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LONG-TERM PROSPECTS FOR THE WORLD ECONOMY

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1. Introduction

What kind of world economic environment are governments, enterprises and individuals likely to encounter at the turn of the century? What major uncertainties and issues will have to be faced at the international level? What are the prospects for the major economic regions of the world? These are some of the questions which are increasingly on the minds of decision-makers as the turn of the century approaches and as they become more sharply aware of the pace of change and of the extraordinary transformations that the world economy has been undergoing in the last few years.

The need for decision-makers in the public and private sectors to develop a longer-term strategic view of events in the global economy has grown, as they have increasingly been confronted with issues of a longer-term nature, such as sustainable development; environment and energy; the economic and social implications of ageing populations in OECD countries; explosive population growth and poverty in developing countries; and the changes in Central and Eastern Europe. While many of these problems have been building up for a long time, some were rather late in moving to the top of the political agenda.

The evolution and eventual outcome of many of these problems, however, often depend critically on actions taken at a relatively early stage. As time goes on, the range of feasible options frequently becomes narrower, problems tend to become more acute and solutions harder to implement. Hence, while there is a danger of making decisions that are too hasty, there are also risks in deferring policy attention for too long.

The purpose of the conference was therefore to examine the principal developments which are likely to influence the evolution of the world economy and of its main economic regions over the next decade or so, to discuss the implications of those developments for international economic relations, and to reflect on the policy agenda for the 1990s. The present paper provides a broad overview of the contributions presented at the meeting and of the ensuing discussion, and serves as an introduction to some of the principal issues.

Section 2 of this overview provides an assessment of longer-term prospects for the main economic regions of the world. First, the future evolution of North America is considered, with an emphasis on the outlook for the US economy and the possible implications of the North America Free Trade Agreement (NAFTA). The outlook for Europe which follows focuses primarily on issues related to the deepening and the widening of the European Community. Prospects for the Asia-Pacific region, with particular emphasis on the future evolution of Japan and of the Dynamic Asian Economies (Hong Kong, Malaysia, Singapore, South Korea, Taiwan, and Thailand), are then addressed. Section 2 concludes with the outlook for other regions of the world (South Asia, Latin America, the former USSR, the Arab world and Africa south of the Sahara).

This regional assessment provides a basis for addressing in Section 3 some of the major questions that are likely to arise at the global level from the interaction between regional and national economic players. Four main issues are considered: the possible shift in the economic centre of gravity from the Atlantic to the Pacific basin; the implications of increasing regionalisation for the future of the multilateral system of trade, investment and technology; the implications of saving and investment imbalances at the global level; and the significance for future international economic relations

of the growing competition among national economic systems. The challenges raised for developed and developing countries alike by environmental problems, though a further possible issue for discussion in a global context, were not addressed at the meeting.

2. Longer-term outlook for the main economic regions of the world

Projections for the global economy in the 1990s and beyond are by and large optimistic. In the industrialised countries, after more than a decade of widespread restructuring, conditions on the supply side are favourable, and provided international financial markets remain stable, the recovery in investment rates over the latter half of the 1980s should feed through into improved output performance over the longer term. Moreover, private consumption and investment could pick up in the debt-stricken developing countries, as well as in Eastern Europe. Thus, estimates for average annual growth in world output up to the year 2000 are broadly in the 3 per cent range. North America and OECD Europe are seen as likely to grow at between 2.5 and 3 per cent. Japan is set to grow at between 3 and 4 per cent, and the Asia-Pacific region as a whole at well over 5.5 per cent (slightly higher for the Asian NIEs). Latin America is expected to grow at around 3 per cent, and Africa at a somewhat lower rate. Finally, growth may resume in some Central European countries towards the end of the decade, after a prolonged period of major structural change.

This basically optimistic outlook needs to be set against a number of major uncertainties. Some, such as the future of the international trade system or the possibility of {ex ante} imbalances between world saving and investment, are global in nature -- either because they depend on the interaction of several regions or because they call for a global response. These are addressed in Section 3 of this paper. Other uncertainties pertain essentially to the regional or the national level. They may be either common to several regions (e.g. impact of ageing populations) or even specific to a single nation (e.g. the US budget deficit). These will be dealt with in this section, which primarily focuses on the prospects for development in the main economic regions of the world.

{Prospects for North America}

In a longer-term perspective, the creation of a North American Free Trade Area (NAFTA) which will foster economic integration between Canada, the United States and Mexico should be a new source of strength for the North American continent. As regards the 1990s, however, most observers seem to agree that growth for the region will probably be in the 2.5 per cent a year range overall, an evolution primarily determined by the relatively moderate performance of the dominant US economy. The latter's dynamism over the next decade will depend largely on its ability to improve the productivity of its labour force and correct for the low rate of capital accumulation experienced since the mid-1980s.

Reflecting the ageing of its population, the rate of growth of the US labour force will decline substantially in the 1990s and into the next century. Thus, overall economic growth will, on the whole, be determined by the quantity and quality of other factors of production, by productivity gains through structural adjustment, and by the improvement in the quality of human

resources, in particular through education and training. Slower growth in the labour force is likely to cause real wages to rise as labour becomes relatively scarcer, creating stronger incentives for the substitution of capital for labour (e.g. more widespread application of robotics and automation). As a result, the rate of growth of the capital/labour ratio (2.2 per cent per annum in the 1980s) could increase in the 1990s. Moreover, with the relatively faster growth rate of labour productivity in manufacturing, resources will continue to shift to services, so that the biggest challenge for the United States over the next ten to twenty years will be to increase labour productivity in the tertiary sector.....

If the United States is to achieve reasonable overall productivity growth over the next twenty years, it will also need to increase public and private investment in physical infrastructure. In this respect, the record of the last two decades has been poor and may have been an important factor in the country's generally weak overall productivity performance. Restoring infrastructure to an adequate level, and even creating critical infrastructures in advance of demand, could be a source of large positive externalities in the 1990s and beyond. The construction of railroads in the 19th century and of the interstate highway system in the 1950s and 1960s represent in this regard interesting precedents. Modernisation of road, rail and air facilities could contribute to significant productivity gains in transport, and the development of an integrated fibre optic communication network, with government leadership, might well speed up the diffusion of new technologies.

