On the Threshold of a Global Economy

Makoto Taniguchi and John West

The world's economies, both inside and outside the OECD area, now have the opportunity of developing closer linkages, which bring with them the prospect of a genuinely global economy. Expanding these linkages over the next two decades or so would boost prosperity, reinforce political security and promote environmental sustainability. But progress to this end would require the tackling of a wide range of obstacles in economic, social and environmental policy and the strengthening of international co-operation.[1]

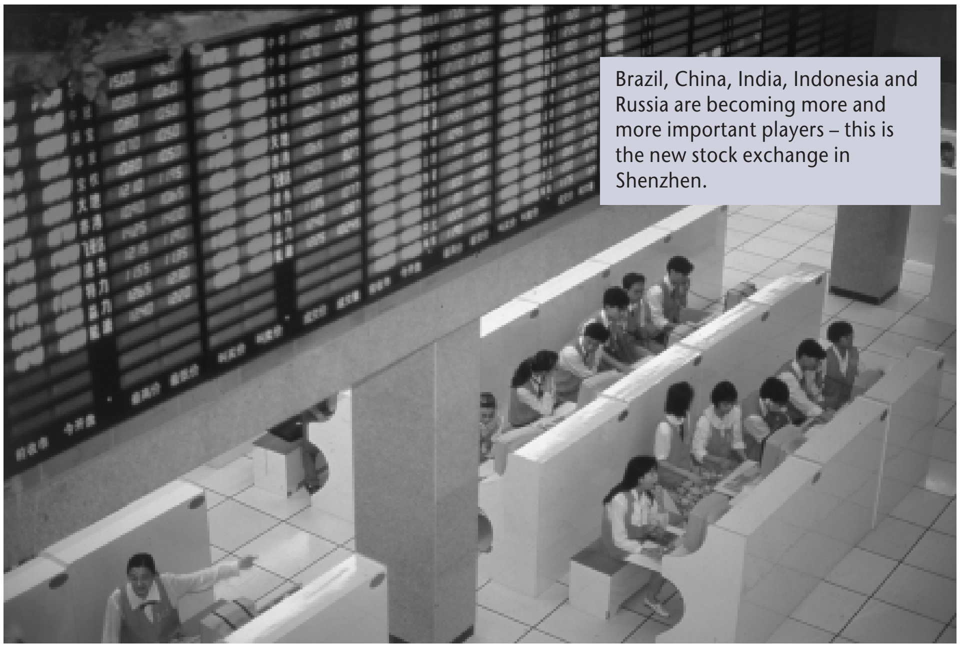
The OECD economies have been growing together throughout the half-century since the Second World War. For many years Europe and Japan both experienced rapid growth as they gradually caught up with the United States. An important driving force was the progressive liberalisation of international trade and financial movements. That allowed OECD countries to specialise in the activities where they enjoyed comparative advantage and to strengthen their trade, investment and financial linkages, thus boosting growth and prosperity for all of them. Very few non-OECD economies joined into this wave of growth during the 1950s and '60s. But from the 1970s, Hong Kong, Singapore, South Korea and Chinese Taipei started following in the footsteps of Europe and Japan. Dynamic, export-oriented growth boosted living standards, virtually eliminating poverty in these economies.

Makoto Taniguchi is a former Deputy Secretary-General of the OECD; John West works in the Private Office of the Secretary-General.
E-mail: john.west@oecd.org

These developments have been beneficial also to the OECD economies. The fast-growing 'Asian Tigers' have become an increasingly important market for OECD exports and a destination for profitable investments. OECD consumers gain substantially as the price of goods imported from these economies is generally much lower than goods produced locally or in other OECD countries. And resources in the OECD area are thereby freed for higher-value uses, especially in skill-intensive services and capital equipment – some of which, in a virtuous circle, is then exported to non-OECD economies, thus further stimulating their development.

