentives so as to achieve more effective oversight and improving risk management and corporate governance). The enlarged Assembly considers international co-operation to be particularly important in building a stronger, globally more consistent, supervisory and regulatory framework for the financial sector so that it serves the real economy, promotes sustainable enterprises and decent work (according to the International Labour Organization's definition) and better protects savings and pensions. In this respect, the enlarged Assembly commends the multilateral work achieved and the standards set by the OECD as regards the different aspects of social and employment policies, social cohesion and good governance. Moreover, the enlarged Assembly encourages the OECD to further promote the study on "Measuring the Progress of Societies".

10. The enlarged Assembly notes with concern that according to new OECD estimates, global imbalances are likely to increase in the near future. It therefore calls on governments, including those of emerging economies, to address the problem of economic imbalances and structural limitations highlighted by the crisis through co-ordinated reform of national policies, taking into account the size of the respective economies. In part, this should mean the successful unwinding of emergency support measures, but more fundamentally, it should entail measures correcting disproportionate levels of savings, investment and consumption. In recent years, saving and spending rates have diverged between economies, as some have become excessively focused on consumption and others on production. This should include the successful unwinding of emergency support measures, in particular those linked to excessive government borrowing which siphons off resources, but also the provision of adequate social protection and decent pensions. A sustainable growth model also requires that savings and investment be fairly distributed globally and not excessively concentrated.

11. The enlarged Assembly welcomes the conclusions of the OECD Ministerial Council meeting of 27 and 28 May 2010, adopted by the OECD member states and accession countries. These conclusions are relevant to all open market economies and place strong emphasis on fiscal consolidation, implementing structural reforms and strengthening commitment to the fundamental principles of propriety, integrity and transparency. These policies and strategies are essential to ensure that recovery takes hold and is transformed into balanced and self-sustained growth.

12. The current economic crisis had led to record unemployment in many OECD countries and has given rise to fears of a jobless recovery. Unemployment and output gaps are likely to remain high. The enlarged Assembly believes that appropriate labour market and social policies can do much to promote a job-rich recovery. As countries face the challenge of fiscal consolidation, the enlarged Assembly deems it particularly important to continue to make room in budgets for cost-effective labour-market programmes that support workers at greatest risk of becoming long-term unemployed and thus losing attachment to the labour market.

13. The enlarged Assembly is convinced that labour market reforms need to be implemented to raise potential output, support innovation and prevent high unemployment from becoming entrenched. It welcomes the OECD Reassessed Jobs Strategy which provides a comprehensive framework for promoting greater labour market adaptability. Moreover, it welcomes the OECD's emphasis in the Green Growth Strategy and encourages the Organisation to continue to play a key role in global efforts to promote green growth and social sustainability. At the same time, the enlarged Assembly encourages the OECD to carry out more work/ analysis on the pressing issue of youth unemployment as policies are needed to help young people find a firm foothold in the labour market – including the enhancement of skills to promote their career prospects.

14. In the aftermath of the global crisis, the enlarged Assembly welcomes the OECD's approach in considering corporate governance to be a crucial area in which lessons need to be learned and best practices extended. It welcomes the conclusions of the OECD Corporate Governance Committee which found that corporate governance weaknesses and failures had played an important role in the development of the crisis, particularly in terms of remuneration, risk management, board practices and the exercise of shareholder rights. In this respect, the enlarged Assembly reiterates its support for the OECD Principles of Corporate Governance which provide a good platform from which to address failures and it hopes that priority will be given to their implementation.

15. The enlarged Assembly welcomes the joint efforts of the OECD and the Council of Europe which have led to the establishment of a Protocol (CETS No. 208) amending the Convention on Mutual Administrative Assistance on Tax Matters (ETS No. 127). The Protocol reflects technological developments in information transfer and brings the Convention it into line with the "international standard on exchange of information for tax purposes" – the leading code of its type (initiated by the OECD). It should facilitate the fight against tax evasion and counteract tax avoidance and has been made available to countries which are neither members of the OECD nor of the Council of Europe. The amendments to the Convention introduced by the Protocol were designed specifically to allow access to, and exchange of, bank information to both combat tax crimes but also to address other forms of non-compliance (other civil tax matters such as abusive transfer pricing and aggressive tax planning). The enlarged Assembly is confident that – strengthened by the Protocol – the pioneering work of the Convention will now achieve a new scale and scope and that it will become a keystone for international tax co-operation.

Social and health policy

16. The enlarged Assembly commends the work undertaken by the OECD in recommending responsive, fair and effective labour market policies that could respond to the current unemployment crisis and beyond. It encourages the OECD to invite its members to step up efforts to create jobs and to maintain effective support for the people most in need, notably young people and the long-term unemployed. It remains, however, particularly concerned about the situation of older workers, who face a sharp increase in long-term unemployment, and of the elderly who will be hit hard by pension reforms. The enlarged Assembly therefore urges the governments of the OECD countries to strengthen their policies aimed at achieving the right balance between work and retirement and at facilitating a longer active life, and to ensure that pensions are sufficient to allow elderly women and men to lead a decent life and that pensions are safe in the wake of economic crisis.

17. The enlarged Assembly also notes that growing health spending puts pressure on government budgets and warns against the risks of indiscriminately cutting spending in public health care, since this could threaten equal access to health in OECD countries. It therefore invites the OECD countries to make the issue of good governance in the health sector a priority, given the importance of democratic accountability and transparency in public health decision-making, and to recognize that the protection of health as a human right is an essential condition for social cohesion and economic stability. Equal access to health care and treatment should be ensured to everyone living in OECD countries, without any discrimination including on the basis of immigration status or financial means."

Environment and agriculture

18. The enlarged Assembly welcomes the work done by the OECD in the environmental field and is pleased to note a growing awareness that emergence from the economic crisis depends on the development of new environmentally friendly sources of growth.

19. In this connection it hails the launch of the Green Growth Strategy, which pinpoints the principal obstacles to be overcome in order to foster strong and ecologically sustainable economic growth and which simultaneously offers policy-makers practical tools for making the transition to a greener economy.

20. The enlarged Assembly stresses the need for the rapid adoption of tangible measures, in particular with regard to the reform of environmentally harmful subsidies (for instance for fossil fuels), the elimination of barriers to trade in environmental goods and services, support for innovation (in accordance with the principle of precaution applied to the development of all new technologies whose environmental effects are not yet known for certain) and the dissemination of clean technologies and harmonisation of means of action at the international level.

21. It proposes devising new tools for measuring well-being, no longer focusing on material well-being alone but also taking into account the quality of the environment and the quality of life. In this connection, it refers to Recommendation 1885 (2009) on "Drafting an additional protocol to the European Convention on Human Rights concerning the right to a healthy environment" and recommends that the Committee of Ministers take all the necessary measures to ensure that this instrument is drawn up as soon as possible.

22. At the same time, the enlarged Assembly stresses the need to reach an international agreement on greenhouse gas emissions, so that the largest possible number of countries is committed to achieving a substantial reduction.

Migration and population

23. The enlarged Assembly expresses its concern over the effects that the recent economic crisis has had on international migration flows and on the employment situation of migrants in most OECD countries. It welcomes the OECD's continuing efforts to assist governments in seeking responses and adjustment to the tightened labour market situation. In this respect, it particularly hails the recent publication of International Migration Outlook 2010.