The need to accelerate the capital/labour substitution, to improve the quality of labour and to upgrade the physical infrastructure will cause an increase in the demand for productive investment. Whether or not the United States will be able to generate sufficient funds to match the related capital accumulation needs is an open question. A slightly increased rate of gross investment, however, should be sustained, both for investment-related and saving-related reasons. On the investment front, a substantial reduction in the level of housing construction, brought about by a decline in the number of young people looking for housing, could make room for more productive investments. On the saving front, an increase in total savings of 2 per cent of GNP could result from two mutually reinforcing developments. First, the private saving rate may rise because of a shift in population distribution in favour of age groups that normally have the highest saving rate. Secondly, the federal budget deficit as a share of GNP could decline, in particular as a result of a reduction in military expenditures.

The "peace dividend" resulting from reduced East-West tension would, in fact, not only alleviate the strain of military outlays on the public budget but also constitute an opportunity in a much broader sense, especially since some of the resources (including skilled labour) hitherto devoted to military objectives could be redirected towards civilian applications. In the longer run, this could significantly improve the competitiveness of the US economy. However, future military conflicts, perhaps of a different nature, and perhaps requiring different forms of armament, cannot be ruled out. Hence, the reduction in military expenditures may not be as significant as expected. Moreover, the conversion of armament industries from military to civilian production could be costly and extend over several years.

Even if the overall level of funds available for public investment is adequate in the future, it will need to be channelled to the proper level of government. In this regard, some way will have to be found to increase federal support to, or raise the taxation capacity of, states; it is at the state level that the heavy burden of financing both infrastructures and the development of human capital will fall.

è The creation of NAFTA, and freer trade between the United States, Canada and Mexico, should stimulate intra-industry rationalisation of production and foster economic growth for all North America. The gains, which may be greater for the smaller economies, are likely to be in the form of real income effects, reduced consumer prices, scale economies, dynamic effects (more rapid rate of introduction of new technology), and reduced uncertainty -- thereby encouraging investment and risk-taking. The extent to which the potential benefits can indeed be realised nevertheless remains to be seen. While serious negotiations are under way, there is still substantial uncertainty with regard to the nature of the agreement that will eventually be reached, notably because of the tripartite character of the negotiations, the unequal degree of integration among the three economies and the differences in size and level of development. An additional element of uncertainty in the 90s will be the nature of the relationship between Quebec and the rest of Canada.

Whatever the outcome, it is highly probable that NAFTA will accelerate the migration of US "Rust Belt" companies and blue-collar jobs towards Mexico, with the result that US labour adjustments in term of occupational shifts and changes in relative wages could be greater than under the Canada-US FTA. In particular, if this happens in a period of slow or moderate growth, some observers fear that these adjustments could create a backlash against imports of products originating from outside the North American continent, notably from the Asia-Pacific region. However, given the limited absorptive capacity of the Mexican economy resulting from the poor quality of existing infrastructure facilities, the potential labour displacement could be very gradual indeed.

Whether or not NAFTA creates -- directly or indirectly -- increased discrimination against third parties as the overall structure of its economy improves over time, Mexico may become in the medium term a strong competitor for Asia-Pacific countries on the North American market. Moreover, it is likely that a change in foreign investment flows in favour of Mexico, notably from the advanced OECD Member countries, could be even more important in this context than the impact on trade flows.

In a longer-term perspective, an important question is whether NAFTA, as currently envisaged, is a stopping point or whether it is the first step towards the creation of a North American common market. Once under way, the process of deeper integration may indeed prove inevitable, as closer economic relations call for new mechanisms to deal with new sources of conflict, and perhaps even greater harmonization of policies. However, concerns in Mexico and Canada about a potential loss of sovereignty in the foreign policy area and US reluctance regarding a free flow of labour appear, at least for the moment, to make a real common market unlikely.

US dominance could prove to be an obstacle to the harmonization of commercial policies, because in the past the United States has more than once used trade and investment restrictions as instruments of foreign policy. From a US perspective, the liberalisation of labour flows raises a serious problem because of the income differential between Mexico and its two northern

partners. Nevertheless, in the longer run, the growing scarcity of labour in the US as a result of the ageing of its population could lead to a more liberal US attitude towards labour migration within the region, and -- depending on the evolution of the new world order in general and on the political future of Canada in particular -- the issue of sovereignty in foreign policy might also be less relevant.

{The outlook for Europe}

With regard to Europe, most analysts expect a healthy growth performance (in the 3 to 4 per cent range) over the next decade and into the next century, although persistently high unemployment rates and related social problems are a source of concern. This generally positive outlook is largely predicated on the expected static and dynamic gains to be derived from the creation of the Single European Market. Further liberalisation of goods markets will promote rationalisation and restructuring, and offer new opportunities for gains in scale economies. Sharper competition in the provision of services, especially in banking, insurance, information services and transport, will raise efficiency and reduce transaction costs. More liberal public sector practices will stimulate public administrations and public monopolies to improve their overall performance. The liberalisation of financial markets will foster competitiveness through better resource allocation. The freer movement of workers, notably in the case of the professions and crafts, should improve the functioning of related labour markets.

In addition to the Single European Market initiative, further measures for deepening the integration process have been envisaged with the aim of establishing an economic and monetary union. The creation of "Social Europe" (i.e. the establishment of "best practice" binding norms for working conditions and labour market policies) has been advocated to provide for more equal living and working conditions. Finally, alongside such deepening of the economic dimensions of the Community, including the creation of an independent European Monetary Institute and later on a common currency, serious rethinking of the other institutional dimensions appears unavoidable. The options under consideration in this regard range from intensified co-operation between nation states to the creation of a confederation or even a federal state.

The recent Maastricht agreement has carefully avoided incorporating any final decisions regarding these options, but it was agreed to strengthen the power of the European Parliament to amend and veto European legislation, and to widen the domain in which the Commission can make proposals to the Council. The co-ordination of foreign policy and internal security questions, however, is still to be dealt with at the intergovernmental level and remains outside the Community. Whether this somewhat artificial division of responsibilities can effectively be maintained in the years to come is, however, an open question. The answer depends in part on the extent to which it is possible to reconcile the different requirements for the deepening and widening of the integration process.

