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**SIXTH INFORMAL CONSULTATION BETWEEN THE OECD TRADE COMMITTEE AND CIVIL SOCIETY ORGANISATIONS (CSOs)**

**Submission by the Business and Industry Advisory Committee to the OECD (BIAC)**

**I. BIAC Priorities for the WTO Doha Negotiations**

**II. Trade, Global Sourcing and Structural Adjustment: Policies to Promote Growth and Employment**

**Paris, 19 October 2004**

*This paper has been submitted by the Business and Industry Advisory Committee to the OECD (BIAC). The views expressed herein are those of the author and are not necessarily shared by Members of the OECD.*

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**Business and Industry Advisory Committee to the OECD**

**Comité Consultatif Economique et Industriel Auprès de l' OCDE**

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Committee to the OECD**

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*Policies to Promote Growth and Employment***

Paris, 19 October 2004

**BIAC Trade Committee**

## I. BIAC Priorities for the WTO Doha Negotiations

1. BIAC welcomes the July *Framework Agreements* that have revitalized the WTO Doha Development Agenda as recommended by the BIAC Presidents' May Statement. We salute the political commitments and flexibility of Member governments to move the negotiating process forward, particularly on the agricultural issue. Important frameworks and principles have been laid down. The agreements concluded at Geneva have helped to overcome the Cancun stalemate, restore confidence in the WTO process, and provide the basis for achieving BIAC objectives in the negotiation. It is essential that this momentum is maintained if substantive progress is to be achieved when WTO Ministers next meet in Hong Kong at the end of 2005.

2. At the same time, BIAC understands that the real negotiations on binding commitments are just beginning, that the most difficult negotiations remain ahead. BIAC regrets the original deadline of 2005 will not be met and that there is no agreement on a new deadline. This is a missed opportunity. In effect, this means that business will continue to trade, invest and conduct commercial operations for a longer, unspecified period without any of the considerable potential benefits of further trade liberalization and modernized WTO disciplines. The same is true for other participants in the global trading system.

3. In view of the substantive progress reflected in the July frameworks, BIAC believes it is an appropriate time to update its priorities for the negotiations. BIAC recognizes that liberalization of agricultural trade remains the most critical issue for achieving a successful negotiation. Increased agricultural market access remains an important BIAC objective, as well. Still, it is clear that the acceptability of the final result to BIAC members will depend on ambitious liberalization of industrial tariffs and market access for services, with meaningful participation of emerging markets and developing countries. True reciprocity remains an essential outcome for BIAC members, as well as the main engine for bringing the benefits of the Round to developing countries. We also recognize that the WTO as a rules-based system needs to continuously improve "rules" and that such efforts are an important part of the Doha agenda.

4. BIAC welcomes the agreement to negotiate on trade facilitation. It understands that it was not possible to reach agreement on negotiations on investment, competition and government procurement in this Round. These issues are importantly linked to trade. Governments should seek other ways to make progress in these areas. The WTO should continue to maintain these issues in its work program. BIAC continues to support specific actions in these areas.

5. As shown by the WTO's 2004 World Trade Report and OECD Studies, the countries that maintain some of the highest trading barriers are developing countries. This has the effect of reducing the magnitude of south-south trade. By "opting-out" or requesting lengthy transition periods the benefits that can accrue from trade between developing and least developed countries is restricted. The richer developing countries, for example, those leading the G20, should accept the common trade liberalization disciplines of the WTO system, which will benefit their own economies, as we as their trading partners, especially regional partners.