There is now an historic convergence of interests among both OECD and non-OECD economies in strengthening their trade, investment and financial linkages. Over the past decade, democratic government and market-based economic development have been spreading widely – most notably in the former centrally planned economies but also in an increasing number of developing countries. World trade and

1. ***Towards a New Global Age: Challenges and Opportunities – Policy Report***, *OECD Publications, Paris, 1997;* ***Towards a New Global Age: Challenges and Opportunities – Analytical Report***, *OECD Publications, Paris, forthcoming 1997.*



Brazil, China, India, Indonesia and Russia are becoming more and more important players – this is the new stock exchange in Shenzhen.

J. Aaronson/Aspen/Cosmos

M. Beth Camp/Matrix/Cosmos

Thanks in part to imports from the emerging economies, resources in OECD countries can be directed to uses with higher value-added.

investment have been increasing dramatically. And the 'Big Five' countries, Brazil, China, India, Indonesia and Russia, are emerging as powers of global importance. A genuinely global economy is now taking shape, in which all countries can participate actively. The pace of integration of non-OECD economies into this global economy has nonetheless been uneven. A large number of developing countries, particularly in Africa, have seen their participation in international trade and investment fall.

The Challenge of Change

Structural change is a fact of life in most economies. History has witnessed a dramatic decline in, for example, the size of agriculture in OECD economies, where it now accounts for less than 7% of employment; services, by contrast, once regarded as the 'soft' part of the economy, now employ over 60%. And skilled labour has been in much higher demand with the expansion of knowledge-intensive industries.[2] Rapidly emerging economies in Asia are now seeing similar trends: manufacturing sectors are declining as economic growth becomes more service-oriented.

Along with rapid technological progress, international trade, investment and financial flows have become important motors for structural change. In recent years, world trade has been increasing three times more rapidly than GDP; over the past decade, foreign direct investment has been growing six times faster.

Non-OECD economies have been a driving force in this acceleration of globalisation. Excluding Korea and Japan, both members of the OECD, Asia now accounts for close to 20% of world trade, more than three times its share of 25 years ago. Moreover, seven Asian non-OECD economies (China; Hong Kong, China; Chinese Taipei; Singapore; Malaysia; Thailand and Indonesia) are now among the world's top 30 trading nations. The dynamic and emerging economies in East Asia and Latin America, and an increasing number of transition economies, are also demonstrating that integration into the global economy is a powerful strategy for accelerating growth and development. Development co-operation has played a catalytic role in this process.

But developments in the global economy can lead to social unrest and protectionist pressures, especially when they coincide with the high and persistent unemployment seen in many OECD countries over the past two decades. Globalisation is often blamed for unemployment, inequality of income and de-industrialisation. Indeed, this accelerated rate of change brings with it higher adjustment costs, especially for low-skilled workers and industries, even though the benefits to society as a whole outweigh the costs.[3] Other high-skilled industries are stimulated, especially in the services sector (not least in information technology and finance industries), where exports have been growing twice as fast as merchandise exports. The response from OECD governments should be to improve the flexibility of labour and product markets, foster life-long learning[4] and reform social policies in order to improve the capacity of individuals and firms to adjust and innovate, and maximise the benefits of globalisation.[5]

Projections of Prosperity

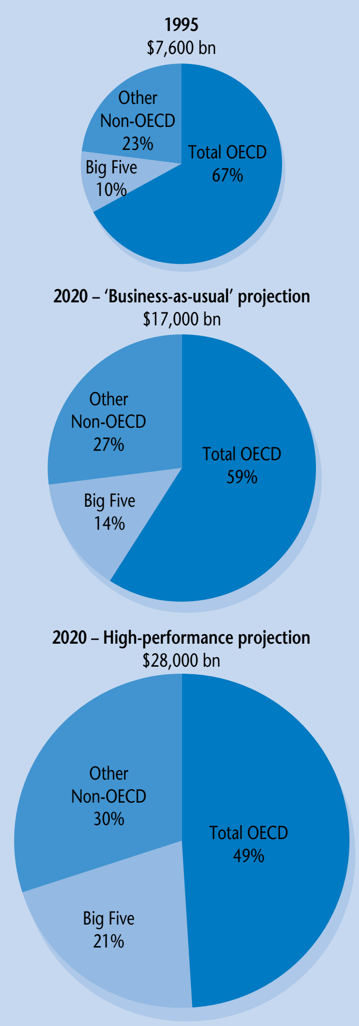
Investments in human capital and rapid technological progress will provide the potential for continued growth in prosperity, even with 'business as usual' policies. Information technology, biotechnology, advanced materials, alternative energy sources and improved transport will help create wealth – but they will also stimulate structural change. The full realisation of the potential benefits of these developments depends in large part on ensuring that the design of government policies both fosters these market-driven trends and helps adaptation to the changes they bring.