While greater integration would contribute to a more stable macroeconomic environment and make Europe more competitive, it could also exacerbate regional inequalities. For instance, the convergence of macroeconomic policies and the introduction of ceilings for budget deficits will reduce the scope for national policies to promote underdeveloped regions. Fixed exchange rates and (ultimately) the creation of a common currency could

introduce, at least in the medium term, an additional element of rigidity to the detriment of the less advanced member countries. Social Europe would force an artificial reduction of labour cost differentials which could undermine the cost advantage of the poorer regions in labour-intensive activities. Thus the increased dualism which may result from the deepening of integration could erode the cohesion of Europe, unless more active support policies in favour of the less advanced regions are implemented.

The deepening of the European Community could, to a certain extent, raise barriers to the second dimension of European integration, namely the widening of membership. Potential new members will have to be prepared to adhere to more stringent rules, to make more extensive adaptations, and to give up more of their sovereignty than in the past. However, this should not be a major problem for most of the EFTA countries, which have already established close economic links with the Community, have a comparable level of development and have similar institutional and social frameworks. •••

Some of these countries -- such as Austria, Finland and Sweden -- have even already pegged their currency to the deutsche mark or the ECU. Moreover, most if not all should be in a position to contribute actively to the internal cohesion programmes of the Community. So, with the exception perhaps of Switzerland (where major constitutional problems need to be resolved), EFTA countries should be able to achieve full membership before the turn of the century. The implementation of the recently concluded European Economic Area (EEA) agreement represents for most EFTA countries nothing more than a further intermediate step towards definite integration.

The widening of the EC to Central and Eastern Europe raises issues of a different nature. While the economies of Central Europe are relatively small at present (15 per cent of EC GDP), the economic gains to be achieved from their successful integration with Western Europe could be substantial in the longer term. Moreover, the EC has an important stake in the political stability of its neighbours and in ensuring that they have the ability to address the serious environmental problems inherited from the previous regimes. Finally, the successful transition of Central European countries to a market economy could have a strong demonstration effect on other countries, not only in the East but also in the developing world.

With active Community support, rapid progress may be achieved in Hungary, Czechoslovakia and Poland. However, the special association status granted to these countries needs to be complemented by other measures. Particularly important in this context are specific development programmes designed to facilitate transition to a market economy, but also a rapid removal by the Community of trade restrictions in those sectors where East European countries could have a comparative advantage in the shorter term, such as agriculture, steel and textile products. This would encourage them to pursue the painful structural reforms currently under way. Other Eastern European countries which are less advanced on the path of political and economic reform (such as Romania) will in all likelihood need a longer adjustment period.

The confused and uncertain situation in the former USSR constitutes one of the most serious challenges for Europe. Most experts expect a further deterioration of the economic situation over, perhaps, the next five years -- followed, in the best of circumstances, by only very moderate and very uneven growth. However, given the size and the wide range of the problems involved (ethnic, political, social, economic, environmental), the scope for influencing

the course of events in the former Soviet Union is very limited. Even massive aid from the West could, at best, play a subsidiary role and would only serve to provide some leeway in the process. Substantial flows of foreign direct investment are, however, also unlikely as long as the present state of confusion prevails and as long as the legal and economic infrastructure of the newly independent republics remains incomplete.

Several factors which discourage private Western companies from investing in the former USSR need to be addressed. First, the demarcation of power between what remains of the central authorities and the republics should be clearly defined and adequate mechanisms which guarantee political stability put in place. Second, efficient regulatory frameworks and administrative structures which support the functioning of a market economy need to be established. Third, prices should truly reflect supply and demand relations and the ruble (or the currencies which may replace it in some of the new republics) should be made convertible to hard currency. And finally, the bottlenecks in the physical infrastructure, particularly in transport and communications, need to be effectively overcome. There is no doubt that considerable time will be required before these conditions are met.

{Asia-Pacific perspectives}

The Asia-Pacific region should continue to experience rapid growth in the future, the region's average overall growth rate being expected to be in the 5 to 6 per cent a year range in the 1990s and beyond. These rates are significantly higher than for the rest of the world economy; the region's share of world income could therefore rise from 24 per cent in 1989 to 35 per cent in 2010 and to over 50 per cent by 2040. Japan will continue to be the dominant economy in the foreseeable future and a major contributor to economic development, while Australia and New Zealand will strengthen their links to other economies within the region. The Dynamic Asian Economies (DAEs) will play an increasingly important role, and other countries at an earlier stage of development could be a source of renewed dynamism in the future. However, despite this optimistic vision, Asian countries will be confronted with serious challenges, notably of an environmental and social nature.

For Japan, most observers anticipate an average growth rate in the 3 to 4 per cent range in the 1990s and into the next century. However, the country is expected to face some new constraints which will have a major bearing not only on internal patterns of growth, but also on its relations with the rest of the world. The rapid ageing of the population will result in a decline in the working age population after 1995 and a decline in the labour force after 2000, despite increased participation of women in the labour market. As labour shortages could be compounded by reductions in working hours, Japan may also be confronted with the need to reconsider its immigration policies.

Demographic trends could have serious implications too for consumption, investment and national saving. In this regard, the share of total investment in Japanese GNP is projected to fall from 32 per cent in 1990 to 29 per cent in 2000, but due to the rise in labour-saving investment, it could increase again to about 30 per cent thereafter. At the same time, aggregate saving is expected to gradually decline from 34 per cent in 1989 to around 29 per cent in 2010. Hence, on balance, while Japan should continue to be a net saver in the 1990s -- the decline in saving being matched by a corresponding decline in investment -- after the turn of the century, it may not be able to maintain the

position of a major capital exporter. This development might be further accentuated if Japan embarks on new programmes for a major upgrading of its infrastructure. Consequently, the current external surplus may remain in the range of 1 to 1.5 per cent of GNP up to 2000 and fall to close to zero over the 2000-2010 period.