## II. Trade, Global Sourcing and Structural Adjustment: *Policies to Promote Growth and Employment*

### Executive Summary

1. New patterns of industrial production have major implications for business and society. Comparative advantages are shifting, new sources of competition are being created and the not so new phenomenon of “outsourcing” is raising concerns among policymakers and in the broader public perception.
2. These changes are a response to a multiplicity of factors, amongst them shifts in comparative advantages, new sources of competition, advances in technology and communications and changing consumer preferences.
3. The political debate on “outsourcing” must refrain from focusing on limiting inward and outward foreign investment. Governments must firmly reject protectionist policies that would restrict cost-effective investment decisions and competition, increase costs, and limit investors’ ability to allocate resources to their most productive uses. The opposite is required: the implementation of policies that encourage economic growth, spur trade and thus offer companies the opportunity to compete more efficiently and create employment.
4. BIAC believes that for OECD economies to respond to these challenges, the right policy mix must encompass a range of complementary measures:
  - **Promotion of worldwide free trade as key to stimulating economic growth;**
  - **Investment in education, training and re-training;**
  - **Policies that foster innovation, SMEs and entrepreneurship;**
  - **Broader structural reforms.**
5. BIAC welcomes the first results of the OECD’s project on “Trade and Structural Adjustment”. The project is important for business because it aims at deepening understanding of the benefits of trade liberalisation and of the importance of appropriate adjustment policies. This should be the basis for policy recommendations to OECD member governments on how to best frame national trade adjustment policies. BIAC would like to see this project focus on:
  - **Enhancing the support for the multilateral trading system;**
  - **Fostering understanding of the benefits of trade liberalisation;**
  - **Deepening understanding of worldwide sourcing and the related data;**
  - **Addressing misconceptions about outsourcing;**
  - **Addressing the importance of outsourcing, exports and FDI for developing countries;**
  - **Providing information on national structural adjustment programs;**
  - **Emphasising the link between structural policies that facilitate adjustment taking into account the work of the OECD on the relationship between growth and structural reforms;**
  - **Best practices for regulatory frameworks to increase employment and labour mobility.**

## **Introduction**

The world trading system and countries' commitment to market liberalisation is under attack on many fronts. Governments have failed to make progress in the current WTO Doha Round of trade liberalisation, while wide-spread misconceptions regarding the benefits and perceived costs of global free trade and investment are leading policy makers to overreact and implement measures that are harmful to the world economy as a whole.

Companies engaged in worldwide sourcing and international investment increasingly find themselves in a defensive position against both public opinion and policy makers. Changing trade and business patterns, the consequences of increased foreign direct investment (FDI) and of "outsourcing" and "offshoring" have been stirring up public debates for decades. However, the issues at stake today are increasingly important and complex, a complexity which is not reflected in media coverage emphasizing alleged job losses attributed to worldwide sourcing by companies. The OECD has the skills and prestige to inject much needed data and facts into the debate as well as to produce the right policy recommendations for OECD governments.

In fact, the issue of how companies and sectors can adjust to restructuring pressures stemming from international trade liberalisation and new patterns of industrial production and services is not at all a new one for the OECD business community. What is new is that challenges that hitherto were predominately confined to the manufacturing sector now confront the service sector and higher-value activities on a global basis in a phenomenon that is commonly described as "outsourcing". In manufacturing industries, worldwide sourcing has already transformed companies from vertically integrated production structures to highly specialised production units linked by global supply chains.

Business has recognised the potential of this restructuring process to generate hardship - for individual employees, companies, even for an entire sector. Thus, we are very much interested in studies on how OECD governments have successfully enacted appropriate adjustment policies in the past and recommendations of how they may do so in the future in order to ease the transition process. This is the task of intelligent structural adjustment policies. But this is also the task of getting the right policy mix which must encompass a range of complementary measures, amongst them: Promotion of worldwide free trade as key to stimulating economic growth; investment in education, training and re-training; policies that foster innovation and broader structural reforms.

## **A. Trade and structural adjustment: Better understanding the “outsourcing debate”**

BIAC welcomes the first results of the OECD horizontal project on “Trade and Structural Adjustment”. The project aims at deepening understanding of the benefits of trade liberalisation and of the importance of appropriate adjustment policies. It should be the basis for policy recommendations to OECD member governments on the best way to frame national trade adjustment policies.

New patterns of industrial production have major implications for business. Comparative advantages are shifting, new sources of competition are being created and the not so new phenomenon of “outsourcing” is raising concerns amongst policymakers and in the public at large. Nowadays, companies source products and product components from offshore producers around the globe because of advances in technology, transport, communication and as a way to meet competitive pressures through greater and more cost-effective efficiency.

