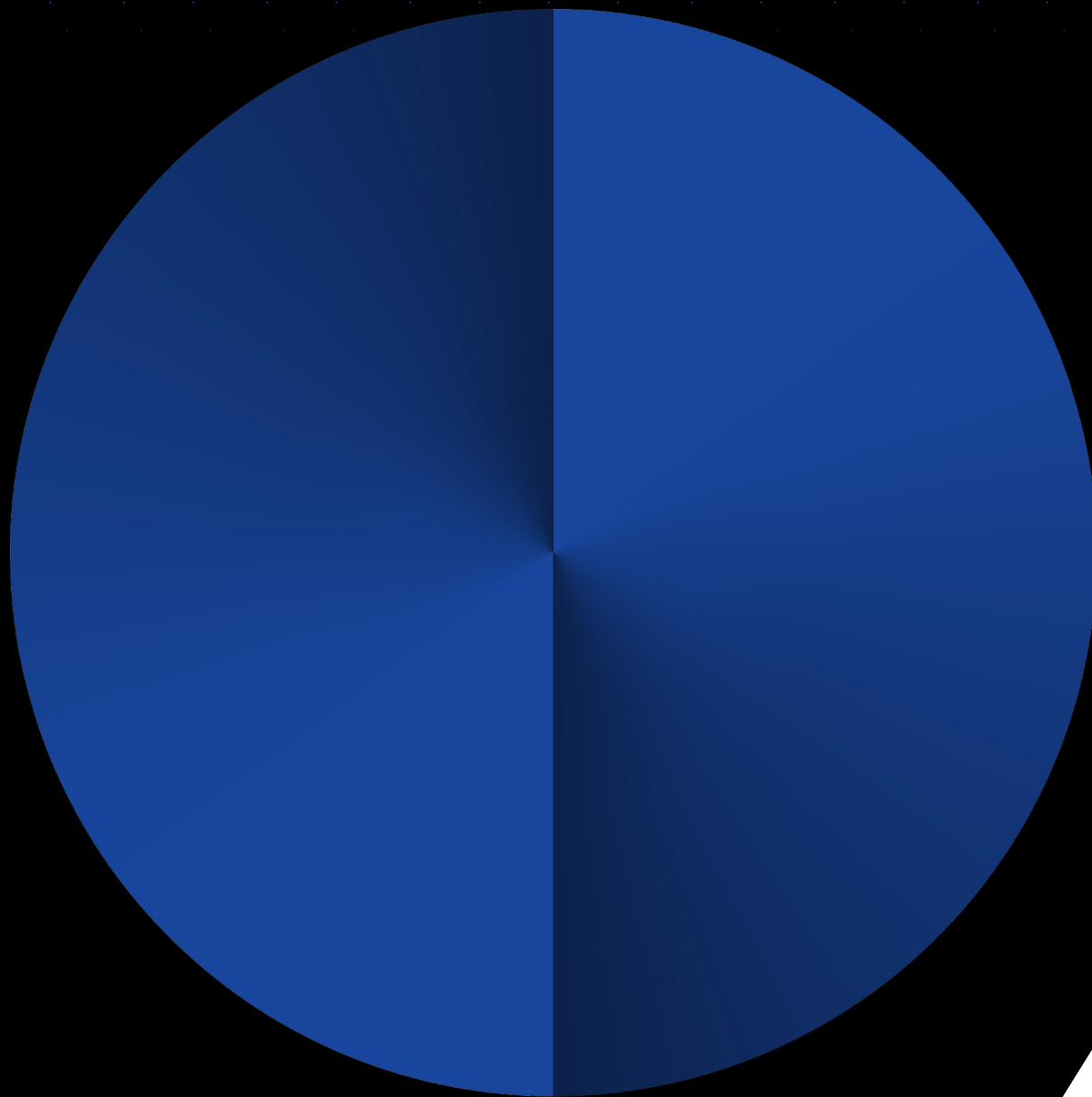


Meeting of the OECD Council at Ministerial Level

Paris, 7-8 June 2017



KEY ISSUES PAPER

Key Issues Paper

MAKING GLOBALISATION WORK: BETTER LIVES FOR ALL

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KEY MESSAGES FOR MINISTERS

- **Economic globalisation has advanced rapidly over the past three decades**, albeit with a slowdown following the global economic crisis. Trade and foreign direct investment flows have increased respectively from 17% and 0.9% of global GDP in 1990 to 28% and 3.2% in 2016, while cross-border movements of people have also been on an uptrend, with now about one in ten people living in OECD countries born abroad. **These evolutions have facilitated productivity gains and global economic growth, the integration of emerging economies in global markets and the lifting out of poverty of hundreds of millions of people, while also bringing important non-economic gains as well, with greater linkages among our societies and culture, and better knowledge of other cultures.**
- **Globalisation has also been a vector for the dissemination of technological advances, in particular digitalisation, which in many cases have been transformative.** Digitalisation vastly reduces the transaction costs of communicating and coordinating globally, enabling fragmented production processes that take advantage of expertise and comparative advantages that exist globally. It can also improve access to health care, skills development or other services and provide entirely new ways for people to connect, socialise, collaborate and participate in societies. It provides opportunities to produce more and better products and services more cheaply, thus increasing consumers' welfare. **The processes of globalisation and digitalisation being intertwined, so too are their effects on the economy and people's well-being.**
- **Today, there is a backlash against globalisation in some OECD countries.** While the causes and expressions of the backlash are country- and time-specific, discontent is fuelled by the fact that, **in spite of all its positives, the way globalisation has proceeded is also linked to the stagnation of the well-being of many in the lower half of the income distribution in a number of OECD countries, in contrast to the situation at the top end of the income distribution.** Median household incomes have risen only slowly in many OECD countries and have even fallen in some, while the conditions of employment and social mobility have deteriorated to some extent in some advanced economies. The *Inclusive Growth Initiative* of the OECD has shown how greater income inequality tends to bring greater inequality of opportunities (quality education, health, networks, quality jobs) and lead to more unequal outcomes, which are reinforced across generations. This contrasts with the situation for the top income group, whose income and wealth have continued to increase rapidly. **In developing and emerging economies, while poverty levels have decreased significantly, inequality levels have remained very high.**
- **The drive for deregulation at the domestic and international levels, while bringing benefits in terms of growth and innovation, has also hit some people and firms that were not well placed to compete in global markets, and added to the consequences of market distortions that have undermined fair competition in some sectors. Relying on metrics such as GDP per capita that provide information only on averages, as well as on models that did not capture well the complexity of the global economy, is one reason why policies have been too weak or not well enough tailored to address the challenges of open economies nor avoided the financial crisis.**
- **There are several mechanisms through which globalisation and technological change may have contributed to the stagnation of middle-class living standards and to the widening of the gap vis-à-vis the top 1%.** In particular, there is some evidence that these processes have:

contributed to the fall in labour's share of national income; aggravated local blight and regional inequality; fed the dominance of leading firms in some sectors; allowed the rise of some market distortions; fuelled the process of financialisation; and added to pressure to shift taxation from wealth and high-income individuals onto labour. The combination of technological change and globalisation has put at risk many jobs involving routine tasks, while digitalisation appears to be contributing to the polarisation of labour markets. Globalisation has also aggravated some other problems, including the growth of illicit trade and competition.