Another major development in the 1990s and beyond will be the relocation of industrial production outside Japan. The ratio of international production of Japanese companies may increase from the present level of 6 per cent or so, which is low by international standards, to 20 per cent by 2010 (approximately the current level for Germany). Part of the outward investment will be "market oriented", i.e. flowing to other advanced countries in North America and Europe; part of it will be "cost oriented", i.e. flowing to less developed countries, notably in the Asia-Pacific region. This will contribute to increased intra-industry trade between Japan and the rest of the region, but sustained investment outflows are very unlikely to result in a hollowing-out of Japanese domestic manufacturing.

Australia's and New Zealand's economic relations with other countries in the region are set to grow substantially. Both economies are likely to meet their import requirements increasingly within the region and to continue at the same time to be major suppliers of food, minerals, fuel and services to other Asian countries. Trade liberalisation and other market-oriented reforms (e.g. deregulation of banking) under way or planned in the region could further improve the two countries' economic prospects. However, in order to take full advantage of the prosperity of the region in the future, both will need to make a major effort to boost their industrial base, upgrade the skills of their labour force and improve their R&D capability. Nevertheless, with regard to the ultimate impact of the policy initiatives taken to date, there still remain major uncertainties. The stakes appear to be particularly high for New Zealand, where far-reaching market-oriented reforms have been launched with rather mixed results. While success would enable New Zealand to take full advantage of the dynamism of the region, failure could open the door to a period of prolonged stagnation and social unrest.

For the rest of the Asia-Pacific region, most projections are highly optimistic. Advanced DAEs (South Korea, Taiwan, Hong Kong, Singapore), which will still be experiencing rapid but diminishing growth rates towards the end of the century, should progressively catch up with the developed countries. For the region as a whole, however, this gradual slow-down may possibly be offset by the take-off of ASEAN countries fuelled by substantial investments from Japan and advanced DAEs. China may also resume rapid growth in the 1990s if the fundamental issues of how to proceed with economic reforms are effectively addressed. Considerable risks, however, remain on the political front. In particular, it is uncertain whether the passing of China's ageing leaders would not lead to turbulent power struggles and the breakdown of central authority, which in turn could result in ethnic conflicts and the kind of warlordism China suffered in the 1920s and 1930s. In other socialist countries in the region (Vietnam, Laos, Mongolia, North Korea), reforms under way or contemplated could start to pay off in terms of improved economic performance in the years to come as economic relations with other countries in the region expand.

Over the 1980s, DAEs experienced a growing gap between their investment and saving ratios, resulting in an excess saving of more than 10 per cent of their GNP in 1990. However, in light of the considerable resources that will be needed to upgrade physical and social infrastructures in many of these countries, it appears unlikely that this gap will be sustained in the future. In Taiwan, for instance, inadequate infrastructure has resulted in congestion, power shortages and industrial pollution. This has led the authorities to earmark more than \$300 billion for public infrastructure upgrading over the next six years. In Korea, major efforts will be needed to alleviate the acute housing shortage and improve transportation infrastructure, notably between Seoul and Pusan. More mature DAEs, such as Singapore, may also be faced with significant increases in social and health expenditure due to ageing of the population.

Continued urbanisation and industrialisation will exacerbate environmental problems facing large Asian metropolises in the future (urban population in the whole Asian continent is expected to rise to 2.3 billion in 2000, compared with 750 million in 1990). According to a recent UN study, sulphur dioxide, dust and soot levels in many Asian cities are already well above safety limits. Efforts will also need to be intensified to protect tropical forests which have been destroyed at an alarmingly high rate, notably in Malaysia, Thailand, Indonesia and the Philippines. There is concern, however, that efficient control of the forest economy in the ASEAN countries may accelerate the destruction of the forests in other countries such as Laos or Cambodia.

Asian countries may have to modify their export strategy in the 1990s. In particular, the US markets may be neither as accessible nor as attractive as in the past, since protectionist pressures are mounting and the US economy is unlikely to grow as fast as it did in the 1980s. Moreover, trade liberalisation within the North American economy and the possible extension to other countries in Latin America could result in the emergence of new competitors for Asian producers on North American markets. Hence Asian countries need to diversify their export markets. In this regard, Europe is a possible but uncertain option: the expected new economic dynamism due to the European integration process should provide an expanding market with growing import capacity. However, European suppliers themselves may gain in competitiveness; certain protectionist barriers -- in particular, quantitative restrictions -- might exclude outsiders from the gains of the internal dynamism; and new competitors for the Asian producers, such as those from Central Europe, may even benefit from preferential market access.

A more promising alternative for Asian countries might therefore well be to intensify exchanges within the Asia-Pacific area. Such an increase in intra-regional trade would strengthen the economic integration of the region already in progress, contribute to continued dynamism in the area and even provide a mechanism through which the less advanced countries in the region could gradually be integrated into the development process. In parallel, Asian firms, notably in the DAEs, could also respond to increased integration in North America and Europe by seeking to take advantage of the gains to be achieved in the two regions through a strategy of combined trade- and investment-led consolidation of their positions on Western markets. However, the DAEs would need to complement that strategy with the pursuit of liberalisation of their own economies. In this way, they would contribute to making the Asia-Pacific region a more attractive market for North American and European firms. Trade tensions could then subside as the traditional unilateral dependence of Asian countries on Western markets, notably on the United States, gave way to a more balanced interdependence.

{Prospects for the rest of the world}

Outside North America, Europe and the Asia Pacific region, prospects for growth appear to be rather uneven. Real progress could be achieved in major parts of South Asia provided that certain tensions building up in the region can be effectively defused. Improvements appear to be on the way also in Latin America. Developments in the Arab world are unpredictable, while the future of most of Africa south of the Sahara appears rather bleak overall.