24. While recognising that most of the decline in migration for employment has been driven by lower demand, the enlarged Assembly continues to be concerned about the tightening of administrative mechanisms for immigration in several OECD countries. It renews its call on the governments of member states to keep open legal avenues of entry and employment of migrants and to provide guarantees for adequate and effective protection of the rights of migrants as well as for their equal treatment with native-born job seekers on the labour market. The enlarged Assembly further calls on governments to adopt measures that would help identify and to meet endemic skills shortages that will become more apparent with economic recovery.

25. Furthermore, considering the structural needs for labour on the one hand and the increased number of irregular migrants residing in OECD countries on the other, the enlarged Assembly encourages the OECD to carry out a study on the possibilities of regularising the status of those irregular migrants who cannot or will not be returned to their countries of origin, and their integration in legal channels of the labour market.

Education and science

26. The enlarged Parliamentary Assembly welcomes the OECD's development of a new student performance assessment tool, Assessment of Higher Education Learning Outcomes (AHELO), a tool to assist universities in assessing and improving teaching, to help students in making better choices in selecting educational institutions, and policy-makers in ensuring that the considerable amounts spent on higher education are spent well. In addition, this tool will allow employers to know whether the skills of the graduates entering the job market match their needs.

27. The enlarged Parliamentary Assembly draws the attention of member states to the need for more focused budget spending on education policies, bearing in mind the OECD's findings that the quality of education and training is more important than the length of education programmes, and that the learning (and teaching) environment must be improved in order to render education effective and optimise outcomes. The OECD programme Centre for Effective Learning Environments (CELE) promotes the exchange and analysis of policy, research and experience in all matters related to educational construction with the objectives of improving the quality and suitability of educational buildings, ensuring that the best use is made of the resources devoted to planning, building, running and maintaining educational buildings and giving early warning of the impact on educational construction of trends in education and in society as a whole.

28. Again with respect to the optimisation of resources, the enlarged Parliamentary Assembly notes the OECD's warning that a new form of "digital divide" has emerged with respect to ICTs, separating students with an economic, cultural and social capital enabling them to gain the right competences and skills to benefit from computer use, and those who do not. Studies show that although governments invest in computing equipment for schools, their use by teachers and students is not ensured as it should be. Global indicators are needed

for assessing how so-called “21st century competencies” are integrated into compulsory education to improve teaching processes, enhance individualised education programmes and prepare students for adult life by giving them those skills necessary in a society where technology-related competencies are increasingly indispensable.

29. The enlarged Parliamentary Assembly is concerned that figures for OECD member states still show that immigrant students often have more restricted access to quality education, leave school earlier and have lower academic achievement than their native peers. It encourages Council of Europe member states to step up efforts to ensure that first and second generation migrants have early and equal access to education and to the appropriate assistance in integrating national systems, and that educational structures are designed to suit pupils from different cultural backgrounds.

B. Explanatory memorandum by Mr Moscoso del Prado Hernández, rapporteur

1. Background

1. In October 2010, meeting in Strasbourg, the enlarged Parliamentary Assembly of the Council of Europe will hold its annual debate on the work of the OECD. This provisional report provides key findings from the rapporteur's recent contacts with OECD staff, undertaken in preparation for the debate. This report was reviewed by the Committee on Economic Affairs and Development and revised, in consultation with national delegations, before being submitted for adoption to the enlarged Committee on Economic Affairs and Development and the enlarged Parliamentary Assembly.

2. The rapporteur expresses his thanks to all those at the OECD who have helped in the report's compilation. Their advice and expertise have been crucial in gaining a broad perspective on the ongoing effects of the economic crisis, and the challenges it poses for the future. This year, as last, uncertainty is a dominant theme, and so this report offers a cautious overview of current data and key economic trends, together with a discussion of likely developments over the year to come. As in previous years, it also provides a summary of the position in individual OECD member countries and other key emerging economies.

3. Having made an assessment of economic prospects, the report will examine how the OECD believes that they can be improved. It will outline the main lessons to be drawn from the crisis, in the OECD's view, and how specifically they should be addressed. In particular, it will discuss issues of corporate governance, including executive remuneration and risk management, which have proved especially controversial. Finally, it will look at an important development in the fight against bank secrecy and tax evasion, jointly undertaken by the OECD and the Council of Europe, and launched in May 2010.

2. Introduction: prospects for the world economy

The recovery is stronger than expected, but risks are increasing

4. Last year's rapporteur opened her report by quoting from the OECD's interim Economic Outlook, which radically downgraded their forecasts for the year, and spoke of "the deepest and most synchronised recession in our lifetimes". Indeed, the scale and speed of events – a near meltdown in global financial markets, followed by a collapse in world trade – made it difficult to form a credible forecast, but the headline figures were dramatic: in the first quarter of 2009, the GDP of member countries shrank by 2.1%, the fastest contraction since OECD records began. All the same, the report pointed to early signs of a "tepid" recovery, based, in their view, on the lessons of the 1930s having been borne in mind, with open markets maintained and with broadly correct macroeconomic policy (that is, monetary and fiscal) responses, as well as measures to support financial markets and institutions.

5. This view has been borne out by events and, in fact, the pace of recovery has continued to accelerate, though at varying speeds across the world. Having contracted by 3.3% overall last year, GDP in OECD countries is projected to rise by 2.7% this year, well ahead of the 1.9% forecast last November; next year, steady if unspectacular growth of 2.8% is expected, as the effects of government stimulus and industrial restocking fade. Amongst the major OECD economies, the United States will lead the way, with growth of 3.2% expected during this year and next. Overall, in its latest economic outlook, the OECD describes the current situation as "relatively auspicious". Strong growth in emerging market economies is contributing significantly. However, the strength of the recovery greatly differs across OECD areas and it has been the weakest and the most erratic in the euro area.

6. The key reason for this rapid recovery is that, with a measure of financial stability achieved, world trade has rebounded. After shrinking by 11% in 2009, its first annual decline since 1982 (and registering the steepest monthly falls since the 1930s), global trade growth of 10.6% is expected this year, and 8.4% in 2011, thereby returning to pre-crisis levels. This dynamism is very much driven by the larger non-OECD economies – which, as a whole, registered negative growth only during the last quarter of 2008 – and particularly China, India and Brazil. Accordingly, global output growth is expected to be around 4.5% during this year and next. One impact of the crisis has therefore been to hasten the decline in weight of the major developed countries within the world economy, their share of global trade volumes having fallen by around 2%, and of global industrial output by around 4.6%.

7. These trends suggest a range of complex, and inter-connected, risks for the recovery. On the one hand, the relatively slow growth expected in many OECD economies, and particularly in the euro area (where 1.2% GDP growth is likely this year, and 1.8% in 2011), is likely to act as a drag on global growth potential. In

addition, these growth disparities could imply a resumed widening in global economic imbalances, whereby some countries run huge trade surpluses, others huge deficits, and much of the increase in world trade is funded by borrowing. Such extremes disrupt stable investment and growth, and their emergence in recent years contributed to the recent crisis.