- **There is uncertainty about the extent of the various possible downsides to globalisation, but in current circumstances it is worth addressing the problems even before such uncertainty is fully resolved.** For unless the various sources of dissatisfaction with economic globalisation are addressed, political pressure to unwind at least some aspects of globalisation may put in danger the large benefits that have been generated by growing openness to trade, investment and movements of people.
- **A policy response is therefore urgently needed to make globalisation work for all and avoid prompting a damaging retreat from economic openness.** But such a response is only likely to succeed if it goes beyond trying to “fix” aspects of globalisation that are the subject of discontent. It should be framed in the context of a new policy narrative based around the concept of inclusive growth, aimed at improving multi-dimensional well-being in increasingly open and digitalised economies, which would help improve the living standards of those that have been left behind. Not all elements of such a policy response are yet fully developed, and more work, sharing of practices, and innovative thinking will be needed to grasp and address the challenges of an increasingly connected and digital world. However, a number of policy directions at the national, sub-national and international levels suggest themselves:
 1. **We need to replace the “growth first, distribute later” with a more integrated approach in which the low income groups are better placed to contribute to the growth process, and are also able to benefit from it.** We should avoid the silo approach with growth policies determined in one place while social issues are handled in another one. **It is not only a question of redistribution. It is about providing people with the means to succeed, in line with the Productivity-Inclusiveness Nexus approach developed at the 2016 MCM.**
 2. **At the national level, governments should step up their efforts to bolster people's ability to cope with change and succeed in a globalised and digital world.** Social protection and safety nets need to be adapted and improved, especially in the light of the changing work environment created by digital technologies, while not creating disincentives to increased innovation and productivity. But protecting and compensating will certainly not be enough. Equally important will be the move towards an “empowering State”, which involves developing creative solutions to ensure universal access to quality healthcare and education, develop stepped-up active labour market and skills policies, shift the tax burden off labour, develop a strategy for small and medium-sized enterprises and strengthen technology diffusion and the integration of migrants.
 3. **At the sub-national level, regional development policy approaches should focus on reinforcing each region's advantages rather than only on redistribution.** Also, there is often a need for strengthening the ties between rural and urban areas, and for employment and skills policies as well as strategies for entrepreneurship, innovation and investment to better respond to local circumstances. Better policy coordination and metropolitan governance arrangements can reduce municipal fragmentation and residential segregation by income.

4. **Finally, at the international level, there is a need for the governance of globalisation to catch up with the globalisation of economic activity, while taking due account of concerns about national sovereignty.** One aspect of this is strengthening international standards and making them more effective in helping level the playing field and improving inclusiveness. In particular, greater international collaboration on competition, state-owned enterprises, business accountability, fighting corruption and illicit trade would make a significant difference. Full implementation of existing agreements to crack down on tax avoidance and tax evasion are also key. The other main area concerns bilateral and plurilateral trade and investment agreements. Government officials should be encouraged **to further consult with their constituents and other impacted stakeholders on trade and investment policy; engagement at the local level would help to improve understanding of the likely impact of trade and investment reforms on communities.** This would also mean more transparency and consultation than in the past, as well as continuing the trend towards incorporating standards in other areas in such agreements.

SESSION NOTES FOR MINISTERS' DISCUSSIONS

Discussion on Item 5. Domestic policies to ensure people, firms, regions and cities can thrive in an open and digitalised environment

While economic openness and technological change are necessary for increased productivity, income and growth, they also contribute to higher concentration of gains in the more mobile factor of production, the reduction in labour's share in national income and involve transitional costs, as factors of production are switched from import-competing sectors to export sectors or from traditional industries to more modern types of industries. Laid-off workers may be unemployed for a time before finding new jobs, some capital may have to be scrapped, workers may have to move to another town or region to find work and so on. Recent evidence suggests, however, that such losses have been more widespread, larger, more region-specific and more durable than anticipated. There is also evidence of a growing productivity divide between leading and laggard firms, driving wider wage and income differences. With technological progress and digitalisation, many "routine" jobs are already disappearing, and this process is likely to accelerate in the coming years. Some jobs that in the past absorbed unskilled or low-skilled workers will no longer exist. Many jobs will require higher skills, for example, repair and programming of robotic functions.

New policies need to be put in place that need to favour both enhanced productivity and inclusiveness taking into account the opportunities and challenges of economic openness.

Breakout Group 1. Ensuring all people can thrive in an open and digitalised economy

OECD countries have long sought to provide temporary income support to those who lose their jobs and to help them to access training in order to find another good job quickly. In practice, however, these approaches have not been sufficient to adequately address the problem. In addition, the number of people entitled to transfers has declined. Low-income groups usually get low-quality education, and therefore their ability to upgrade and upscale their skill sets is limited. Improving existing mechanisms for income support and training for displaced workers is vital for inclusive growth in open economies, especially considering the number of people entitled to transfers has declined; but it is not enough. Social protection systems must become social enabling systems, and better public services should be provided to low-income groups and backward regions. Part of this is ensuring access to good quality healthcare and education for everyone, strengthening opportunities for the most disadvantaged. Also, entitlements could be better linked to individuals, ensuring transferability from one job to the next and, ultimately, from one country to the next. Universal basic income is being discussed in some settings as a possible alternative to improved targeted transfers to individuals adversely affected by economic shocks, and small-scale trials are being conducted, although adverse effects on incentives should also be considered. Some OECD member countries have fared better in limiting inequality while achieving a dynamic business environment, and their experience could suggest lessons for others.

In any case, education and skills policies need to be enhanced significantly so that workers have skills and competences adapted to the changing needs of the economy, with improved access to lifelong training for disadvantaged workers. In line with PISA lessons of the best performing education systems, the best resources and teachers should be deployed for the most backward schools and regions. These policies need to be locally adapted in order to ease the transition from manufacturing and resource extraction sectors to knowledge-intensive services. Action must be taken to make workers more informed, adaptable and mobile before any displacement actually happens. Policies to enhance gender equality also need strengthening for inclusive growth. Finally, international migration, while positive for receiving countries on balance, poses

specific challenges. While integration policies for migrants have improved, much remains to be done, especially for vulnerable migrants, in terms of education and training, activation policies, labour market access and settlement in areas with the best jobs prospects. A strengthened social dialogue between governments, business representatives and trade unions, will be needed to advance on these issues.

Questions: What policies can effectively and efficiently help workers thrive in a digital and globalised world? How can governments best address the challenges of globalisation and digitalisation regarding social protection systems? What experiences can be shared regarding the adequacy of the policy mix to help the population better cope with the rapid pace of change in the world of work?

Breakout Group 2. Ensuring firms can thrive in an open and digitalised economy

Narrowing the gap between those firms which are at or near the productivity frontier and the rest by better allowing the latter to catch up would help to reduce inter-firm wage inequality and erode capital rents enjoyed by some dominant firms. One aspect of that is to improve the diffusion of knowledge, technology and know-how. Since most knowledge is created abroad, maintaining an open system of trade and investment is an essential element of any effort to increase diffusion, while maintaining incentives for knowledge creation and innovation. The implementation of the *OECD Ministerial Declaration on the Digital Economy: Innovation, Growth and Social Prosperity* is important to facilitate the free flow of information. Another important aspect is to ensure a pro-competitive business environment that avoids obstacles to entry and allows for speedy exit of non-viable firms to allow capital to be reallocated to more efficient firms. While some Small and Medium-Sized Enterprises (SMEs) are at the productivity frontier and are amongst the most innovative companies jump starting entire new industries, many also lag in the adoption of digital technologies and are behind the productivity frontier. Addressing market failures related to access to finance, skills and access to foreign markets would help them narrow the gap with the leading firms, which are generally large.

Questions: What policies could help encourage technology diffusion to reverse the divergence in productivity levels between leading firms and the rest? What policies can ease access to local and global knowledge networks by SMEs and foster investment by SMEs in knowledge-based assets such as R&D, human resources, organisational changes and process, which are essential to turn technologies, including digital ones, into productivity growth? How to best improve the business environment so that more firms catch up on productivity (policies related to competition, market failures, education and training)?

Breakout Group 3. Ensuring regions and cities can thrive in an open and digitalised economy

Regional development policy should focus on building up a region's own advantages rather than only on redistribution. Urban development policies should seek to improve how cities function and how they are linked in a system. While national urban policies have typically focused on reducing the social and environmental costs in cities, they have paid less attention to the economic role of cities and their relations in a network of cities that supports growth with their hinterland and nation-wide. Rural development policy should go beyond a narrow focus on agriculture as non-farm activity represents a large share of rural economies. For example, in an increasingly digitalised world, access to broadband is critical for firms and people in more peripheral locations to benefit from the opportunities of the digital economy. Finally, enhancing the efficiency and effectiveness of public spending and programmes at the local level, in particular investment, depends on the quality of governance arrangements at national level and across levels of government. Regional contributions to the unequal growth outcomes have been confirmed, and if we want to achieve inclusive outcomes, we should focus on the regional dynamics, and support backward regions.

Questions: What approaches have been successful for the development of urban policy frameworks at national level that take into account cities' important economic contributions whilst addressing critical social and environmental challenges? How can the OECD help Members and Partners develop effective strategies to ensure that rural regions can contribute to and reap the benefits of the digital economy? What types of good governance practices have led to improved quality investments by regional and local governments?