One of the basic conditions is a completion of the move towards global free trade and capital movements[6] that has been underway since the end of World War II. A large number of both OECD and non-OECD governments have committed themselves, within various regional frameworks, to the goal of free trade by certain dates,

Figure 1

Shares in World Trade

1992 $



Source: OECD

such as 2010 and 2020. Another is fiscal consolidation and macro-economic stability. Third, the OECD countries will have to make further advances in structural reform. And a large number of non-OECD economies must develop the necessary capacity for development, in terms of policy frameworks and governance systems, and social, human and physical capital.

Looking forward to the year 2020, the implementation of such a strategy would see a vastly different and much improved world, for both OECD and non-OECD countries, in particular:

- prosperity would increase substantially the world over, especially among non-OECD countries; OECD living standards in 2020 could be 80% higher than now, while average living standards in the non-OECD area could be 270% higher; substantial reductions in unemployment would also be achieved
- global economic weight would shift towards present non-OECD countries, whose weight in the global economy could increase to more than 60% (from around 40% in 1995), while their share in world trade could rise from one-third to one-half (Figure 1)
- the 'Big Five' could account for more than one-third of world GDP (about the same as the existing OECD membership in 2020), partly because of their very large populations (Figure 2); and China could be the world's largest economy, equivalent in GDP to half of the OECD in 2020[7]
- economic catching-up by non-OECD economies could see their standards of development rise to 30% of those found in the OECD area in 2020, compared with about 15% in 1995
- closer linkages among all economies, as trade might rise from 30% of GDP today, to some 50% in 2020.

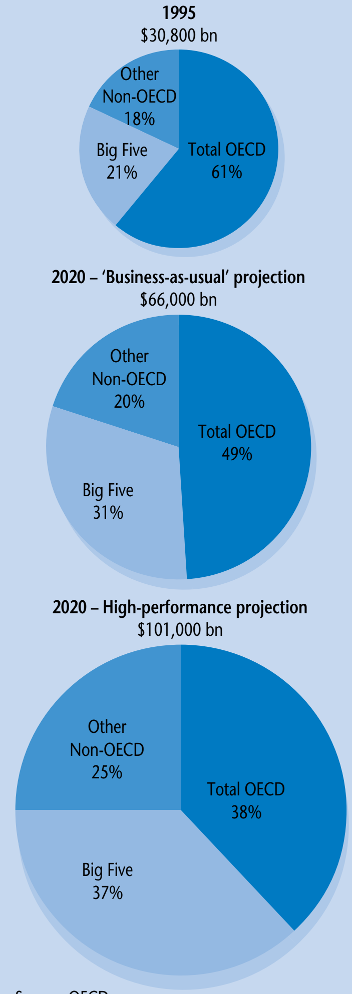
This high-performance outcome is less a forecast than a vision of a realistic possibility for the world economy – if governments undertake the reforms that will let it happen. And it is by no means the maximum that could be achieved. Moreover, by boosting living standards, it would also enhance the capacity to deal effectively with a large number of problems, not least in the environment, urbanisation and social policy. Less encouraging projections could be envisaged, of course, particularly if governments do not proceed with reform or fail to resist protectionist pressures. A reversal of globalisation could lead to fragmentation, with damaging effects on prosperity and political stability.

Reform on Three Fronts

The prospects for the 'global age' depend on the ability of individuals, governments and the international system to channel, and adapt to, pressures and opportunities for change. Several major steps will have to be undertaken.