The political prospects for South Asia are uncertain. While the end of the cold war is creating a new geopolitical environment for the two main actors -- India and Pakistan -- scope for serious confrontation still looms large. As both countries have now acquired a nuclear capability, a certain "balance of terror" has been achieved; once started, however, any conflict could have devastating consequences. The potential for violent confrontation is further increased by the growing internal dissent which is spreading in both countries. Moreover, Pakistan might enter into a pan-Islamic alliance with Iran, the newly independent Central Asian republics of the former Soviet Union and Afghanistan as a bulwark against India. While co-ordinated efforts by Western powers, Russia and China could contribute to reducing the risks of confrontation, South Asia is likely to remain volatile as long as differences between the two main countries -- including, in particular, issues concerning the future of Kashmir -- are not resolved.

Provided political tensions can be kept under control, the outlook on the economic front is one of cautious optimism. India is well placed to follow Indonesia and other developing countries into a period of high growth and rapid industrialisation financed by a strong inflow of foreign capital. Success will depend critically on the ability of the government to open up the economy to the outside world, to eliminate the Soviet-inspired system of regulations and licensing which has been a major obstacle to development in the past, and to reform the highly inefficient public sector. Another priority is the alleviation of poverty in rural areas, where further degradation of the environment could seriously impair Indian agriculture in the years ahead. In Pakistan, growth in the 6 to 7 per cent range could be achieved and would allow for a gradual increase in standards of living as population growth is expected to decline from 3.1 per cent in 1988 to 2.6 per cent in 2003. However, employment creation is likely to remain a major challenge, especially in view of projected return migration from the Middle East. Moreover, in order to deal with its impending financial crisis, Pakistan will need to improve substantially its export performance in the 1990s, to take appropriate steps to attract foreign investments and foreign technology, and to encourage national savings.

After two decades of sustained economic growth, during which per capita income increased by 3 per cent a year on average, Latin American countries experienced serious difficulties in the 1980s. Looking ahead, most observers expect growth to resume in Latin America in the 1990s. These hopes are based on the far-reaching reforms recently implemented by a growing number of countries to liberalise their economies and create a more favourable business environment. Mexico and Chile were among the first to adopt such measures. Argentina, Brazil and Uruguay have more recently followed suit. While serious problems remain, these efforts are starting to pay off -- as indicated by the renewed interest in the region recently expressed by private investors. As a result of this positive change, the Latin American economy may grow by about 3 per cent a year on average in the 1990s.

In the longer run, President Bush's "Enterprise for the Americas" initiative could potentially lead to the creation of a free trade area which will foster growth and economic integration throughout the continent. However, the United States may not be as enthusiastic about negotiating further free trade agreements in the hemisphere as it has been with regard to NAFTA. First of all, such negotiations require a great deal of political capital for the US President to obtain the necessary authority from Congress to launch and to conclude. Secondly, US strategic interest in a wider agreement is not as great as its interest in agreements with its closest neighbours. The 1990s are more likely to see arrangements between Mexico and its neighbours, as Mexico becomes a magnet for migrants from its poorer southern neighbours.

Prospects for most of Africa south of the Sahara are rather pessimistic. The continent has a vulnerable natural environment (deserts, drought, tropical rain forest) and faces extensive political instability, partially linked to tribalism. With a 3 per cent per annum growth rate projected for the 1990s, Africans' standard of living will not rise significantly because of the rapidly increasing population. The vicious circle of rapid population growth and economic stagnation could lead to a dramatic increase in poverty on the continent. Indeed, it is estimated that 265 million Africans could be living below the poverty line by the year 2000, accounting for one-third of the world's poor.

However, this pessimistic outlook needs to be qualified. First of all, official statistics may be misleading, especially in not capturing the activities taking place in the informal sector, a sector which plays a major role in many African countries. Moreover, the situation is not gloomy everywhere. Some countries, such as Ghana, Madagascar, Tanzania and Togo, have recently been able to increase their growth performance (from 1 per cent on average in the early 1980s to 4 per cent in the 1988-90 period), leading to a modest increase in the standard of living. Also, there may be positive overspill effects to South Africa's northern neighbours if this country finds its way to political stability and new economic dynamism.

Future developments in the Arab world represent a particular source of concern and uncertainty. The main problems facing that region include political and economic instability, demographic explosion and the severe environmental problems likely to result from the expected growth of large Arab cities. The unequal distribution of oil resources will also be a source of continued tensions and often bitter confrontations between various political and religious groups. Arab countries could involve countries in other regions in some of their wars and terrorist actions, notably in light of the world's growing dependence on Gulf oil as other resources (e.g. North Sea oil) are gradually depleted and as Soviet oil or gas may not always be readily available. The Arab world may also be a source of strong outward migration pressures, notably towards Europe. Overall, it is estimated that immigration from the developing world towards Europe in the 1990-2025 period could be of the order of 30 million (including migrants from Black Africa).

3. Global issues

The future evolution of the world economy and of its various economic regions raises a number of major issues which policy-makers will need to be aware of in the coming years. Among these -- with the notable exception of environment-related questions, which were not addressed at the meeting -- four

appear to be particularly important at the global level. The first relates directly to the cautiously optimistic overall picture that has emerged. In light of the major risks and uncertainties which have been identified at the regional level, what other possible futures might be considered? In particular, what might be the implications of a shift in the centre of economic gravity from the Atlantic to the Pacific basin? A second issue pertains to the implications of what appears to be a strong trend towards regionalisation of the world economy for the effective operation of the multilateral system of trade and investment. To what extent and under what conditions are regionalisation and multilateralism incompatible? The third question focuses on the potential risk of future {ex ante} imbalances between saving and investment at the world level. What are the possible implications for economic growth, notably in developing countries? The fourth issue relates to increased interdependence between nations and its consequences for the pursuit of national economic policies and for rivalry between different socio-economic systems. Will system competition or even system friction increase, and what could be the effects on the multilateral system of trade, investment and technology?

{The shift of economic gravity}

Barring any major unforeseen event at the global level, the world economy in the 1990s and beyond will depend largely on the performance of its three main economic regions (North America, Europe and Asia-Pacific) and on the interaction that is likely to take place between them. While growth prospects and major uncertainties have been assessed for each region in isolation, it is also instructive to consider the overall global picture that may emerge from a combination of these outlooks, in particular the changes in the economic centre of gravity which could result from differences in the relative economic performance of each of the main regions. A central question in this regard is whether relatively poor economic performance in North America and Europe combined with high growth in the Asia-Pacific region could lead to a shift in economic gravity from the Atlantic to the Pacific basin. Economic gravity in this context needs to be measured not only in terms of economic weight (i.e. share of world GNP), but also in terms of the ability to use this weight effectively in international negotiations.