Discussion on Item 6. Building inclusive globalisation by implementing better policies for improved competition, capital allocation, and wealth dynamics

The large net economic benefits that globalisation has brought are linked to the greater competition it has fostered. Nevertheless, there are some dynamics in the way globalisation has unfolded that may affect negatively fair competition and the level of market concentration in some sectors; and globalisation has had consequences on tax policies. These factors have had significant effects on capital and wealth dynamics across people, firms and regions.

There is evidence of a tendency for market concentration to increase, and this development could both partly explain, and partly be explained by temporary market dominance due to innovation in a sector that is changing rapidly and be the result of healthy competition in a new industry. In some other cases, it may be linked to features of markets that tend to entrench the advantages of leading firms, while in other cases it may reflect successful rent-seeking behaviour by large incumbent firms. This development could explain part of the widening divergence in productivity and wages between firms within any given sector. This divergence is found to be a greater source of growing inequality in labour income than growing differences within firms or across sector averages. A related issue is the maintenance of a level playing field among state-owned and private business amid the internationalisation of State-Owned Enterprises (SOEs), as well as the need to prevent the growing rise of cartels and fight corruption and illicit trade which tend to be given additional opportunities in a globalised world.

The digital sector is one where market dynamics deserve to be further researched in view of the importance of the sector for future economic growth. While there is little doubt that the digital sector has allowed many small start-ups to thrive, outcompeting old businesses in long-stagnant sectors, creating new business models and sometimes wholly new activities, or enhanced consumer choices through internet search and e-commerce, some features of the sector can favour the emergence of dominant firms. Scale without mass, coupled with the global reach of the Internet, allows firms to expand globally in a short time, even with limited human resources and tangible assets. Fixed costs are typically significant but marginal costs close to zero, ensuring important economies of scale at least in some parts of the industry. In addition, the complexity of technologies may have increased the sophistication of complementary investments required for the successful adoption of new technologies. It is also possible that we are entering an era in which know-how is more difficult to acquire, making it harder for other firms to catch up. In addition to reinforcing education and skills policies, attention should focus on ensuring continued market competition and an open Internet so that digitalisation can bring its full benefits.

Another case is the financial sector. Financial intermediation is crucial to the functioning of a market economy, facilitating the efficient allocation of capital and economic growth. At the same time, there is evidence of growing market power for leading financial companies and of the persistence of rents for both capital and labour in this sector. This has contributed to inequalities of income and wealth in a number of ways, including high earnings by financial sector employees; the growth of credit in relation to incomes, in conjunction with the tendency of banks to concentrate their lending on high-income households who can thus benefit more from investment opportunities, while low-income groups, backward regions and women have been more left behind; and stock prices that have risen much faster than national income, disproportionately

benefitting affluent households. These issues merit attention and relate to competition policies, corporate governance practices and financial literacy.

Finally, certain evidence suggests the trend towards greater capital mobility has been accompanied by the increased use of tax-advantageous jurisdictions, which has helped to erode the overall progressivity of the tax system. Profit-shifting and tax avoidance by some MNEs may have also contributed to rising market concentration. The OECD/G20 work on Base Erosion and Profit Shifting (BEPS) and Automatic Exchange of Financial Account Information for Tax Purposes (AEOI) can make the international tax system fairer and more transparent by reducing evasion and avoidance. While the level of tax progressivity is a country's sovereign right and varies depending on governments in place, it is appropriate for governments to reflect on the scope that exists to reduce the weight of taxes on labour incomes and strengthen the effectiveness of the taxation of capital incomes, wealth and property, in cases where this tax mix presents concerns.

Questions: In a context of market concentration in some sectors, how can countries more effectively ensure a fair global level playing field among firms? Is there a role for greater international cooperation to help level the playing field? What concrete measures can policy makers take to ensure that the financial sector serves inclusive growth? While increased tax progressivity is not automatically the best solution to promote inclusive growth, and the balance between benefits and transfers needs to be carefully reviewed in each individual country, what is the scope of more progressive taxation by domestic governments in the global environment in the countries that may want to increase tax progressivity?

Discussion on Item 9. International trade and investment for the benefit of all

At a global level, the available evidence is clear. Open economies grow faster than closed ones, with the expanded opportunities offered to firms giving rise to stronger productivity growth and more innovation. Salaries and working conditions are almost always better in companies that trade than those that do not. Over the past three decades, trade and investment have helped to pull hundreds of millions of people out of poverty – by providing better employment opportunities and by expanding households' consumption possibilities via lower prices and greater variety. For international trade and investment to bring their full benefits, the right domestic policies need to be put in place, as discussed in items 5 and 6 of the MCM. However, the way international trade and investment, which fall under a various set of international rules, evolve is also crucial to inclusive globalisation.

A common concern for opponents of trade agreements has been the way that these frameworks have been developed has not considered the need for more inclusiveness in the opportunities they create, nor in the outcomes they produce. Critics also complain that national priorities in other areas, such as labour or environmental standards, are often compromised. Many modern trade and investment agreements have started to address issues such as these by including provisions on labour and environmental standards. Their form and aim can vary: some aim to promote higher standards, (e.g. requiring countries to introduce new domestic labour laws); or to promote greater adherence to existing international norms (such as the Conventions of the International Labour Organisation - ILO); or to strengthen their enforcement by linking them to trade dispute settlement; or simply by creating a new avenue for bilateral dialogue and pressure. Some exhortatory provisions are aimed at signalling the importance of issues (such as Human Rights).

There are concerns that adding such provisions creates opportunities for them to be misused for protectionist motives. There are also issues about who determines compliance with international labour or environmental standards, and the legitimacy of trade negotiators to handle other issues. Higher standards requiring capacity to implement may also give rise to requests for financial or other assistance. But the alternative may be continued erosion of public support for liberalisation; this is one reason why the recent

trend towards building in cooperation on issues like labour regulation should be welcomed and encouraged.

Another theme of the popular discontent expressed about trade and investment agreements is that they are concluded with insufficient consultation, transparency and democratic oversight. While much progress has been made, trade policy-making needs to become even more open, one where more people can debate the issues, assess the pros and cons and feel a greater sense of confidence that the trade-offs inherent in reaching agreements make sense. This also requires changes to *how* engagement takes place. In the impact of trade, context matters, geography matters. Government officials should be encouraged to consult with their constituents and other impacted stakeholders on trade and investment policy; engagement at the local level would help to improve understanding of the likely impact of trade and investment reforms on communities. Finally, thorough cost-benefit analysis allows policy-makers to take into consideration the broader effects of international agreements on domestic policies concerning inclusive growth.

Finally, the concerns about international trade and investment are indeed aggravated if the playing field is uneven due to differences in legal and regulatory frameworks for corporate governance and responsible business conduct (RBC), or in their effective implementation and enforcement. There has been much progress with respect to the promotion and uptake of RBC standards in recent years, but major gaps in approaches and coverage across countries and sectors persist. The OECD has played and continues to play a central role in promoting RBC, through the Guidelines for Multinational Enterprises, which form part of a broader OECD instrument, the Declaration on International Investment and Multinational Enterprises, as well as its more specific due diligence guidance for responsible business conduct in specific sectors, including the minerals, extractive, agriculture, garment and footwear, as well as the financial sectors.

Another important related question is how best to fight against international corruption and illicit trade, as well as how we can advance incorporate the need to transition to a low carbon economy through international trade and investment.

Questions: How can trade and investments agreements contribute to more inclusive economies? How can these agreements provide better opportunities for SMEs? What is the best way of ensuring that stakeholders, including the general public, are more effectively involved in the negotiation of trade and investment agreements to ensure their buy-in? What are the factors that explain the remaining gaps in approaches and coverage of Responsible Business Conduct and how can they be overcome?

1. THE RISE IN DISCONTENT ABOUT GLOBALISATION IN ADVANCED ECONOMIES

1. This year's Ministerial Council Meeting takes place against a backdrop of **growing discontent about economic globalisation**¹ in a number of OECD economies, and governments need to address the facts that lie behind this discontent and consider how to influence how globalisation is proceeding so that it may yield more inclusive growth.