8. On the other hand, there is some danger of "overheating" in the larger developing economies, which becomes more likely, and would be all the more significant, as these countries assume a greater share of the world economy. With sizeable capital inflows from the rest of the world, and with energy and commodity prices once more increasing, inflationary pressure is apparent in Brazil and India, and particularly in China, where stimulus spending has fuelled domestic demand and a property-price bubble has arisen. The OECD notes that domestic demand in China has also helped to boost imports and reduce their trade surplus – which is, so far, helping to lessen the growth of global economic imbalances – and points out that any "boom-bust" outcome would have a particular impact on those whose growth is now driven by exports to China.

Major economies face a post-crisis "hangover"

9. Apart from these risks, many countries – and particularly the large, developed economies – face a series of difficult policy challenges. The financial crisis called for a rapid and massive response on the part of governments, and this support will need to be unwound without jeopardising recovery. In the OECD's view, governments need to prudently re-tighten monetary policy, bringing an end to such processes as quantitative easing, and raising interest rates as appropriate, so as to prevent inflation taking hold; hopefully, this will avoid the need for dramatic tightening of policy later on, which would seriously damage growth. The key challenge is to strike the right balance between policies aiming at achieving fiscal consolidation while at the same time supporting the recovery and job creation.

10. At the same time, though, governments will have to address the consequences of exceptional stimulus spending and the rescue of debt-stricken institutions. More than €1 000 billion was injected into OECD countries under fiscal stimulus packages in 2009, and although broadly successful, these interventions have increased deficits, leaving some governments carrying levels of debt unprecedented in peacetime, while social costs (such as unemployment benefit) have increased and revenue expectations have been slashed. So an institutional debt crisis threatens to become a sovereign debt crisis, as markets worry that governments cannot meet their commitments, and this new crisis of confidence begins to erode the world's recently recovered stock indices, and to destabilise foreign-exchange markets.

11. Although the phasing out of fiscal support will to some extent slow recovery, the OECD feels that countries must begin to end such exceptional measures now, or no later than next year, depending on their circumstances. For with rising debt levels having threatened national credit ratings, countries face an increasing cost of debt-servicing that will itself hold back growth and make debt even harder to support in the long term. This threat is compounded, because a synchronised recession is leading to a synchronised consolidation: with so many countries curbing spending at once, governments will have little ability to "grow their way out of debt" in the short term.

12. At this point, the market's most pressing focus is on the euro area, with concern about the ability of Greece to service its debt having expanded to include members such as Portugal and Spain, along with anxiety over the lack of economic convergence within the euro area overall, and doubts as to its long-term viability. Market turbulence and the real prospect of an effective default by at least one euro member have highlighted the need for a stronger institutional and operational framework, and for bolder measures to be taken to ensure fiscal discipline. However, while the euro's unique structure makes its difficulties exceptional, it is not alone in facing a challenge to its fiscal credibility. The United Kingdom is also faced with a difficult challenge in reducing its budget deficit, as is Japan – and so too is the United States, though the pace of its recovery and the dollar's role as an international currency have helped to protect it.

13. Meanwhile, although economic activity is picking up, the growth in jobs is not keeping pace – a very difficult challenge in a period of financial austerity. Over the last two years, the number of unemployed in OECD countries has risen by 16 million; the OECD believes that the rate may now be peaking, at an average 8.5% – well short of the 9.9% that was predicted last May – but that it is likely to fall only slowly in the near term. While there may be significant job creation in the United States, it is likely that in Europe and Japan increased demand will be largely met by increased working hours and productivity. The OECD points out that social and labour-market policy can do much to promote employment in a period of recovery, especially cost-effective programmes that target those at risk of being long-term unemployed, and measures that increase labour-market flexibility. It cautions that schemes aiming to remove labour supply, such as early retirement, will instead distort the labour market, while also increasing fiscal pressures.

Long-term growth prospects depend on decisive action

14. Summing up at the launch of this year's Economic Outlook, the OECD Secretary-General described this as "a critical time for the world economy". While the overall picture is far brighter than might have been expected at this time last year, the recovery is still highly vulnerable. Governments are likely to be carrying excessive debt levels for some time to come and output gaps remain large, while the global economy is, once again, in danger of growing imbalance, and facing inflationary pressure. In short, a recession unprecedented in modern times is leading to an unprecedented range of threats and a great deal of uncertainty – with some commentators now warning of the possibility of deflation, brought on by a combination of high debt and low growth, or even a "double-dip" recession. Although the OECD does not see this as likely, it is unsurprising that global markets and investors lack confidence. Indeed, for the "relatively auspicious" growth scenario described earlier to be fulfilled, monetary tightening and fiscal consolidation will have to be successfully implemented, without derailing recovery, while the groundwork needs to be laid for long-term growth. Therefore, to address the structural problems confronting the world economy, the OECD calls for a comprehensive programme of reforms.

15. In its latest Economic Outlook, the OECD features a series of predictive models looking as far ahead as 2025, which suggest that without decisive adjustments to global policy, OECD-member growth is likely to remain mediocre, while unemployment and fiscal deficits stay high and imbalances continue to grow. In many countries, this picture will be exacerbated by demographic trends. But, says the OECD, such an outcome is not inevitable: a combined package of measures, beginning in 2011 and involving fiscal consolidation, exchange rate realignments and structural reforms in most regions of the world, could add substantially to growth prospects, adding perhaps 2% to 3% to the baseline growth scenario.

16. The current economic crisis had led to record unemployment in many OECD countries and has given rise to fears of a jobless recovery. Unemployment and output gaps are likely to remain high. The rapporteur believes that appropriate labour market and social policies can do much to promote a job-rich recovery. As countries face the challenge of fiscal consolidation, it is particularly important to continue to make room in budgets for cost-effective labour-market programmes that support workers at greatest risk of becoming long-term unemployed and thus losing attachment to the labour market. Moreover, major labour market reforms need to be implemented to raise potential output, support innovation and prevent high unemployment from becoming entrenched. Here it should be noted that improving the effectiveness of national educational and training systems has also been identified by the OECD as another policy priority related to achieving a strong and sustainable recovery (the OECD is developing a comprehensive "Skills Strategy" in this field). This report will examine the lessons that the OECD believes should be drawn from the crisis, and the measures they recommend, including the need for financial regulatory reform. But first, we will conduct a brief survey of specific developments in the world's key economies, as viewed by the OECD's experts.

3. A survey of key economies

17. Though expected to shrink by 4%, the economy of the United States contracted by only 2.4% last year, and is expected to grow by 3.2% this year, and again in 2011. While bank lending has not yet returned to normal, consumer demand has recovered well, and corporate profits have rebounded, bolstered by efficiency savings, particularly in terms of headcount reductions. Job creation has, accordingly, only been evident in recent months, and unemployment is expected to remain relatively high, falling back from 9.7% in 2010 to 8.9% next year.

18. This moderate pace of recovery is expected to be sustained, as households recover from an average 15% fall in wealth and employment levels begin to rise. With domestic demand increasing, a strong export performance is likely to help offset increased imports, preventing a surge in the trade deficit. But despite the positive trends, output remains below 2007 levels, and capacity utilisation is lower than at the bottom of the last two recessions. And while large companies are recovering well, smaller firms are still constrained by lack of credit. United States growth performance is likely to remain weaker than it was after recent recessions, with house prices recovering only gradually, and housing starts remaining at very low levels.