It is therefore a challenging, timely and essential undertaking for the OECD to analyse country-specific case studies in eight sectors and point out the domestic structural policies that would facilitate adjustment.

The starting point of this project should remain that “outsourcing” is not a zero sum game and that many jobs are either kept or created during the process of worldwide sourcing as efficiency gains are transferred to consumers in terms of lower prices, or re-invested in new businesses. Thus, BIAC would like to see the final results of the OECD analysis focusing on:

- **Enhancing support for the multilateral trading system;**
- **Fostering understanding of the benefits of trade liberalisation;**
- **Deepening understanding of worldwide sourcing and the related data;**
- **Addressing misperceptions about outsourcing and the contribution of outsourcing to development;**
- **Providing information on national structural adjustment programs;**
- **Making the link between structural policies that facilitate adjustment taking into account the work of the OECD on the relationship between growth and structural reforms;**
- **Focusing on regulatory frameworks affecting entry and exit to labour markets.**

**BIAC believes that appropriate structural adjustment programs are an important policy tool to address the disruptive impacts of trade liberalisation and to maintain political support for open trade and commerce.**

## **B. Ever changing environment for business**

The old and simplified model of a multinational enterprise setting up a plant in a host country no longer corresponds to the reality of much of international investment as it exists today. Thanks to technological developments, continued rounds of trade liberalisation and a world wide opening up of sectors for investment, since the beginning of the 1990s companies have had a growing number of alternatives in international production.

FDI indeed dramatically soared before the recent downturn in 2001, and is now again increasing. Global FDI total outflows have been multiplied 17-fold since 1985 to 1.3 trillion US dollars in 2000<sup>1</sup>. As a result, the production and consumption of goods and services have been internationalised. Today, 60 000 parent companies have established more than 500 000 foreign affiliates worldwide. National firms, even quite small ones, have become multinational by increasingly localising their production facilities outside their home countries to benefit internationally from local competitive advantages. Companies transcend national borders by establishing a network of subsidiaries and linkages with local enterprises to relay outsourcing and offshore activities on a global scale.

This new pattern of international production has major implications for business, including the following:

- Changes in production processes and technologies;
- Increasing competition and new sources of competition (e.g., China);
- Constant pressures to reduce costs and improve productivity;
- Mismatches between job requirements and labour skills;
- Mounting labour compensation costs (including payroll taxes and benefits);
- Shorter product cycles and need for agility and flexibility, e.g. lower inventories;
- Importance of efficient international supply chains for reducing costs and reliable, fast delivery of components;
- Increased cost generated by enhanced supply chain security requirements;
- Proliferation of conflicting and too rigid e.g., not performance based, regulations.

## **C. Policy options for OECD governments**

The issue of how companies and sectors can adjust to restructuring pressures stemming from international trade liberalisation and new patterns of industrial production is not a new issue for the OECD's business community. What is new is that now the service sector is also confronted with the phenomenon described as "outsourcing" on a global scale. In manufacturing industries, outsourcing and international production of components transformed manufacturing from vertically integrated production structures to highly specialized production units decades ago.

For OECD economies the policy answers to these developments must encompass a whole range of supplementary measures:

- Promotion of worldwide free trade as key to stimulating economic growth;
- Investment in education, training and re-training;
- Fostering innovation, SMEs and entrepreneurship;
- Broader structural reforms.

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<sup>1</sup> OECD, "Foreign Direct Investment for Development", 2002, p 10.



## **1. Promotion of worldwide free trade as key to stimulating economic growth**

The world trading system and the open markets that it promotes are essential to sustainable economic growth, to supporting and diffusing innovation and technology, and to reducing poverty by creating wealth. Multilateral free trade policy has an important complementary role in helping countries absorb and capitalise on the growth and development potential of a rapidly changing global marketplace. The economic growth and improved living standards around the world we have seen over the past 50 years would not have been possible without the disciplines and achievements of the GATT/WTO system. Consequently, BIAC would like to express its strong concern to OECD governments about the continued stalemate of the current Doha Round.