2. This trend is visible in opinion polls on attitudes to different aspects of economic globalisation and growing support for movements pledged to roll back at least some of these aspects. Large majorities of respondents in EU countries say that globalisation benefits large companies and not average citizens. Some 45% of EU citizens cite immigration as the most important issue facing the EU at the moment, and a majority have negative views about immigration from outside the European Union. In the United States, a Pew Research Center Survey shows that 49% of Americans think that the US involvement in the global economy is a bad thing because it lowers wages and costs jobs, compared to 44% saying that it is a good thing because it provides the US with new markets and opportunities for growth².

3. **The rise in negative sentiment about globalisation is far from a monolithic phenomenon** – not all countries show high levels of discontent, and the focus of discontent varies across and within countries, as well as across time. In particular, people in non-OECD economies have generally maintained an overall positive view of globalisation.

4. The discontent of some parts of the world's population has also been amplified by the Internet and social media. Although they have brought innumerable benefits, including allowing individuals to access a huge range of facts, opinions and analyses, they have often resulted in fragmentation rather than diversity of information sources, and made it harder to distinguish facts from falsehoods.

5. At various times and places the discontent has been directed at immigration, trade imbalances or trade agreements with particular trading partners³, inward investment (including in real estate), outward investment (e.g. offshoring), perceived unfairness in the policies of other countries distorting fair competition, the use of tax-advantageous jurisdictions for tax evasion and avoidance, growing inequalities and the power and influence of large multinational enterprises. But there are some identifiable themes in the disparate manifestations of dissatisfaction: a sense that globalisation has primarily benefitted a relatively small number of already wealthy people; a feeling that globalisation has sapped the power of national governments to redress social injustice and implement national priorities; a belief that globalisation has contributed to declining social mobility (making it harder to escape from relative deprivation); and a more general sense of loss of identity. The overall sense is of a growing feeling that globalisation has left too many behind and has been advanced with insufficient democratic legitimacy and accountability. Some fear that national standards are threatened by globalisation, while global standards are often absent or too weak to provide an adequate substitute.

6. Qualitatively, the phenomenon of strong political opposition to various aspects of economic globalisation is not new. There were major anti-globalisation demonstrations in previous decades (e.g. at

¹ Throughout the paper, economic globalisation (or just “globalisation”) refers to the economic integration of different countries through growing freedom of movement across national borders of goods, services, capital, ideas and people.

² [Pew Research Center Survey, 12-19 April 2016.](#)

³ Survey data suggests limited discontent about trade as such in advanced economies. The Pew Research Center reports large majorities in favour of the statement “trade is good” in Europe, Asia and North America. Similarly, in the Autumn 2015 Eurobarometer survey, 69% of respondents viewed the term “free trade” in a positive light, while a relative majority saw “protectionism” negatively (41% negative versus 38% positive).

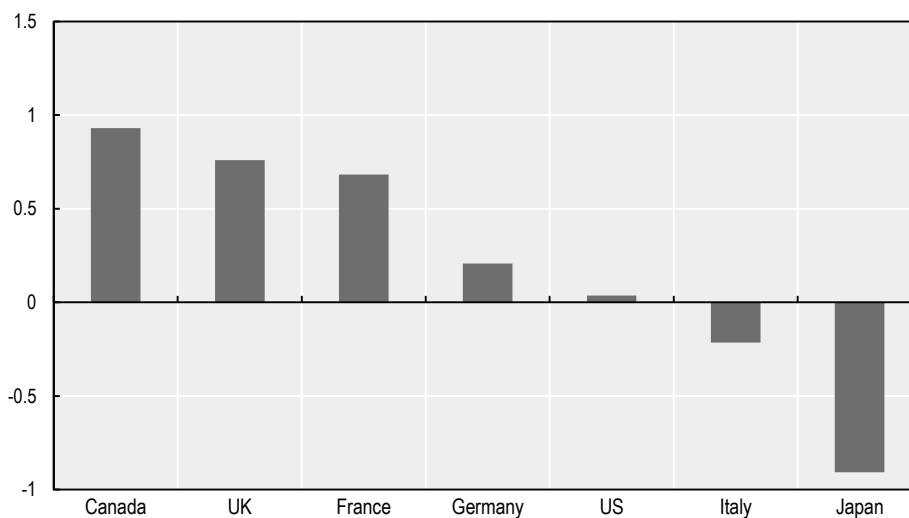
the World Trade Organisation (WTO) meetings in Seattle in 1999 and the G8 meeting in Genoa in 2001), and, in some countries, parties hostile to immigration and sometimes the liberalisation of trade and investment have had electoral success in the past. The current episode, however, is different in that this is the first time in the past 80 years that a number of governments in major advanced economies are espousing at least a partial unwinding of past liberalisation as regards the international movement of goods and services, capital and/or labour.

7. That this is so is likely connected to a juxtaposition of two key facts: **that economic prospects have to a certain extent dimmed for the bottom 40% of the income distribution in many of the advanced economies while the incomes and wealth of those in the upper tail of the income distribution continued to expand.** The causes are complex, and certainly involve the effects of technological change as well as domestic policy choices. But these two facts sit alongside a third, which is **the progression of globalisation.** Whatever the reality about causal links between this third fact and the other two, the combination of these three conditions, which is new, has in some places provided fertile ground for arguments against further international economic integration.

8. **On average, the recent rate of improvement of living standards in many advanced economies is slower than in the past.** In the 25 years or so after 1990 median real disposable household incomes slowly if at all in many OECD economies (Figure 1A). At the same time, many OECD economies saw sustained rises in the relative cost of core items such as housing, education and healthcare, which squeezed the discretionary spending capacity of the middle classes (Figure 1B).

Figure 1A. Median real household disposable income

Average annual percentage change 1990-2013¹

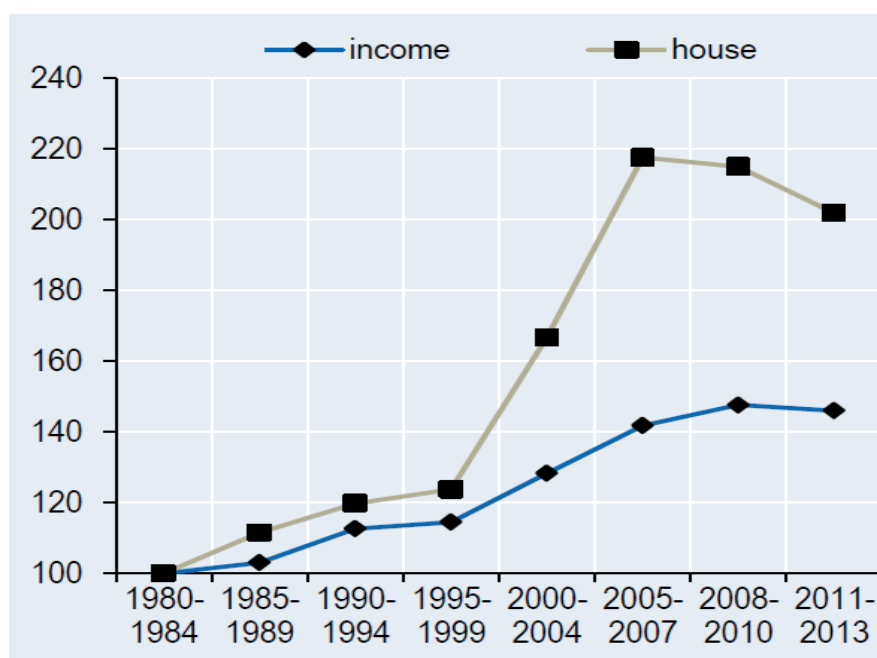


1. For Canada 1990-2011, for France 1995-2015, for Italy 1991-2013, for Japan 1995-2012, and for the United States 1989-2014.

Source: OECD Income Distribution Database (2016), www.oecd.org/social/income-distribution-database.htm.

Figure 1B. Median real household income and house prices

(OECD average, index, 1980-84 = 100)



Note: OECD average comprises Australia, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, United Kingdom and United States.

Source: OECD Secretariat calculations.