19. For the United States administration, a key judgment will be the timing and speed of policy stimulus withdrawal. Monetary policy has already tightened somewhat without adverse effect, but it is unclear whether output growth is yet self-sustaining. However, the United States' fiscal position is poor, with the government deficit at 10%, and likely to fall only slightly as the current stimulus programme subsides. Current fiscal plans are therefore unsustainable, with debt likely to keep rising as a ratio of GDP, and a plan for fiscal consolidation

is needed. At the same time, there are signs that the recent structural improvement within the United States economy is petering out, with savings rates already starting to fall as private consumption rises – posing the risk that the imbalances that contributed to the recession will widen once again.

20. In Mexico, where the economy contracted by 6.6% last year, growth of 4.5% is expected this year, and 4% in 2011. A strong export performance has led the way, but domestic demand is likely to improve as unemployment falls back, from 5.5% in 2009 to 4.5% next year. However, oil production remains in decline, and given its important contribution to government revenues, this calls for caution in fiscal plans. With a relatively strong exchange rate, real inflation under control and a large amount of slack still in the economy, the OECD feels that monetary conditions can be kept supportive to help maintain the recovery. Canada is also rebounding strongly, with GDP expected to rise 4% this year and 3.2% in 2011, driven by strong exports, easy monetary conditions, domestic credit and stimulus spending. Unemployment is falling, inflation is muted, but the ratio of household debt to disposable income is at a record high, as are house prices. The OECD feels that monetary policy should continue to tighten gradually, while making allowance for the strong currency, and remaining stimulus measures be allowed to expire, while the government should provide more detail on its deficit-elimination plans, and embark on the structural reforms needed to achieve them.

21. Brazil, too, has recovered dramatically, supported by huge stimulus spending; growth of 6.5% is likely this year, and 5% in 2011. Unemployment has fallen to levels not seen since 2002, though inflation of 6.2% is expected. Monetary stimulus is being gradually withdrawn, and strong tax receipts have maintained a primary government surplus. However, with long-term budget pressures, the OECD welcomes the 1% spending cuts announced in the budget, which should help to restrain inflation without the need for interest rate hikes. Meanwhile in Chile, the recovery was interrupted by the earthquake and tsunami that struck in February. However, the country is well placed to finance reconstruction, and under this impetus, growth is expected to rise from 4.2% this year to 5.3% in 2011.

22. Japan has made an impressive recovery, boosted by demand from China, which accounts for a quarter of its exports. Total exports are likely to grow by around 18% this year, while fiscal stimulus has offset the impact of declining wages and employment. Accordingly, having contracted 5.2% last year, growth is expected to reach 3% this year, falling back somewhat to 2% in 2011. However, with industrial production still below capacity, unemployment is expected to remain above 4.5%. Despite job-protection subsidies, employment levels have fallen and this has intensified deflationary pressures, which had returned with the economic crisis. By early 2010, core consumer prices were falling by 1% annually, the fastest rate since 2001.

23. The OECD therefore recommends that Japan maintain interest rates at near-zero levels and, in these exceptional circumstances, implement qualitative easing measures to restore a degree of inflationary pressure. At the same time, while fiscal stimulus has helped to create recovery, it has also helped increase the budget deficit from 3% of GDP in 2007 to 9% in 2009. Given that overall public debt is expected to reach 205% of GDP next year, an all-time record in the OECD, while net debt will be the highest in the OECD after Greece, there is a need to scale back public expenditure and develop a credible medium-term plan to bring the budget into balance. This should include tax reform proposals and sit alongside a growth strategy that offers reforms designed to boost productivity growth and improve living standards in the context of a fast-shrinking working age population.

24. Korea has achieved one of the strongest recoveries in the OECD, with exports and production surpassing pre-crisis levels. Now the world's ninth-largest exporter, it has been helped by a fall in the value of the won, and demand from China, to which a third of its exports go. Fiscal stimulus has been reversed, unemployment has fallen and growth of 5.8% is likely. The OECD feels Korea should now focus on its deficit-reduction plans and on structural reforms, particularly in services, while remaining monetary stimulus and special assistance to smaller firms should be removed.

25. Having slowed to 8.7% in 2009, growth in China is likely to reach 11.1% this year. There has, however, been a significant structural shift, with stimulus measures boosting domestic demand as the major source of growth; so, despite booming exports, the current account surplus has fallen from around 10% of GDP in 2007, or US$220 billion, to an expected 2.8% this year, around US$70 billion. Inflationary pressures are evident, with rising import and commodity prices, but food prices have fallen and companies have so far absorbed cost increases, so that headline inflation has reached only 2.8%. However, there are signs of overheating, especially in urban property prices; measures have been taken to restrict credit, but further action is suggested to curb land prices.

26. Growth is predicted to moderate in 2011, to around 9.7%, as infrastructure spending and other stimulus declines. But with wages having risen strongly, consumer confidence is high and private sector investment remains strong, so that the economic rebalancing should continue and the trade surplus remain subdued. The OECD feels that progress toward neutral monetary conditions should be maintained, involving some increase in interest rates, and measures to allow a gradual appreciation of the currency.

27. Following a poor harvest, a sharp fall in agricultural output has held back growth in India, though it should still reach 8.3% in 2010 and 8.5% next year. Export growth has resumed, and the current account deficit is set to remain below 3% of GDP. Partly as a result of food costs, inflation has surged to 7.7%, though it should moderate to 6.1% in 2011. All the same, consumer demand pressures, the curbing of price subsidies and increases in excise duty are likely to make inflation a persistent problem, and perhaps the most significant risk that India faces, especially if there is a further harvest failure. In addition, the substantial budget deficit may cause government borrowing to exert pressure on firms' own borrowing costs. The OECD notes that steps have been taken toward fiscal consolidation and the ending of support measures introduced during the crisis. Interest rates have begun to rise, though they are still at historically low levels, and sizeable monetary tightening is recommended in the coming months, to help control inflation.

28. In Russia, GDP has bounced back from a contraction of 7.9% last year, to 5.5% growth in 2010, with 5.1% expected next year. Higher oil prices have helped to drive up the current account surplus; but with rising real wages and higher capital inflows, domestic demand is also likely to improve strongly, despite restricted availability of credit. Inflation, meanwhile, has fallen back. The OECD feels that this unexpectedly strong recovery provides a platform for fiscal deficit reduction and that measures to support demand should now be phased out, while longer-term structural measures, such as those promoting competition and innovation, should be prioritised.

29. The euro area has experienced a moderate recovery, with growth likely to strengthen from 1.2% this year to 1.8% in 2011. This has largely been driven by domestic stimulus and demand in export markets, which is now being bolstered by a weakening currency. Exports from Germany and France are expected to grow by around 10% this year, and business confidence here has recovered – as it is also doing in Italy, though having recently lost competitiveness and without strong markets in the developing economies, firms there are finding it hard to build export share.

30. Employment levels are ceasing to fall, though unemployment is likely remain stable, at over 10% during this year and next. Inflationary pressures remain subdued, reflecting considerable spare economic capacity. Investment is likely to recover only gradually, given weak growth prospects and, crucially, the uncertainty caused by current financial market turbulence, which itself jeopardises the chances for recovery in at least some member countries.