The first is a strengthening of the free, open, multilateral trading system. Much progress has been made towards global free trade and capital movement, not least through the Uruguay Round commitments. The creation of the World Trade Organization has provided the legal basis for the new multilateral trading system. OECD countries are negotiating a multilateral agreement on investment (MAI), which will be open to accession by non-OECD countries – a number of which have indeed indicated their wish to accede.[8] And already more than half of world trade now takes place within free-trade agreements or among countries that have decided to achieve free trade by a certain date. Further, the OECD is developing global principles for international treaties, transfer pricing and for countering international tax evasion and avoidance. An increasing number of non-OECD countries are also associating themselves with these rules.

Figure 2
Shares of World GDP
1992 PPP$



Source: OECD

But the multilateral system will continue to encounter difficulties. Protectionist pressures and trade frictions will be a virtually unavoidable part of the globalisation process, as the accommodation of a larger presence of non-OECD economies will require substantial adjustments and the service sector becomes increasingly exposed to international competition. Some obstinate border barriers remain in OECD countries, not least in agriculture. And despite the continuing trend towards liberalisation, barriers to trade and capital movements are generally still high in non-OECD countries. A large number of 'behind-the-border' barriers are now being tackled, especially in domestic regulations and competition policy. And new conundra are emerging for taxation policy, such as global tax competition and the implications of global communication technologies, particularly the Internet.

2. *Candice Stevens, 'The Knowledge-driven Economy',* ***The OECD Observer****, No. 200, June/July 1996.*

3. *Jean-Claude Paye, 'Technology, Employment and Structural Change', and George Papaconstantinou, 'Technology and Jobs',* ***The OECD Observer****, No. 194, June/July 1995.*

4. *Edwin Leuven and Albert Tuijnman, 'Life-long Learning: Who Pays?',* ***The OECD Observer****, No. 199, April/May 1996.*

5. *Nicholas Vanston, 'How Regulatory Reform Affects the Economy',* ***The OECD Observer****, No. 206, June/July 1997.*

6. *Stephen L. Harris and Charles A. Pigott, 'A Changed Landscape for Financial Services',* ***The OECD Observer****, No. 206, June/July 1997.*

7. *Barrie Stevens, 'China Enters the 21st Century',* ***The OECD Observer****, No. 201, August/September 1996.*

8. *William H. Witherell, 'An Agreement on Investment',* ***The OECD Observer****, No. 202, October/November 1996.*

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Some countries, not least in Africa, which participate less in the globalising economy must improve their capacity to lead their own development.

The second step is progress with domestic policy reform. With the structural upheavals that can be foreseen, and with their aging populations,[9] OECD economies will have to become more flexible, adaptable and innovative. But although there have been considerable advances in the liberalisation of financial markets and international trade, there has been less progress in reforming labour and product markets.

Labour markets in the OECD area will have to cope with the related objectives of achieving smooth adjustment and maintaining social cohesion, in a world where many employees will change jobs, and possibly even careers, several times during their working life.[10] Although higher living standards for all seem within reach, there may also be a widening in income distributions, as labour-market pressures from trade and technology favour skilled manpower over the less specific forms of human capital. Social and educational policies should then attempt to enhance the capacity of individuals to change, and focus on the training requirements of unskilled workers.

The third step calls for strengthening policies for sustainable development. Although globalisation can promote a more efficient and less environmentally damaging pattern of economic development, its gains may be overwhelmed by the pollution and resource-use associated with increased economic activity.[11] Environmental policies must ensure that the benefits of economic growth are not undercut by the impacts on health of pollution, and the increased degradation or loss of productive agricultural lands, fisheries and other natural resources.

■ ■

The global economy holds enormous promise, though it is still fragile. The vision of a global age is already inspiring the working agenda for the international community. The OECD can help realise this goal through its analysis of issues involved in globalisation and by developing international rules of the game, using its multidisciplinary capacities. And it can strengthen the foundations for global governance, especially through its partnerships with non-OECD economies. These countries will increasingly shape developments in OECD countries and in the world economy as a whole. And with the globalisation of the world economy, and the internationalisation of many policy issues, the role of international co-operation and the multilateral system will become even more important. ■

*9. Lans Bovenberg and Anja van der Linden, 'Pension Policies and the Aging Society' **The OECD Observer**, No. 205, April/May 1997.*

10. See pp. 24–27.

11. See pp. 9–12.

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