The OECD business community remains strongly committed to the multilateral trading system with the WTO at its centre. Multilateral liberalisation of international trade is vital to lifting the developing world out of poverty and to creating business opportunities for both OECD and non-OECD companies.

- Re-starting the Doha Round, without overloading the agenda, is our top priority. OECD business organisations see a need to focus negotiations on: Non-agricultural tariff reductions and reduction of Non-tariff barriers, strengthened and expanded commitments on Services and finally Trade Facilitation.
- We also recognise that the WTO as a rules-based system needs to continuously improve "rules" and that such efforts are an important part of the Doha Agenda.
- For resolving the Cancun impasse, we believe it is crucial that negotiators overcome the deadlock on agriculture. This is a prerequisite for progress on other core issues. Market access for agricultural products needs to be improved and trade-distorting subsidies reduced, particularly in OECD countries. At the same time, OECD business and industry expects developing countries and emerging markets to help rebuild momentum for the Doha negotiations and to increase their own market access commitments for agricultural and industrial goods and services.

## **2. Investment in education, training and re-training**

Education plays an increasing and crucial role in the "innovation policy" of OECD countries. The quality of human capital is a key contributor to innovation and economic development and is becoming ever more important in the context of the knowledge society. As trade in services and information grows, tomorrow's economy will increasingly call for employees with new skills and competencies beyond those in the traditional economy. Therefore, an efficient education system, adapted to the ever changing needs of the labour market, and the improvement of skills and employability are both crucial to continued economic growth and increased employment.

Education, research and development, and the use of new technologies are key factors to promote employment, competition and economic growth. Links between education, innovation and technology need to be continually strengthened; in this context basic literacy, numeracy and scientific knowledge are fundamental.

The increasingly dynamic labour market brought on by globalisation has necessitated an important shift in thinking about goals of education. Rapidly evolving job profiles responding

to market needs require employees to have an education that equips them with the ability to respond and adapt to market changes and new technologies. This need become even greater as a result of changing demographics (see Part II below). Likewise, management of companies is increasingly horizontal, requiring teamwork to complete complex tasks, and emphasising entrepreneurship in exploring new business opportunities. OECD governments must:

- Reassess and improve existing public programs providing worker education, training. Adjustment assistance to ensure that they effectively addresses challenges stemming from trade liberalisation;
- Ensure that employees in the service sector must also have access to adjustment assistance programs;
- Ensure that education, lifelong learning and especially vocational education, are relevant to today's technology and service oriented economies.

### **3. Fostering innovation, SMEs and entrepreneurship**

OECD research has shown that while information and communication technology is a significant source and force multiplier for economic performance, an even more fundamental source of growth is innovation. The development of new products, processes and services drives improvements in productivity. It also facilitates the fulfilment of numerous societal needs, such as improved health and environmental protection. As has been elaborated by the OECD, innovation often involves organisational as well as technological change and requires sizeable complementary investments in worker training, manufacturing and marketing, in addition to investment in R&D. Governments need to foster investment and innovation through government funding and sponsoring, including offering tax incentives for R&D.

**There is a continuous need for better understanding of how innovation impacts economic prospects and what other factors must be in place to generate a sustained, economy-wide improvement in productivity and output. In fact, innovation appears to be playing an increasingly important role in driving economic growth.**

**The following general conditions must be in place in order for innovative opportunities to spread quickly in the context of economic activity:**

A regulatory and legal environment that is strongly in favour of open market competition and business creation;

Incentives to encourage skill acquisition and necessary changes in the organisation of the workforce;

Continuation of strengthening standards world-wide for intellectual property rights protection;

Closer relations between industry and academia to raise standards of excellence, ensure effective knowledge and technology transfer and achieve mutually beneficial personal exchanges and awareness;

Generally, encouragement for SME and entrepreneurship development.

#### **4. Broader structural reforms**

In fact, adjustment to trade-related impacts addresses only a fraction of the dislocations caused by competition and innovation in domestic markets. Therefore, any adjustment programs directed at trade impacts should be integrated with larger efforts to address on-going, non-trade related structural adjustment needs within national economies.