31. The decline of stimulus support measures, and in particular the phasing out of "car-scrapping" schemes, had a negative impact on growth in many countries during the early part of 2010. With housing markets still generally weak, and many households concentrating on paying down debt, monetary policy has therefore been accommodating. Instead of focusing on consumption increases, the OECD thinks interest rates in the euro area should rise as confidence returns and the economy strengthens,

32. The euro area budget deficit rose from 2% of GDP in 2008 to 6.3% in 2009 and, while there is substantial variation between members, a determined process of fiscal consolidation is clearly needed (given that this average is more than double the Maastricht criteria of 3%). Several euro members – notably Greece, but also Ireland, Portugal, Spain and Italy – have promised, or are implementing, early and in some cases drastic action to tighten their fiscal plans, despite some of them still being technically in recession. But it is not clear that these will be sufficient, in all cases, to restore lost confidence. The OECD suggests that every effort should be made to present credible and transparent plans, based on measures that have a good track record in achieving results. It also points out that other countries, such as France, will now need to present credible medium-term fiscal consolidation plans, and that Germany, too, will face challenges in meeting its newly passed deficit reduction rules.

33. Prompt and massive response by euro-area governments and the European Central Bank have calmed financial market turbulence, but the region's underlying weaknesses are far from settled. Moreover, as the instability has gone on, the markets have raised broader concerns about the perceived internal contradictions of the currency, and even cast doubt upon its long-term viability. Such concerns will need to be directly addressed, the OECD says, by strengthening the area's financial regulatory and supervisory architecture, and firmer adherence to rules. There is certainly a need for stronger oversight of domestic policies, taking account of competitiveness issues, and consideration should be given to the following options: external auditing,

effective sanctions for non-compliance, and even the possibility of de facto fiscal union. It has now become evident that stronger institutions, stronger enforcement procedures and a stronger will to introduce unpopular reforms are essential – indeed a "quantum leap" in the euro-zone economic governance.

34. After the deepest recession since the 1930s, the United Kingdom economy has returned to growth, led by household and government consumption, and some recovery in export performance. GDP, which fell by 3.1% last year, is likely to grow by 2.2% this year, though the recovery will only gain strength next year, when growth will be 2.6%. Unemployment, which was at 5.4% in 2007, will ease back from 8.1% this year to 7.9% in 2011 (these figures refer to 4th quarter over 4th quarter rates). Though wage growth is subdued, headline inflation has reached 3%, driven in part by the phasing out of VAT cuts at the start of the year – but the overall outlook for inflation remains highly uncertain. Given the United Kingdom's very high public debt, the OECD believes that far-reaching fiscal consolidation plans will need to be announced this year, and that monetary tightening will need to continue. Moreover, it warns that if inflation should turn out in excess of expectations, further fiscal and monetary measures may be unavoidable.

35. Throughout central and eastern Europe, similar processes of fiscal adjustment and restructuring are getting under way. In Hungary, where an end to recession is expected soon, the initial success of public spending reforms has boosted investor confidence and supported the currency, but recent concerns about the prospect of default highlight the scale of the challenge in restoring finances. The Slovak Republic, which expects 3.5% growth this year on the back of strong exports, has put forward an ambitious programme of spending cuts, while Poland, which led the way in growth amongst OECD members last year, is continuing to perform strongly and has announced some consolidation measures. However, further steps are awaited here that would allow the country to meet the Maastricht criteria. In the Czech Republic, which withdrew fiscal stimulus measures early and began limited consolidation, further spending restraint is generally agreed to be necessary, but no consensus has yet been reached on how to achieve it.

36. In Turkey, meanwhile, the economy has rebounded, with a strong export performance likely to bring 6.8% growth this year. The rapidly-growing labour force means that unemployment levels are expected to keep rising, but domestic and international confidence continues to improve, boosted by prudent macroeconomic management. Ongoing progress in fiscal transparency should maintain this progress, while the OECD also recommends labour-market reforms that would improve competitiveness and the economy's ability to create jobs.

4. Specific areas of OECD activity examined in depth

4.1. Lessons of the crisis – A strategic response

37. The OECD believes that the global response to the crisis has been impressive, with co-ordinated action taken on a sufficient scale, and with sufficient speed, to avert its worst consequences. This success has only confirmed the need for all major players to be involved in economic governance, and to address the weaknesses and failures – particularly those of regulation and economic imbalance – that have become evident. In the OECD's view, this means creating a new global model of economic growth, a task that becomes ever more complex, and more essential, as the number of major players increases along with the expansion of world trade. On the other hand, these competing economic models directly influence the work and perceptions of the OECD through its member countries.

38. In addition, as previous sections of this report describe, the recovery is fragile and many countries face a difficult immediate task in stabilising their economies, particularly in reconciling economic and social support with the need to achieve more sustainable finances. But even so, the OECD believes the lessons of the crisis need to be drawn without delay, such as the importance of policy advice, setting standards, and monitoring effective implementation by member countries, partly because there are short-term economic benefits to be gained from rapid action, and partly because, as they put it, "the long term starts now".

39. From the early days of the crisis, the OECD has maintained, and kept constantly updated, a "Strategic Response to the Crisis," which acts as a resource for reform and development, and forms part of the action plan agreed at the G20 London summit. It highlights the need to align financial sector regulations and incentives, so as to achieve more effective oversight and risk management. And it calls on governments to respond to the economic imbalances and structural limitations highlighted by the crisis, through co-ordinated reform of national policies. Most OECD countries, it says, could improve their immediate growth prospects by measures such as the reform of anti-competitive product market regulation, the reduction of tax burdens for low-income workers, a focus on environmentally friendly technologies and more effective training programmes for the unemployed.

40. Overall, the “strategic response” has three key themes:

41. *Growth should be stronger:* in order to avoid the mediocre growth described earlier in this report, we need more stable international markets and more effective national policies. Certainly, there needs to be better regulation of financial markets, to encourage a better relationship between the search for return and the assessment of risk, while at the same time striking a healthy balance between business and governments. This includes reforming capital regulations, to reduce the amount of leverage placed at risk and improve liquidity management, while also streamlining the international regulatory framework, to improve governance and ensure disclosure and accountability to owners and creditors. In the future, when a better regulatory system is in place, the OECD believes that those who place capital at risk, including large creditors, should be allowed to lose money when things go wrong; at the same time, they point out that the increasing complexity of financial products and instruments will require improved education and protection schemes.

42. Stronger growth also requires that governments address the imbalances within their economies, so that national instability is avoided and global imbalances are not allowed to widen once more. In part, this means the successful unwinding of emergency support measures, but more fundamentally it entails correcting disproportionate levels of savings, investment and consumption. In recent years, saving and spending rates have diverged between economies, as some have become excessively focused on consumption and some on production. Governments have a big role in influencing this – for instance, by not borrowing excessively themselves and siphoning off resources, by not distorting markets, but also by ensuring that there is adequate social protection and pension provision, so that consumers are not induced to save excessively. A sustainable growth model requires that savings and investment are well distributed globally, and not excessively concentrated. Moreover, innovation policies are needed more than ever to create new products, jobs and possibilities to tackle the lasting effects of the crisis.