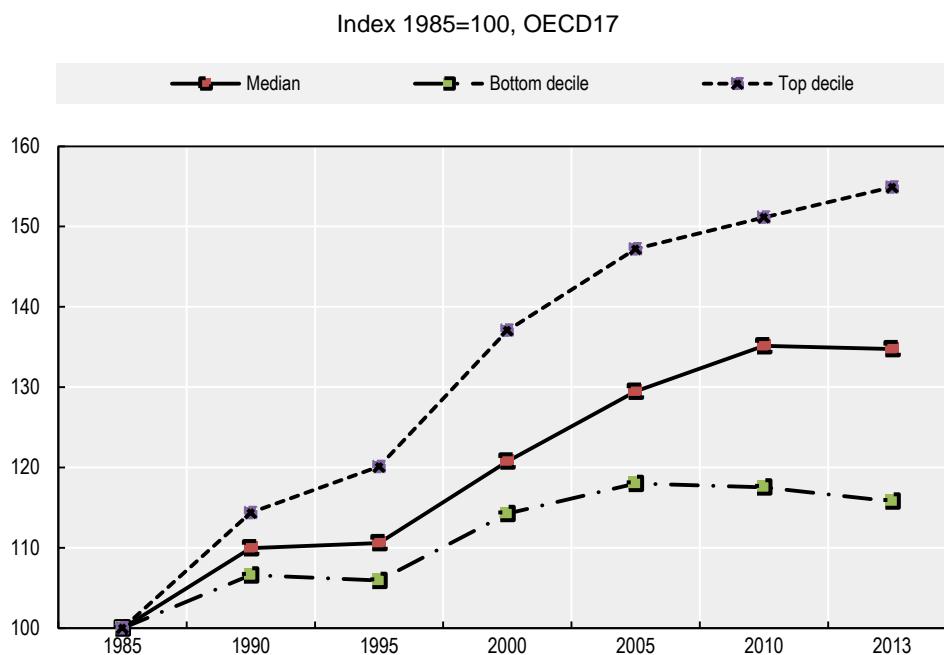
9. **The picture for the post-crisis period is even less encouraging, particularly for the lower- and middle-income groups** (Figure 2). Virtually all OECD economies have experienced slow average productivity growth since the crisis and even slower wage growth, especially in the lower deciles of the wage distribution. In a few economies, average per capita incomes remain far below their pre-crisis peaks. Even economies that have done relatively well since the crisis have generally had much slower productivity growth than before, and even slower wage growth.

10. Moreover, the **worsening income dynamics in the lower half of the distribution have been compounded by developments in some non-income dimensions**. A growing number of people in the advanced economies are in **non-standard forms of work** that on the one hand offer more flexibility in working arrangements but, on the other, provide less protection of employment and social rights and less predictable earnings. Since the mid-1990s, more than half of all job creation was in the form of non-standard work (OECD, 2015a). A recent study estimated that, in the EU, 13% of all those in employment aged 15-64 (and 54.5% of the self-employed) were at risk of not being entitled to unemployment benefits, while 8% (and 37.5% of the self-employed) were at risk of not being entitled to sickness benefits (Matsaganis et al., 2016).

11. The slowdown in the growth of real incomes for those in the lower half of the income distribution, which in some countries has meant a stagnation or actual decline, has been accompanied in many cases by a fall in social mobility. While trends in earnings intergenerational mobility do not show a clear tendency across countries, intergenerational mobility of education outcomes show a significant decline for the cohorts born after 1975 (OECD, 2017a).

12. **The deterioration in prospects for lower-income groups in many advanced economies has not been matched by a similar worsening for the upper reaches of the income distribution** (Figure 2). The decades-old trend towards greater income inequality in the advanced economies has been driven in part by a surge in incomes at the top end, and especially among the top 1%.

Figure 2. Trends in household disposable income by income group in selected OECD countries¹



1. Unweighted average of 17 countries: Canada, Germany, Denmark, Finland, France, United Kingdom, Greece, Israel, Italy, Japan, Luxembourg, Mexico, Netherlands, Norway, New Zealand, Sweden and United States.

Source: OECD Income Distribution Database (2016), www.oecd.org/social/income-distribution-database.htm.

13. Data on wealth is scarcer than for income, but **the available information indicates that household wealth is much more concentrated than income**. Tax data also indicates that, in recent decades, wealth inequality increased, often reflecting an increase in stock and housing prices relative to consumer prices (OECD, 2015a). Other trends, including the decline in tax progressivity at the top end of the income structure and the reduced use of wealth taxes, have also contributed to the changes of the distribution of wealth.

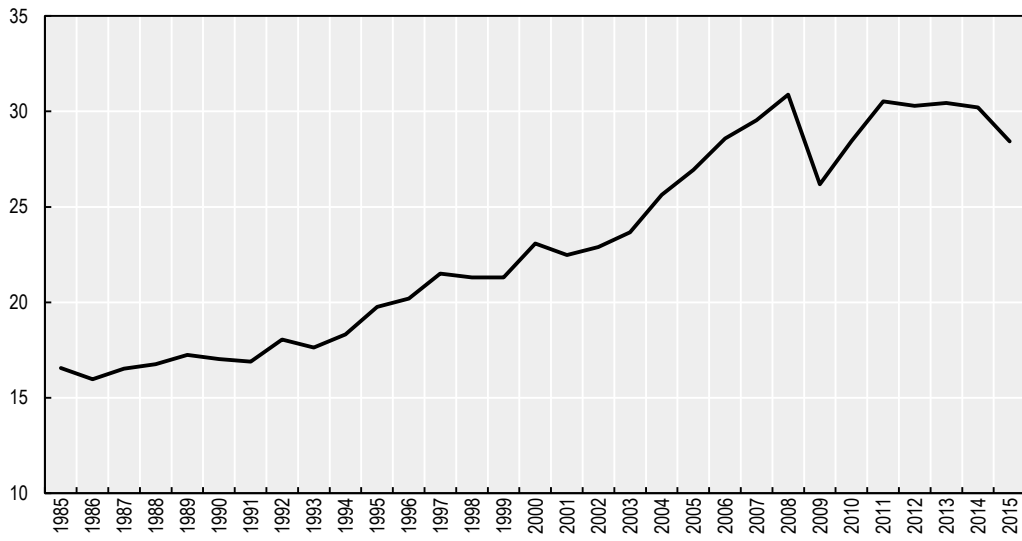
14. On average, in 2012 the top 1% wealthiest households in OECD countries for which data are available owned about 18% of total household wealth, more than the 13% owned by the bottom 60% of the distribution (OECD, 2015a). Strikingly, Zucman and Saez (2016) show that in 2007, the wealth of the top 0.1% in the United States was equal to that of the bottom 90%. The surge in wealth at the top end is also illustrated by the mushrooming number of billionaires: at a global level, the number increased from 140 in 1987 to 1810 in 2016. Piketty (2014) compiled data from eight OECD countries since the 1970s and concluded that, like income, private wealth has tended to become more unequally distributed in recent decades, reversing a long-term decline throughout much of the 20th century. Since the crisis, there are indications that the trend towards greater wealth inequality has deepened. Comparable data from six OECD countries indicate that the crisis has increased wealth concentration at the top in four of them, while wealth inequality at the bottom of the distribution increased in five countries (Australia, Canada, Italy, the Netherlands and the United States) (OECD, 2015a).

15. **The secular advance of globalisation is evident from a range of indicators.**

- **The ratio of global trade flows to global GDP increased from 17% in 1990 to 28% in 2016** (Figure 3A). The uptrend has not been at a constant pace, with a marked slowdown since the crisis. Also, around the long-term uptrend the trade-to-GDP ratio has fluctuated with oil price cycles, given that oil represents a much larger share of total international trade than it does of world GDP: the high-point was 30.9% in 2008, when oil prices were high, and after plunging in the global crisis it recovered to over 30% in 2013-14 before slipping back as annual average oil prices fell sharply in 2015-16. As trade has expanded, it has also embodied more foreign value added, reflecting the development of global value chains (Figure 3B). Today more than 70% of world trade is in intermediary products moving along global value chains.
- **Flows of foreign direct investment and portfolio investment, though more volatile than trade, grew even more rapidly on average over the past 25 years** (Figure 3C).
- **Cross-border movements of people have also been on an uptrend** (Figure 3D). In 2012, one in ten people living in the EU and OECD areas was born abroad, totalling around 115 million immigrants in the OECD and 52 million in the EU, of which 33.5 million were from non-EU countries. In both the EU and the OECD, the immigrant population has grown by more than 30% since 2000. The cross-border flows of people have been swelled in recent years by large flows of asylum-seekers fleeing armed conflicts. The number of asylum-seekers coming to OECD countries spiked in 2015 to 1.65 million, some five times the level of the mid-2000s (Figure 4).⁴ This surge, which was concentrated in the European Union, exposed even the most welcoming countries and communities to the challenge of providing support and job to a large number of people, and was an important factor fuelling discontent with globalisation in some European countries.