Longer-term adjustment responses will necessarily involve a broader range of policies, including macroeconomics, job creation and competitiveness initiatives, regulatory policies as well as labour market adjustment policies.

Accordingly, BIAC continues to support the OECD's conclusions concerning the reasons for divergence in growth and economic performances across OECD members. Results show that the causes can largely be attributed to different national policies. Although growth trend divergence in OECD countries has been caused by multiple factors, as a general rule, overly rigid policy settings are to blame for bad performance and reform options urgently need to be considered. BIAC urges continued OECD work on defining necessary reform efforts.

The prevalence of heightened economic risk, which featured high on BIAC's agenda at last year's consultation with OECD Ministers, has seemed to diminish as factors have shifted. However, we have clearly seen some economies remain more robust in resisting shocks than others. Again, structural flexibility and structural policy settings are fundamental determinants of the resilience of economies to shocks. Work in the OECD on this message is important for business in order to keep the pressure on OECD governments to undertake needed reforms.

Appropriate macro-economic policies and a performance-based regulatory environment that is favourable to entrepreneurship are necessary for boosting employment. The OECD has made an excellent contribution in this respect through its Growth Study as well as its Jobs Study and follow-up reports. BIAC also supports additional work on these subjects in the context of the new OECD horizontal Trade and Structural Adjustment project.

The business community is focused on dialogue with major stakeholders to generate necessary reforms for bringing about more jobs and economic growth. In this context, BIAC conducted a survey of its members examining what positive steps could be taken to improve employment rates in OECD countries. The following are a number of key concerns raised by business in OECD countries in their survey responses:

- The heavy burden of taxation and social security contributions, which constitute a barrier to employment, in particular with regard to unskilled or low-skilled workers.
- Over-regulation and lack of flexibility in the labour market. For example, overly rigid employment protection legislation is often a disincentive for companies to hire due to the difficulties they encounter in an economic downturn.
- Overly bureaucratic regulations for the hiring of temporary workers. In this context, practical instruments should be considered for temporary workers who wish to join companies' workforces when possible and when employers are satisfied with their performance. Greater flexibility in working patterns and work arrangements would be beneficial.

- Imbalances between available skills and market demands continue to be a pressing issue. Closer links between the education system and the labour market are necessary, and forward planning is essential.
- Low activity rates of certain parts of the population (for example: older workers, young workers, and women) must be tackled. Increasing employment rates among those groups will be crucial in view of the demographic changes we face.

Governments must take on the growth and employment challenges involved with new patterns of industrial production, including the not-new phenomenon of outsourcing. Apart from the need to apply worker-sensitive trade adjustment policies, BIAC continues to strongly believe in the necessity of structural reforms that will stimulate demand and activate supply in labour markets.

The need for structural reforms implies: fostering entrepreneurship, allowing for greater flexibility to manage human resources, activating the supply side of the labour market by addressing the needs of all groups and, stimulating investment in human capital formation and the promotion of life long learning. The OECD project on Trade and Structural Adjustment should also examine these areas of inflexibility that inhibit such adjustments.

## **Conclusion**

Business believes that governments should not let the outsourcing debate be dominated by those simply criticising the transfer of jobs overseas. The political debate must refrain from trying to set limits on inward and outward foreign investment. Governments must firmly reject protectionist policies that will restrict cost-effective investment decisions and competition, increase costs and limit investors' ability to allocate resources to their most productive uses. The opposite is required: the implementation of policies to encourage economic growth, spur trade and thus offer companies the opportunity to compete more efficiently and create employment.

While the cost to individuals who lose their jobs is obvious, the benefits of efficient and cost-effective sourcing – such as lower prices for goods and services and increased exports to emerging economies – are clearly there, however difficult they may be to estimate quantitatively. Much remains unknown about the role of outsourcing and offshoring in OECD economies and the impacts on employment and productivity. BIAC believes that the OECD can be very helpful in injecting much needed rationality into this debate. Whether by examining the benefits of foreign direct investment to the home country, or by analysing the scale of adjustment pressures stemming from improved productivity rather than worldwide sourcing: the potential role for the OECD in clarifying this debate is enormous, and BIAC encourages the organisation to continue this analysis.