43. *Growth should be cleaner*: the crisis has shown, once again, the distorting effect of relying on finite resources, which are subject to heavy price swings, while causing pollution and waste, thereby both lowering living standards and creating inefficiencies. Overall, the world economy is substantially more resource-efficient than it was a generation ago; but with its rapid expansion, the imperative is greater than ever to move to a new low-carbon model of energy and resource management, which will, in turn, do much to raise living standards and has a huge potential for creating high-quality and productive jobs. Future growth needs to be smarter and more knowledge intensive, and this is more than ever possible with the spread of communications and information technology. Moreover, such a transition is vital in the fight against climate change – and increasingly, we have learned that investments that are harmful to the environment should not be made simply so as to support the economy, for they contain hidden costs for future generations. These objectives can be assisted by “green” tax reform, ending subsidies to fossil fuel production and consumption, and by removing barriers to energy efficiency. Also, many of the stimulus programmes emphasised environmentally friendly infrastructure, such as power and public transport projects, and these can be used to give new impetus to public and private investment directed toward a low-carbon economy. In this respect, the rapporteur welcomes the OECD’s work on the Green Growth Strategy which has become an important flagship project.

44. *Growth should be fairer:* for future growth to be socially sustainable, more effective trade and development policies are needed, with common principles of global governance, based on co-operation between developed and emerging economies. OECD members can obtain much greater impact from their international development efforts, if they ensure that these take place on a more level playing field, with policies and resources more effectively co-ordinated, and deployed in partnership with recipients. And increasingly, development efforts need to pay attention to open markets; it is a great success in the response to this crisis that free trading principles have been maintained and the energy and speed of recovery shows what a powerful force an open trading system can be. But we now need to ensure this is built on, both by ensuring that any distortions put into the market are removed, and also by extending trade opportunities more broadly than before. Not only will this help to build a stronger trading system that delivers greater prosperity for all, but will specifically help to increase opportunities and living standards for the world’s least developed countries.

45. Moreover, all round the world, growth must be focused on increasing employment – unemployment breeds poverty and hinders long-term growth, while the social deprivation it causes can exacerbate the very protectionist and isolationist sentiments that make poverty itself so difficult to tackle. With only a slow short-term fall in unemployment expected in most OECD countries, the strategy suggests a range of employment incentives and schemes, and suggests that a priority be placed on encouraging new businesses, pointing out that nearly all the additional private sector employment in the United States seen over the last twenty-five years has come from companies less than five years old.

46. The “strategic response” also emphasises the contribution to fairer growth made by strong health care, and particularly by educational policies. Launching the OECD’s Innovation Strategy in May, the Secretary-General noted that, as part of stimulus measures, many governments had wisely raised spending on education and research. As the focus now turns to spending restraint, he suggested that waste can be curbed by steps such as reforming universities, cutting red tape and sharing research data, and that in many countries there is a great deal of scope for rationalising policy so as to foster innovation and research investment so that, in short, a simpler approach could make research more productive.

47. Of course, these efforts to encourage growth that is at once stronger, greener and fairer rely on transparency. The world needs growth that is demonstrably equitable and respects the rights of all. This entails initiatives to combat corruption, bribery, tax evasion, bank secrecy, and to promote equal opportunities and a fair basis for investment, whether at a local, global or national level. Of course, tackling these areas requires a relentless focus, but they are indispensable to fulfilling economic potential, and the OECD believes that solutions must be internationally co-ordinated, continuously applied and constantly monitored and verified. This is especially true for the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (Anti-Bribery Convention). Implementation of this legally binding instrument by its 38 parties is rigorously monitored by the Working Group on Bribery in International Business Transactions.

48. To assist in the development of this new economic model, the OECD is involved with the Global Standard initiative. Launched by the G8 last year, and also known as the Lecce Framework, the Global Standard is a co-operative forum of international organisations, which aims to build on existing international tools and instruments so as to develop a common set of principles and standards. The Financial Action Task Force on Money Laundering, World Bank, IMF, and Financial Stability Board are amongst other key members. On 25 May 2010, OECD ministers adopted a “Declaration on Propriety, Integrity and Transparency in the Conduct of International Business and Finance”. The issues addressed by the declaration include competition, corporate governance, investment and responsible business conduct, financial regulation, tax co-operation, anti-corruption, interaction between government and business, financial literacy and consumer protection.

49. Naturally, those collaborating on the Global Standard are taking into account other current international initiatives, in particular the Global Charter for Sustainable Development. Accessibility is also a priority for those involved with the Global Charter, which is regarded as “work in progress” and aims to generate informed opinions and contributions and to stimulate debate.

4.2. Lessons of the crisis for corporate governance

50. As discussed above, the OECD regards corporate governance as a crucial area in which lessons need to be learnt, and best practice extended, in the aftermath of the global crisis. Over the last eighteen months, the OECD Corporate Governance Committee has consulted widely, conducted a series of meetings that included representatives from Brazil, Russia, China and India, and in February published its conclusions in a paper entitled “Corporate governance and the financial crisis”.

51. The committee found that corporate governance weaknesses had played an important role in the development of the crisis, particularly in terms of remuneration, risk management, board practices and the exercise of shareholder rights. And they found that such weaknesses are not confined to financial sector companies, but exist more broadly. Reviewing the specific failures that have taken place, it was felt that the OECD Principles of Corporate Governance (first published in 1999, and updated in 2004) provide a good platform to address the failures, and that the priority should be to see these principles thoroughly adopted, rather than to replace them. Here, we’ll examine some of the key points these principles set out, relating to the major weaknesses revealed.

52. As a preliminary, it should be noted that corporate governance is an immensely complex field, and that a “one size fits all” approach is often unworkable or inappropriate. Hence, the OECD continues to believe that the use of self-regulating codes and standards is preferable to tightly defined regulation. Nevertheless, given clear recent instances of regulatory failure, the paper calls for jurisdictions to regularly review the capacity of their supervisory and enforcement authorities, to ensure that best practice standards are adopted, that correct monitoring is in place, and that they are updated as and when appropriate.

53. Executive remuneration is perhaps the most highly charged public policy issue of corporate governance. Many countries have therefore introduced, or are considering, rules that curtail or regulate executive pay packages.

54. The committee's report reaffirms the position of the principles that a company's board is responsible for setting out clear strategic goals and a judgment on the level of risk that is acceptable; it is then the board's responsibility to establish a compensation structure that meets a range of performance metrics based on these goals. Well-designed and transparent procedures are therefore required, but companies do need to have the flexibility to adjust their policy to suit their own conditions. Therefore the steering group suggests that legal limits and caps be applied only in exceptional circumstances, and it also warns against regulations that might tend to make the fixed element of compensation packages become excessive.

55. The report suggests that the first priority is that compensation be set through an explicit governance process in which the roles and responsibilities of all are clear; beyond the board, this includes limiting the influence of company managers, defining the part played by compensation consultants and ensuring the boards have sufficient information to exercise objective and independent judgment. Secondly, while disclosure is obviously important, transparency is crucial: companies should be able to explain their remuneration strategies clearly and concisely, including an assessment of the total cost, performance criteria and the degree of adjustment involved due to risk.