⁴ International Migration Outlook 2016 <http://www.oecd.org/els/mig/international-migration-outlook-2016-statistical-annex.pdf>

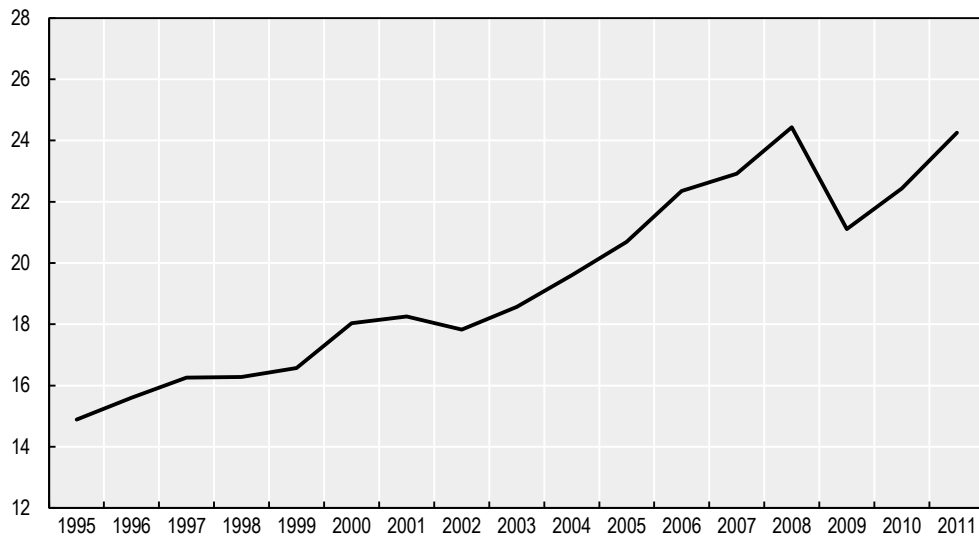
Figure 3A: Global trade flows/GDP



Source: IMF World Economic Outlook database.

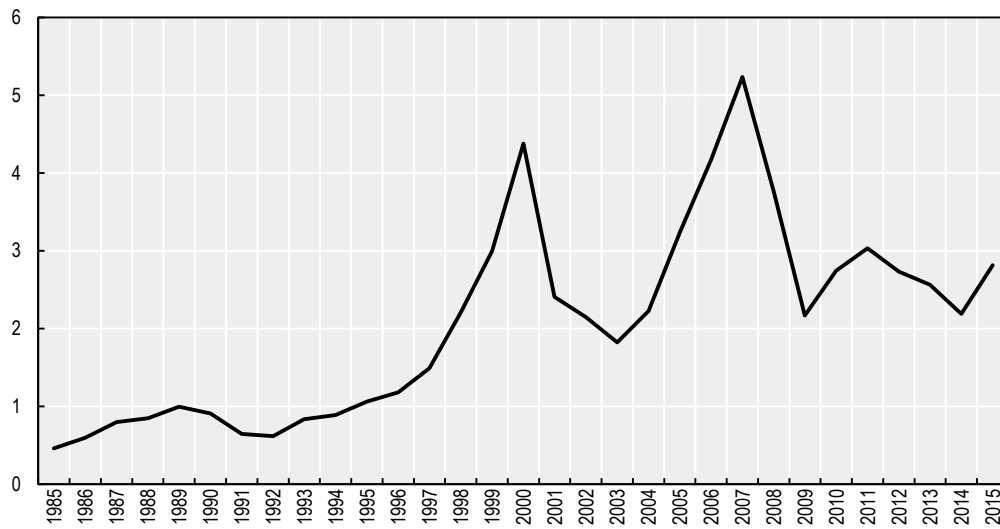
Figure 3B: Foreign value added share of OECD exports

In per cent



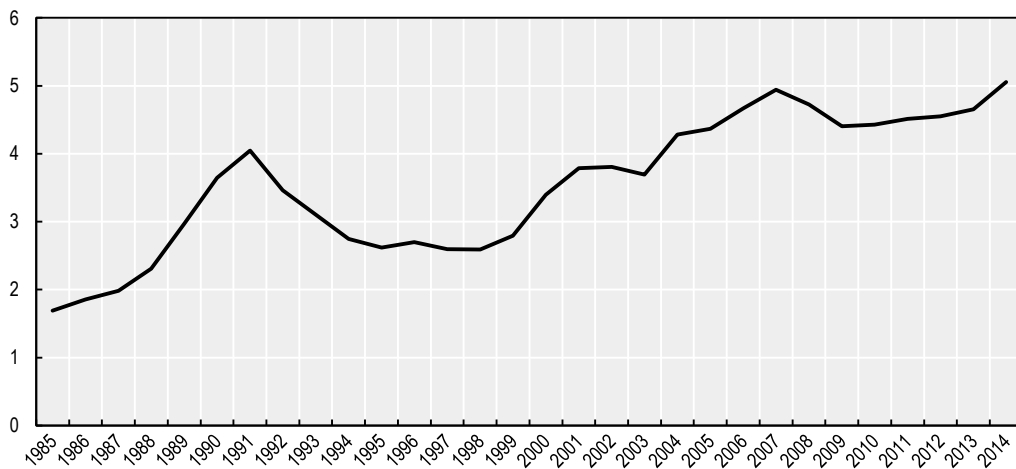
Source: OECD Trade in Value Added (TiVA) database.

Figure 3C: Global foreign direct investment flows/GDP



Source: World Bank World Development Indicators.

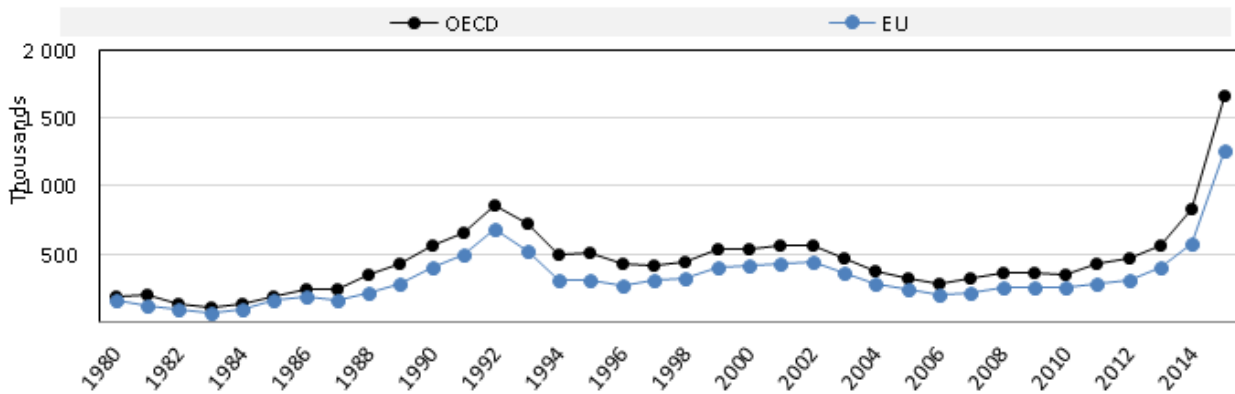
Figure 3D. Migration to OECD countries¹



1. Inflows of foreign nationals to OECD countries for which there are continuous annual data from 1985: Australia, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Luxembourg, Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States.

Source: OECD Population and Vital Statistics database.

Figure 4. New asylum applications in the OECD and the EU



Source: UNHCR.