In the "Business as Usual" scenario which underlies the outlook presented in Section 2, the Asia-Pacific region is expected to grow relatively fast (5 to 6 per cent per annum) compared to North America and Europe (2.5 to 3 per cent per annum). If this growth rate differential persists through the next two decades, the share of the Asia-Pacific region in world GNP will increase from roughly one-quarter in 1990 to about one-third in 2010. This implies that the region would be at least on a par with North America and Europe in terms of overall size, but not in a position to exercise a dominant influence on the world economy on the basis of its economic weight alone. For a much more significant shift in relative economic weight to occur, the Asia-Pacific area would need to outperform the other two regions by a very considerable margin in the decades to come.

Several factors could conceivably contribute to such a scenario. First, the Japanese model of development -- characterised by hard work, an emphasis on education, high savings, application-oriented research and development, a long-term perspective in decision-making (in the business sector among others) -- could prove highly resilient in the face of major changes in the

Japanese economy and its international environment. Secondly, the more advanced of the DAEs could continue with a robust rate of growth performance for some years. Moreover, variants of these highly successful models, which appear to be more easily adoptable in countries with similar values (e.g. Confucian tradition), could rapidly spread to other Asian nations. Indeed, despite the heterogeneity of the region and political misgivings about excessive Japanese influence, the process of integration under way among Asian nations is largely driven by the delocation of Japanese industry and the introduction of Japanese industrial culture.

The gradual emergence of China as a major economic player could strengthen the economic weight of Asia. In contrast to the former USSR, China has been able to implement rather successful economic reforms and expects to be able to double its GNP before the year 2000, despite its lack of progress so far on the political front. In particular, the "spheres of influence" established by Hong Kong and Taiwan in South China are expected to continue to prosper in the future, fuelled by cheap labour from China's inland zone. Moreover, the strong relations which tie mainland China with the large Chinese community outside the country will contribute further to China's influence in the region and the economic position of Asia in the world.

One could envisage a scenario with respect to Asia's competitors that is very different: North American countries are unable to reach an agreement on NAFTA and the United States is unsuccessful in its attempt to reduce its budget deficit, to improve its education system and to upgrade its infrastructure; Europe proves unable to generate and harness the expected dynamics which could result from its integration or to catch up technologically with the other two regions. However, these factors will need to translate into very considerable growth rate differentials for Asia to account for 50 per cent of world GNP by 2010. The region's average annual rate of growth over the next two decades would need to be about 5 to 6 percentage points higher than the North American and European growth rate. This is highly improbable, given in particular the limits to growth expected not only in Japan -- partly as a result of the rapid ageing of its population -- but also in the DAEs because of the increasing infrastructure and environmental constraints they will have to face.

Theoretically, the Asia-Pacific region would not need 50 per cent or more of world GNP to exercise a dominant role, if it were able effectively to bring its greatly increased economic weight to bear in international economic relations, notably {vis-à-vis} North America and Europe. However, to do this would require a considerable degree of regional cohesion of economic and political action, and such an eventuality is unlikely. The extraordinary diversity across the region of political, economic, social and cultural systems would seem to constitute too great an obstacle. It is not surprising, therefore, that closer integration in the Asia-Pacific region has been essentially led by the private sector, with intergovernmental action only of marginal importance so far. Nonetheless, it cannot be excluded that looser economic co-operative arrangements on such matters as foreign investment and technology transfer, perhaps involving some form of dispute resolution mechanism for intra-Asian trade conflicts, might be established between a core group of countries before the turn of the century.

One possible avenue to such arrangements is the further evolution of APEC, a politically more balanced and therefore -- for some countries -- more easily acceptable version of the "Asian Brain" concept as contained in a 1988 consultant's report for Japan's MITI; there are also more restricted

approaches, such as further intensified co-operation in the ASEAN framework. However, it seems that none of the foreseeable solutions could be expected to match the European or North American set-up in terms of effective political weight or international bargaining power. In particular, any attempt by Japan to become an hegemonic power may be strongly resisted by other Asian countries who will try to balance the Japanese influence by seeking stronger ties with the United States or Europe. Finally, even if China is able to successfully overcome its political difficulties and expand its economy, its rivalry with Japan could very well intensify. Hence Asian countries as a whole are unlikely to present a common front to the rest of the world.

{Regionalisation and multilateralism}

While the pace of multilateral trade liberalisation slowed down in the 1970s and 1980s, the process of integration of the major economic regions of the world gathered momentum. This process appears set to continue if not accelerate in the future, notably in North America and Europe. It may also become more important in the Asia-Pacific region. Questions arise with regard to the future evolution of these arrangements and their likely impact on trade and investment patterns, as well as on the operation of the multilateral system in coming decades.

Some observers have expressed deep concern about the increased regionalisation of the world economy. They point out, in particular, that the preferential trade liberalisation features of such agreements could be a major source of trade diversion which may well offset their trade-creating effects. Moreover, regionalisation could have adverse overspill effects since it may induce outsiders who bear the brunt of trade diversion to retaliate by seeking preferential trade agreements among themselves so as to offset their loss of markets and strengthen their bargaining power. This process of competitive regionalisation may undermine the multilateral system and, far from contributing to global liberalisation, could turn the world into one of hostile economic blocs and discriminatory trade regimes similar to those that prevailed in the 1930s.

Others disagree. They welcome regional and plurilateral strategies as perhaps the best way to foster global liberalisation, given the growing obstacles which have brought multilateral negotiations to a virtual halt at present and which are not likely to disappear in the future. They point out that in contrast to multilateral negotiations, regional agreements are attractive because they make negotiations more manageable: a relatively small number of like-minded countries are involved, which reduces the likelihood that liberalisation will be held hostage by a recalcitrant player. Moreover, the free-ride problem implicit in the MFN GATT principle is eliminated. Through gradual enlargement and mergers (e.g. between the EC and EFTA), regional approaches could contribute in a significant way to global liberalisation. Indeed, given continued protectionist tendencies and the very slow pace of multilateral negotiations, regional liberalisation could prove essential for further trade liberalisation in the future.