56. This will address the weaknesses seen in some schemes today, which can be obscure and overly complicated, and have links between performance and remuneration that are weak, or based on too crude a range of metrics (such as a company's stock price), or where rewards are given before the performance is realised. It should then be seen as good practice for remuneration policies to be submitted to a company's annual meeting – and, where this is appropriate, put up for shareholder approval. Such "say on pay" measures have been widely introduced in recent years and, even when non-binding, have been shown to be effective in raising the level of compensation package design and transparency, and in building shareholder confidence.

57. Risk management is another area of corporate governance put under the spotlight by the crisis. As with remuneration policy, an important conclusion of the weaknesses revealed is that company boards need to be responsible for establishing and overseeing enterprise-wide risk management systems, with clearly defined responsibilities for all involved in the process.

58. In most cases, the OECD says, risk management is still insufficiently addressed in corporate governance codes, and this was evident during the financial crisis, with company boards sometimes ignorant of the risks for which they were responsible. For financial companies, which operate in a volatile environment and which trade via short-term borrowing and long-term lending, the requirements for oversight are stringent, and the failures have been obvious. But companies outside the financial sector also face significant risk issues, for instance relating to health issues for pharmaceutical and food companies, and oil spills for a petroleum company.

59. To address this, the OECD says risk-management policies need to be more forward-looking, more clearly expressed and closely related to company strategy. In many companies, the board is advised on risk by the Chief Financial Officer, and a great deal of risk oversight is delegated to the company's audit committee, but the OECD recommends that a Chief Risk Officer, reporting directly to the board, should be regarded as best practice, supported by risk managers who are not separated from company management, but are independent of corporate profit centres. In addition, there should be a degree of external disclosure so that, without breaching commercial confidentiality, markets and investors can be made aware of relevant risk factors in an understandable way, and can be confident that the board has a clear idea of what their risk policy is. It is also worth pointing out that the design of executive compensation programmes is inevitably related to the risk policy of a company, and should therefore be included in any risk management system.

60. The performance of company boards have come under a great deal of scrutiny, in part because of the issues discussed above, but also more broadly. Many criticisms have been made of part-time boards, and their ability to discharge their duties effectively and independently, which the OECD's principles set out as their essential function. To perform better, says the OECD, boards need to be properly supported. For instance, the chair should be able to ensure that the board tackles the most important issues facing the company, and should be provided with the tools and information needed to build appropriate management structures, such as those relating to risk management. The role of chair should, in general, be separated from that of CEO, and board members should have access to specialised training, while also being subject to periodic evaluations. When recruiting, some sort of board nomination committee should be formed, to specify the skills required and identify potential candidates – and, equally, shareholders themselves should be able to nominate board members and play a significant part in their appointment.

61. The role of shareholders has also been questioned; in the run-up to the crisis, shareholders were often seen to be reactive, or merely passive, in approach, and rarely presented any sort of challenge to company boards. Some have associated this problem with the growing importance of institutional investors, who also pose increasing conflict of interest questions. This is a particularly complex area, with many variations between national jurisdictions, so “one size fits all” solutions are difficult. Overall, however, the OECD says participation can be improved by removing barriers to voting, by more flexible voting mechanisms, and by increasing incentives to vote (though equitable treatment needs to be assured for all shareholders). It also suggests that more effective alignment between private and public enforcement instruments could encourage the growth of more active and informed shareholders.

62. Meanwhile, good practice requires that investors disclose voting records, so that there is transparency over any conflicts that exist, and institutions should disclose any codes or principles they follow in exercising their rights. It is, too, important that companies disclose the voting results of shareholder meetings. The authorities, meanwhile, need to ensure good co-operation between shareholders regarding voting by making sure that “acting in concert” rules are clear and understood; and, lastly, the provision of proxy advisory services needs to take place in a transparent and competitive environment.

4.3. Update on OECD enlargement and enhanced engagement

63. Formed in 1960 with a membership of 20 countries, the OECD has in recent years pursued a strategy of vigorous expansion and outreach. For while its original membership represented the key economic players at that time, the organisation had to grow to reflect the expansion of trade and to maintain its position as an influential voice in the world economy. Accordingly, the membership of the OECD rose to 30 countries by 2000 and, in May 2007, OECD countries decided to open accession discussions with five countries: Chile, Estonia, Israel, the Russian Federation and Slovenia. The accession processes of four of these countries have now been completed. Chile formally became an OECD member on 7 May, Slovenia on 21 July 2010, and Israel on 7 September 2010, bringing the total membership to 33 countries. Estonia will become a member as soon as her domestic procedures have been completed. The process for the accession of the Russian Federation is now well under way.

64. The OECD accession procedure is an extremely rigorous and demanding process for a candidate country with in-depth reviews by some 20 OECD committees in diverse fields from investment to anti-corruption, from environment to fiscal affairs, from public governance to scientific and technological policy. An “accession road map” sets out the terms, conditions and procedure for the accession of each country. Each committee examines the candidate country’s willingness and ability to implement OECD legal instruments and the degree of coherence between the policies of the candidate country and those of OECD members. The committee then makes a set of recommendations for further action by the candidate country, some of which need to be implemented before OECD accession. At the end of the process, the OECD Council decides whether to invite the candidate country to become a member on the basis of “formal opinions” from each of the committees as well as all other relevant information.

65. One of the most remarkable features of the OECD accession process is its transformational nature. In each case, the accession process has been a catalyst for reform and the candidate countries have acted quickly and resolutely in responding to OECD recommendations through changes in legislation, regulations or policy. As a result of the accession process, Chile adopted key legislative reforms to ensure full exchange of bank information for tax purposes in line with the OECD standard, to create liability of companies for bribery and to improve the corporate governance of both state-owned and private companies. Estonia liberalised market access for OECD investors in its financial services sector and adopted legislation for better corporate governance of state-owned enterprises. Israel joined and took significant steps to implement the OECD Anti-Bribery Convention, further liberalised its financial services sector and agreed to make changes in its framework for the protection of intellectual property rights. In the run-up to the decision on its accession, Slovenia adopted major legislation to reform its corporate governance framework for state-owned enterprises, creating a new central ownership agency to manage the state’s interests in these companies.

66. As regards Israel, overall the accession process has been, says the OECD, “a catalyst for reforms”. The OECD points to a series of rapid developments which have resulted from discussions with Israel. These include Israel’s signature of the OECD Anti-Bribery Convention, having made relevant legislative changes, and a comprehensive review of environmental standards and regulations, culminating in a commitment at the Copenhagen summit to cut greenhouse gases by 20% by 2020. In addition, the OECD’s review of Israel’s labour market and social policy (published in January 2010) focusing on the situation of Israeli-Arabs and

ultra-Orthodox Jews has had what the OECD calls “an immediate and high-level impact” on policy discussions. So, too, have the findings of last year’s OECD “Economic Survey of Israel”, particularly in relation to the need for improving education opportunities throughout the population.

67. During the accession process, there was much debate and discussion as to the geographical scope of Israel’s statistical data. Since this includes data on the Golan Heights, East Jerusalem and Israeli settlements in the West Bank, a footnote will be included in all relevant OECD documents stating that this data is the responsibility of the Israeli Government and that its use by the OECD is without prejudice to the status of these areas under international law. In specific subjects, however, such as population, labour force, poverty and household income, Israel will provide data broken down separately for these areas. Meanwhile, within a year of the date of its accession, Israel will take part in a joint study with the OECD to measure the impact of including these areas in key economic and social aggregates. This is an unprecedented step, which will help to clarify reporting for the future.