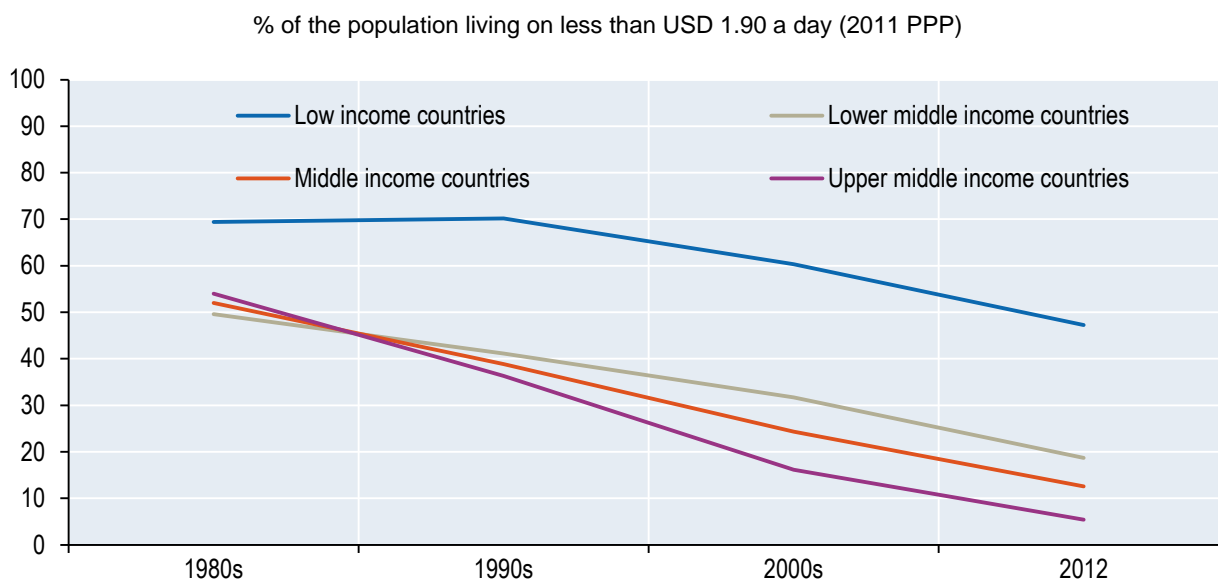
16. The juxtaposition of these developments explains much of the rise in people's discontent and the increased support to isolationist parties or policies in some countries, as well as the erosion of public confidence in government. Public belief in governments in the OECD stood at just 42% in 2016.

17. **As a result of this confluence of conditions, the risk of an economically harmful retreat from international economic integration and cooperation is higher than at any point since the Second World War.** Such a retreat would not only slow the advance of living standards in the countries initiating it, but would also impact negatively on the rest of the world. In addition, it would compromise the attainment of the Sustainable Development Goals by 2030, most notably the goal to eliminate extreme poverty. This makes it all the more important to scrutinise the processes and effects of globalisation to see what can be done to ensure that it yields more inclusive growth and widespread increases in well-being, in the advanced economies and elsewhere. This includes examining the national and sub-national policies that do much to determine the outcome of those processes, and international collaboration and standards that shape the way globalisation advances. That is the overriding aim of this year's Ministerial Council Meeting.

2. ECONOMIC GLOBALISATION, BOUND UP WITH TECHNOLOGICAL CHANGE AND THE DIGITAL REVOLUTION, HAS BEEN POSITIVE FOR MOST PEOPLE IN THE WORLD

18. A range of evidence supports the proposition that economic globalisation has been a large net boon to the global economy. Despite rapid world population growth, the latest period of rapid economic globalisation, since 1990, has coincided with a reduction of more than a billion in the number of people in extreme poverty, mostly in China and India, and strong convergence in per-capita incomes between countries. That association, striking as it is, is not conclusive proof of causation, but both China and, to a lesser extent, India have pursued export-driven growth strategies which have seen the ratio of trade to GDP rise sharply since 1990. Moreover, the export sector in these countries has been an important source of growth of formal employment, which has played a key role in the poverty reduction successes. The share of the world's population living with less than PPP USD 1.90 per day declined from around 35% in 1990 to less than 11% in 2013 (Figure 5), and child mortality in the developing world has fallen by half since 1990. Strong economic growth has also created better material living conditions for people in many emerging and developing countries, giving rise to a new middle class. Indeed, in considering the much-discussed problem of the “squeezed middle class” it should not be forgotten that on a global basis the middle class has expanded and become better off.

Figure 5. Globalisation has coincided with a substantial fall in extreme poverty



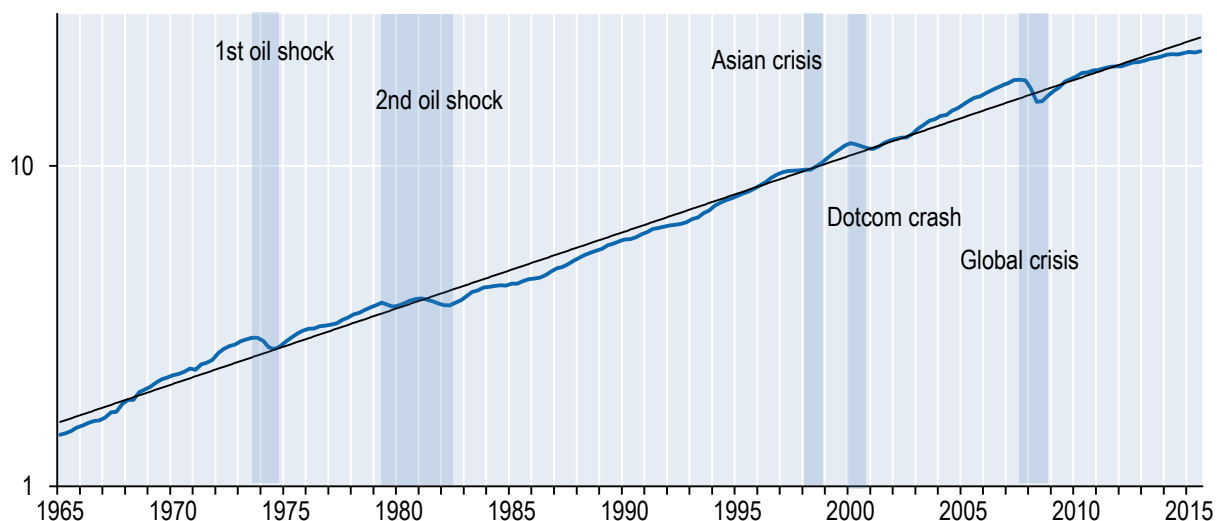
Source: World Bank (2016), World Development Indicators Database.

19. More generally, modern economic history strongly supports the proposition that increasing economic integration between countries has been associated with global growth. Waves of globalisation in the late-19th and early 20th centuries, in the three decades after World War II and from the late 1980s to the onset of global crisis in 2008 all accompanied periods of strong growth of the world economy. And years of slow world growth generally have been times when economic integration was slowing down or had reversed, rather than moving forward (Figure 6). This holds true not only for the Depression era and the recession years of 1974-75, 1981-82 and 2008-09 but also for the most recent worsening of global economic growth after 2011. The November 2016 OECD Economic Outlook estimated that about half of the slowdown in total factor productivity growth in OECD economies from the pre-crisis period to the last eight years could be unwound if the pre-crisis trend of rising trade intensity of GDP were restored.

20. **The channels through which openness creates prosperity are well established.** Standard economic theory, going back to Adam Smith in the 18th century, shows that trade spurs mutually beneficial specialisation, allowing higher overall economic output than when countries are closed to trade. **Rapid technological change helps multiply the effect of trade openness.** As technological progress has brought falling transport costs and faster and cheaper communications, this specialisation has increasingly gone beyond specialisation in entire production processes for given goods, allowing such processes to be divided up along global value chains, with an attendant gain in productivity. The argument for international investment, and indeed for cross-border flows of labour, is analogous to that for trade: if factors are allowed to flow until returns are equalised, overall output is maximised (given a number of standard, though largely counterfactual, assumptions).