One key question is the effect, if any, which the creation of large groupings of countries may have on the balance between liberal and protectionist forces. Country groupings may result in a more liberal attitude to the extent that protectionist arguments originating in one country are likely to have less weight at the regional level than in the purely national

context. However, powerful cross-national coalitions can still materialise (e.g. with regard to agricultural policy in the EC), and a weak decision-making process at the regional level (e.g. unanimous voting rule) may provide opportunities for one of the countries to block liberalisation. In the final analysis, however, the net outcome in the longer run will be determined by two effects: the trade creation and economic dynamics due to intra-regional liberalisation, and the average level of effective protection {vis-à-vis} the outside world.

Over the longer term, much may also depend on the way the business community responds. While further regional integration could affect the decisions of firms related to the localisation of their activities, business may nevertheless increasingly adopt a global approach to its operations. Global supply and demand considerations, new patterns of co-operation and competition and, in particular, the concern of business about access to technology wherever it may be obtained are likely to contribute significantly to the further liberalisation process. As the distinction between "domestic" and "foreign" products and companies becomes blurred, discriminatory protectionist measures based on the geographical origin of products will become more and more difficult to apply in practice. The issue of how to deal with Japanese cars produced in North America and Europe in the framework of import restrictions {vis-à-vis} Japan is a good illustration of this.

The formation of trading blocs may nevertheless force business to adopt strategies which may not be optimal from a global welfare perspective. In particular, private foreign direct investment may be determined (at least in part) by market access rather than efficiency considerations. Moreover, the trading blocs may be tempted to use their bargaining power to gain concessions from others. This power play could significantly undermine the operation of the rule-based multilateral system of trade, investment and technology. As was the case in the 1930s, it would most likely lead to the establishment of a series of discriminatory bilateral agreements between blocs which would not only hamper and distort trade flows, with detrimental effects on all parties involved, but also serve to heighten confrontations between players as blocs excluded from particular bilateral agreements try to muscle in so as to obtain the same market access concessions as their rivals.

An illustration of the way this vicious circle could start is provided by the recent reaction of the European Commission to attempts by the United States to apply direct political pressures for bilateral trade concessions by Japan. Particularly vulnerable in this power play would be those countries or groupings of countries which have relatively weak bargaining power. The increased use of managed trade would exacerbate international tensions, and to the detriment of smaller countries as well as developing countries, thus contributing to widening the gap between the rich and the poor.

{Saving and investment imbalances}

The ability to generate adequate saving and to ensure that such saving is properly channelled to productive investment is a key ingredient in economic progress. However, it appears that on the basis of present and expected saving rates and in the light of massive investment and capital needs in several regions of the world, the 1990s may not only be characterised by persistent regional savings investment imbalances, but also be faced with a dramatically

increased {ex ante} excess demand for financial resources at the global level. As a consequence, international interest rates may continue to remain high or even rise further.

There are several reasons for such an evolution. On the supply side, Japan and Germany -- which have been until recently the major net savers in the world -- are likely to reduce their capital exports in the future. Apart from the need for an ambitious upgrading of its infrastructure, Japan will have to devote considerable resources to the needs of a rapidly ageing population. Germany has already ceased to be a net saver and will have to continue to allocate most of its saving in the coming years to the heavy investment requirement of the reconstruction of eastern Germany. Considering the order of magnitude of this undertaking, it is unlikely that Germany will resume its role of net world saver before the turn of the century. Other countries whose capital export capacity may be reduced over the next decade (if they export capital at all) include Kuwait and Saudi Arabia. Finally, it seems somewhat improbable that the newly industrialising economies with major export surpluses, such as Taiwan and (in the medium term) Korea, could fully make up for these shortfalls.

On the other side of the equation, claims on world saving are increasing. While the US external deficit, at least in absolute terms, shows no signs of substantial improvement, some analysts find it unlikely that the United States will be able to sustain respectable economic growth rates over the next decade or so without considerably larger public and private investments in transport and communication infrastructures as well as in education. There is also strong demand for funds from Eastern and Central Europe and the USSR to finance economic reforms, to invest in industry and infrastructure and to clean up the environment. Huge amounts of resources will be needed for the reconstruction of Kuwait and Iraq. Many of the previously fast-growing newly industrialising economies such as the DAEs and Mexico will be channelling more funds into upgrading physical infrastructures and social welfare. Finally, large capital flows will still be required by numerous countries in the Third World -- be it for development and investment, the coverage of basic needs like food and health, or the reorganisation of debt.

The only silver lining on the horizon is the prospect of major reductions in military expenditure. Any gap which may arise between saving and investment could, in principle, be reduced by a cut in military spending, which is estimated at about 5-6 per cent of world GNP. While the end of the cold war may provide such an opportunity, at least for the ex-Warsaw Pact powers and NATO members, the overall impact is unlikely to be very large in practice: arms-producing and -exporting countries particularly in the West may be adversely affected and restructuring of armament industries will require substantial resources. Moreover, new sources of conflict are likely to arise, and there may be a need for the industrial countries to adjust their weapon systems to the new circumstances. For the Third World, it has been estimated that a reduction of their armament expenditures to about 4 to 5 per cent of GNP could free some \$150 billion. However, even if international financial institutions and individual donor countries made their development aid increasingly conditional on a reduction of armament expenditures, major effects cannot be expected if it is against the perceived interest of the political leadership in the recipient countries.

With very little chance of a substantial increase in private and public saving in the short run, the {ex post} balance between demand and supply of capital may therefore be achieved primarily through a rise in real long-term interest rates. Some observers argue that this could have, in the final analysis, a beneficial effect by acting as a screening device to separate efficient from inefficient investment projects. Moreover, the reduced availability of outside funding will create incentives for governments to undertake reforms (e.g. tax reforms) designed to boost domestic saving and ensure that it is effectively used.