68. Beyond the accession of these five countries, the OECD is determined to continually expand and deepen its global relationships, especially with the major emerging market economies. Accordingly, a process of “Enhanced Engagement” has been offered since 2007 to Brazil, China, India, Indonesia and South Africa. It aims at promoting the engagement of these countries in core OECD work and their active participation in OECD committees, regular economic surveys, and peer reviews in specific policy areas, as well as their adherence to OECD instruments and integration into OECD information systems. In the future, such co-operation will only intensify and in the long term, of course, it has the potential to lead to OECD membership, should the countries involved wish to do so. In addition, the OECD continues to develop its policy dialogue and co-operation with a broader range of non-member economies through a series of global forums in key policy areas and in the framework of regional initiatives including with South-East Asia as a region of strategic priority interest, Africa, Eurasia and Latin America.

4.4. The OECD and the Council of Europe: working together to beat tax evasion

69. For many years, the OECD has worked to improve transparency and exchange of information in order to beat tax evasion – with mixed results. But at last year’s London summit, the G20 declared that “the era of banking secrecy is over” and affirmed the readiness of members “to take action against non-co-operative jurisdictions, including tax havens”. In addition, they called for action “to make it easier for developing countries to secure the benefits of the new co-operative tax environment, including a multilateral approach for the exchange of information”. Thus, the year 2009 saw unprecedented progress on international tax co-operation: the OECD Global Forum now comprises more than 90 countries including all OECD and G20 members and the OECD principles on transparency and exchange of information are now generally accepted.

70. To combat tax evasion, information exchange between states is paramount. If bilateral treaties can be viewed as a useful step in the right direction, (and some 3 000 currently exist), a comprehensive multilateral convention offers far greater advantages, as has been made clear in the G20 discussions. A multilateral approach has an obvious benefit in setting a uniform standard for information exchange, as well as providing adequate guarantees for the respect of taxpayer rights. Both the OECD and the Council of Europe have long been leading activists in this field, and over the last year have substantially renewed their co-operation. In response to the G20’s declaration, the OECD and the Council of Europe have together developed a protocol (CETS No. 208) that amends the Convention on Mutual Administrative Assistance in Tax Matters (ETS No. 127), aiming to reflect technological developments in information transfer, to bring it into line with the “international standard on exchange of information for tax purposes” – the leading code of its type, which was originated by the OECD, and with G20 support has facilitated rapid improvements in international banking secrecy regulations and thus to counteract tax evasion and tax avoidance – and to open it up to countries that are neither members of the OECD nor of the Council of Europe.

71. The convention, originally opened for signature in 1988, was prepared jointly by the Council of Europe’s Committee of Experts on Legal Co-operation and the OECD’s Committee on Fiscal Affairs. In many ways, it was ahead of its time, in pushing for more structured international collaboration on information exchange to combat tax evasion. The convention was designed to apply to all taxes, other than customs duties, and covers a broad range of tax matters, including provisions for cross-border exchange of information, multilateral simultaneous tax examinations, service of documents, cross-border assistance in tax collection, recovery and judicial prosecution. In addition, it imposes extensive safeguards to protect the confidentiality of the information exchanged. As the protocol enters into force, the convention will become an even more powerful tool for multilateral tax co-operation as it will enable a wider group of countries to become parties, while requiring full exchange of information on request in all tax matters, without regard to a domestic tax interest requirement or to any claim of bank secrecy for tax purposes.

72. It is hoped that the pioneering work of the convention will now achieve a new scale and scope. Previously, the convention had been ratified by 14 of the 54 states to whom it was potentially applicable, and signed but not yet ratified by Canada, Germany and Spain, while only two G8 members, Russia and Japan, had yet to sign. In May, the updated convention was presented at the annual OECD ministerial meeting in Paris, and was signed by 11 countries already parties to the convention (Denmark, Finland, Iceland, Italy, France, Netherlands, Norway, Sweden, Ukraine, the United Kingdom and the United States). In addition, Korea, Mexico, Portugal and Slovenia have signed both the convention and the protocol. Poland signed the protocol on 9 July 2010.

73. Speaking at the signing ceremony, the OECD Secretary-General described the new protocol as “another success story in the fight against offshore tax evasion”, and praised the speed with which OECD and Council of Europe officials had been able to bring it forward. And with increasing international awareness of the revenues lost to tax evasion, he predicted that the number of signatories will “increase exponentially in the near future, thus making the Convention a keystone for international tax co-operation”.

5. Concluding remarks

74. The most important consequence of the economic crisis is the massive level of public borrowing. The rapporteur is concerned that government stimulus programmes and rescue packages have led to a sharp deterioration of public finances in many OECD countries. Governments will therefore have to address the consequences of exceptional stimulus spending and the rescue of debt-stricken institutions. More than €1 000 billion was injected into OECD countries under fiscal stimulus packages in 2009, and although broadly successful, these interventions have increased deficits, leaving some governments carrying levels of debt unprecedented in peacetime. At the same time, social costs (such as unemployment benefit) have increased and revenue expectations have been slashed. Public spending cuts and tax rises to deal with "very unfavourable government debt dynamics" (as the OECD has warned in its Economic Outlook) seem indispensable in advanced economies by next year at the latest. The rapporteur agrees with Mr Pier Carlo Padoan, the OECD Chief Economist, who stated: "Exit from exceptional fiscal support must start now, or by 2011 at the latest." Budgetary plans should be "based on credible and well articulated medium-term consolidation plans to restore fiscal soundness". At the same time, the rapporteur believes that the key challenge is to strike the right balance between policies aiming at achieving fiscal consolidation while at the same time supporting the recovery and job creation. We must be flexible in adjusting the pace of consolidation and learn from the mistakes of the past when the fiscal stimulus was too quickly withdrawn.

75. Moreover, it is not enough to rein in the deficits in reaction to what has happened. Countries across Europe need to fundamentally change the way they deal with public finances so that debt crises of this magnitude can never happen again. That means that the stability pact must be taken seriously. There must be better safeguards against member states spending and borrowing too much and an early-warning system to identify problems before they get out of hand. Public trust in our political institutions is also being severely tested. The eurozone faces huge pressures from a “one size fits all” monetary policy and there may be further shocks in the system to come. Therefore, the measures to strengthen the eurozone should aim at three objectives: tighter fiscal rules, efforts to boost competitiveness as well as economic growth and job creation, and the installation of a crisis resolution mechanism to avert or at least to cope more effectively with Greek-style emergencies.

76. To buy time for budgetary tightening, the OECD rightly said that countries should publish detailed plans on how to get their public finances in order, be clear about what they would do if different circumstances arose, cut spending rather than raise taxes and enhance the credibility of their plans by subjecting them to independent monitoring. However, the rapporteur believes that many OECD countries need to reconcile support for a still fragile recovery with the need to move to a more sustainable fiscal path. In other terms, governments must tackle structural reform if they are to cope with the damage wrought by the economic crisis and avoid future financial collapses. Moreover, innovation policies are needed more than ever to create new products and jobs, and to tackle the lasting effects of the crisis.