The risk, however, is that the industrialised countries and the newly industrialising economies, with their relatively satisfactory record of rates of return on investment in recent years, will prove a more attractive target for capital flows than many less advanced countries. In particular, foreign direct investment may shun the highly indebted countries in the south and in the east, and failure to attract foreign investment will also mean lags in economic growth, in employment creation and in technology transfer. To the extent that investment is based on private risk capital, this could result in a further widening of the welfare gap between the advanced countries and the rest of the world.

Another issue is that some of the new demand for investment could distort the operation of capital markets. Indeed, a significant part of the new investment which will need to be carried out over the coming years will involve some form of government intervention, either because the related risks are too high and are largely political in nature (e.g. investment in Eastern Europe) or because such investment falls in the public domain or is subject to substantial externalities (e.g. upgrading of public infrastructures, environmental clean-up). As appropriate pay-off criteria for such investment are difficult to establish, the related capital demand is likely to be largely determined by factors other than market considerations. As a result, any such additional claim on the limited pool of world saving, including public aid programmes -- particularly to the former USSR -- may drive up the rate of interest further and could thus contribute to the crowding out of market-oriented investment.

{System competition and system friction}

The growing internationalisation of economic activities is creating an increasingly competitive environment for firms, both on their domestic and export markets. Their ability to compete effectively in this environment in the future will depend not only on the competitiveness of their own internal resources and management, but also on the particular strengths of the national socio-economic system in which they will have to operate. Such systems are largely shaped by social values and behaviour patterns, by cultural inheritance and social institutions, and by policies at all levels of government. Hence the competition between firms on international markets could increasingly translate into a competition between rival national socio-economic systems, resulting in major tensions among trading partners.

Over longer periods, such tensions could to some extent diminish of their own accord as the underlying divergences between national systems are gradually reduced through market competition, expanded international linkages (e.g. foreign investment) and progress in transportation and communications. Moreover, governments are likely to adopt increasingly similar policies if such

policies are generally perceived as effective in strengthening national competitiveness. However, while this market-driven convergence process could indeed contribute to a more healthy world economy, its pace may be too slow to prevent persistent system frictions during the adjustment period. Moreover, convergence is likely to remain at best incomplete, since many differences in national systems are beyond the realm of government policy, being inherently rooted in the culture and historical experience of societies. The net outcome in the future could be continuing instabilities in international economic relations and growing pressures for new forms of managed trade.

In order to mitigate system frictions in the future, an international policy process designed to promote the convergence of government policies in specific areas could be envisaged. This is not a straightforward task, however. First of all, it is not clear to what system the convergence process should lead and whether this system is indeed necessarily socially desirable and politically acceptable for all countries involved. Secondly, competition between different policy concepts could be seen as an important ingredient of an innovation process towards best practice.

One option adopted by the European Community features the mutual recognition of national regulations which, combined with the free flow of mobile factors (in particular, capital and entrepreneurship), should induce a gradual convergence to a regulatory system which reflects the preferences of the mobile factors {ex post}. However, such a process cannot be envisaged without first implementing {ex ante} reductions of divergences in key regulatory instruments (e.g. competition policy, capital market regulations, technical and environmental standards) between EC members under the auspices of the Commission. Hence, while this approach may work in a grouping of like-minded countries willing to accept some loss of sovereignty in the process, it is less likely to be feasible at the global level, where divergences are bound to be greater and losses of sovereignty more difficult to accept.

In the future, particularly contentious issues are likely to arise at the international level in areas related to access to markets, to capital and to technology. Asymmetries with regard to access to markets have already caused considerable political frictions in the past and have contributed to eroding the commitment to a rule-based multilateral system. Such frictions are likely to continue to the extent that they reflect differences in deep-rooted tastes and behaviour patterns which may reach beyond the realm of policy-making. Frictions related to access to capital might also be difficult to deal with since they may reflect substantial differences in customs and institutional arrangements (e.g. relations between industry and banks) which cannot be easily changed. For technology, differences may arise between nations with regard to the role of governments in the support of technological development, notably the support of generic research, a relatively ill-defined intermediate stage between basic and applied research. Conditions of access to the results of such research may also be a bone of contention.

As international competition intensifies and as interdependence among nations increases in the coming years, system friction is likely to become more frequent. While increased economic integration could contribute to alleviating tensions and hasten policy convergence at the regional level, at least in North America and Europe, conflicts between regions are likely to intensify. There is a danger that such frictions could induce strong political pressures for the adoption of short-sighted bilateral measures (e.g. VER agreements or market share guarantees) which will not only be ineffective in achieving the political

objectives sought, but also undermine the multilateral system. Moreover, the unfulfilled expectations resulting from the very ineffectiveness of such agreements can only exacerbate frustrations, leading to a further escalation of conflicts.

4. Conclusion

To cope with the challenges and to seize the opportunities of the 1990s, developed and developing countries alike will need a stable and open international environment in the years ahead. A successful completion of the Uruguay Round and a strengthening of international co-operation across a broad range of economic and other policies could contribute to such an environment. As key players in international discussions, the United States, the European Community and Japan can and should significantly contribute to shaping the environment they need. The creation of NAFTA could contribute to trade liberalisation and economic stability, not only in North America but also in Latin America. The extension of the Community could contribute to trade liberalisation in Europe and to the stabilization of still shaky Central and Eastern European economies. Closer links between Japan and other Asia-Pacific countries could liberalise economic relations and foster growth in the region.

This more stable and open international environment could in turn initiate a virtuous circle of growth characterised by reduced system frictions and uncertainties, and thus create a more favourable overall climate for investment as well as for the development and diffusion of new technology, notably foreign direct investment and technology transfers to developing countries. In this more favourable context, equity and environmental issues could be tackled in a more co-operative and more effective manner, notably the problems faced by the most underdeveloped regions of the world. Ultimately it is the responsibility of the advanced countries to make regional integration a springboard for extended multilateralism, and to avoid the vicious circle of bloc-building and fragmentation of the world economy.

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END-OF-TEXT