Figure 6. Global trade and GDP growth are positively related

Global trade volume, trillion USD at 2010 prices, logarithmic scale



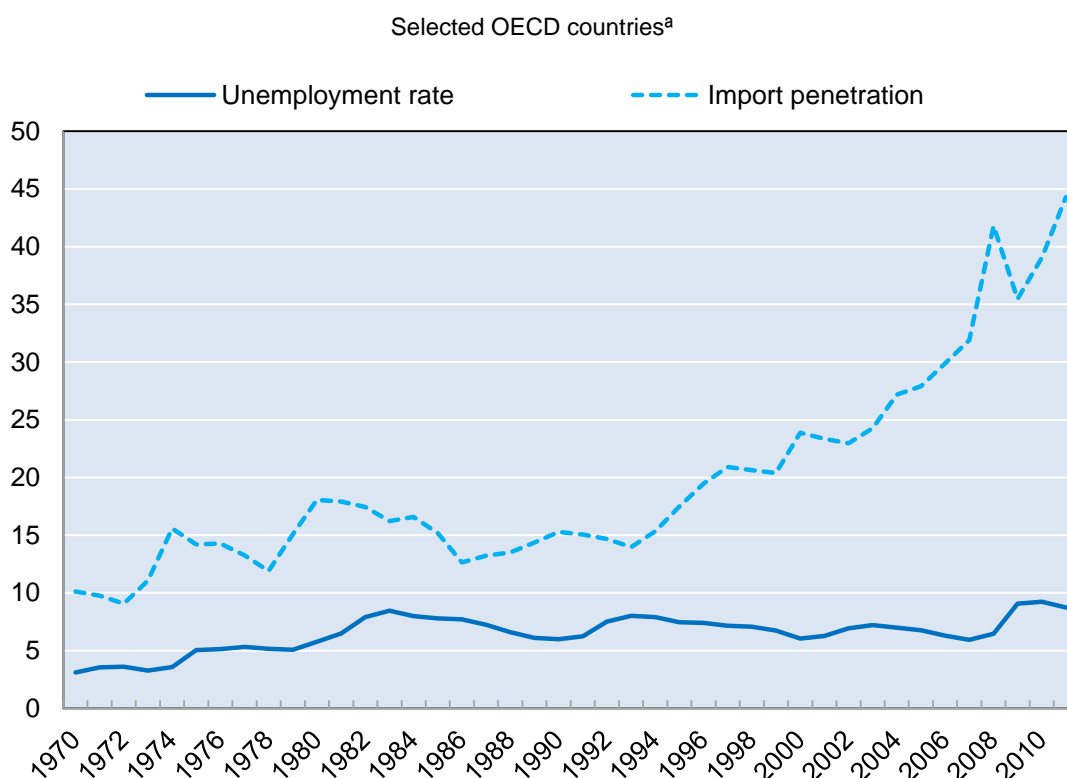
Source: November 2016 OECD Economic Outlook database.

21. A wide range of empirical evidence backs the claim that international trade has large net economic benefits. For example, the results of the OECD-led International Collaborative Initiative on Trade and Employment (ICITE), as well as the OECD large body of work on global value chains, has highlighted how different aspects of trade, including its more novel facets such as global services outsourcing and production off-shoring, play a pivotal role in boosting growth and creating high-value high-pay jobs. Reviewing data over the 1970-2000 period, manufacturing workers in open economies benefitted from pay rates that were significantly higher than those in closed economies. Open economies significantly outperformed relatively closed ones in working conditions, including fatal accidents and life expectancy. Labour rights were also found to be generally better respected in the more open economies. In Japan, trade contributed to a reduction in the number of hours worked and in Chile it interacted with unionisation in the export sectors to raise wages for workers. Moreover, studies for the United Kingdom, United States, Germany and Italy demonstrate that off-shoring of intermediate goods has either no impact or, if any, a positive effect on both employment and wages. The sustained rise in the ratio of imports to GDP in OECD economies came about with no trend increase in unemployment rates (Figure 7). The jobs potentially displaced by new trade and investment opening are dwarfed by the jobs already depending on the operations of established foreign affiliates and on exports of value-added in GVCs. OECD analysis suggests that if G20 economies reduced trade barriers by 50%, they could obtain more jobs overall (a 0.3%

to 3.3% rise in jobs for lower-skilled workers and 0.9 to 3.9% for higher-skilled workers, depending on the country) (OECD, 2012), but the costs of adjustments may be higher than expected.

22. Other research underlines the positive impact of trade on real incomes and aggregate and sectoral productivity. Cerdeiro and Komaromi (2017) estimate that the effect of a one percentage point increase in trade openness on long-run income was around 4% on average since 1990, although they did find a downward trend in that impact over time, with the impact being only around 2% since the crisis. In a similar vein, Alcalá and Ciccone (2004) report that a 1 percentage point increase in trade openness increases long-run productivity by 1.2%, while at the sectoral level, Ahn et al. (2016) estimate that sectoral total factor productivity is raised by about 2% for each percentage point decrease in tariffs on inputs used in that sector.

Figure 7. Trade openness and unemployment rates



Note: Australia, Austria, Belgium, Canada, Denmark, Finland, Former Federal Republic of Germany until 1991, France, Germany, Iceland, Italy, Japan, Korea, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

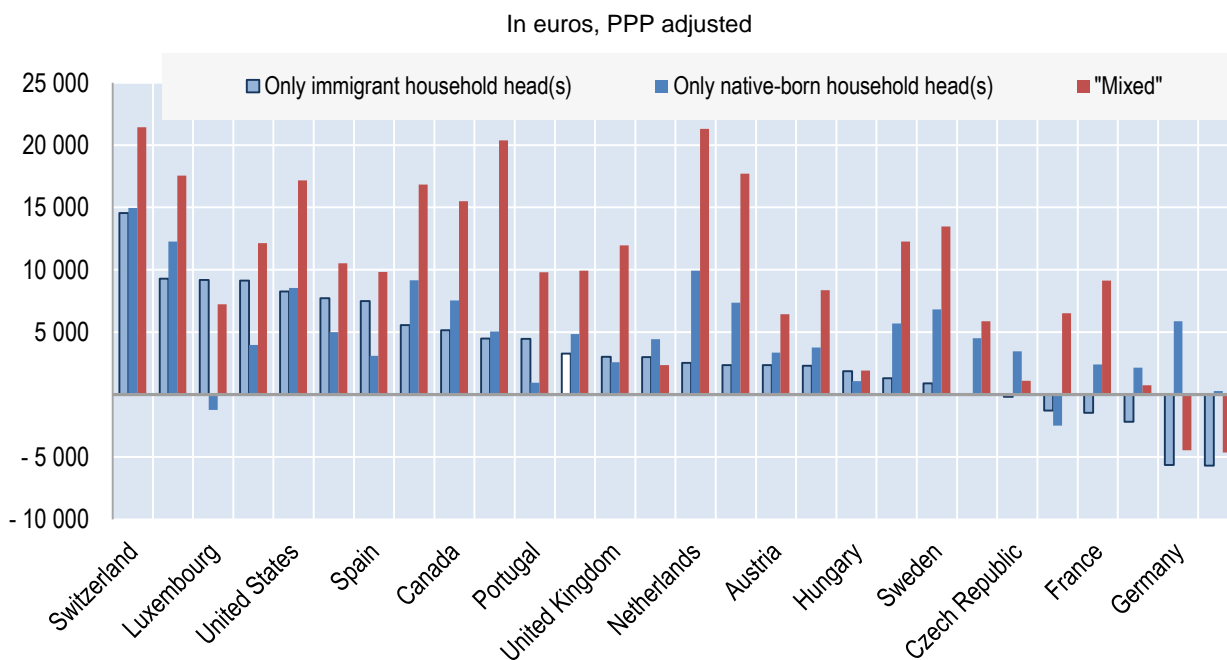
Source: OECD Economic Outlook database

23. Long experience with globalisation, together with more recent theoretical work, points to a number of additional benefits. **Trade provides gains for households through reduced prices and increased choice.** Such benefits are enjoyed not only for traded goods like cars, running shoes and computers, but also for services, including tourism. Firms also benefit from diversity (for their inputs), and are able to access factors and resources in other economies at lower cost. Open trade is a **key pathway for the diffusion of new technologies, knowledge and competition, which are central to achieving productivity gains and improving well-being.** Moreover, tariff structures are often regressive, with high rates on products on which low-income households spend a large proportion of their income, such as

clothing and food. Thus trade liberalisation is often inherently pro-poor. **The experience with foreign direct investment (FDI) indicates that it can encourage the transfer of technology and know-how; private sector development** (including in small and medium-sized enterprises) through linkages with multinationals and integration in their global value chains; **human capital formation both for individuals employed by foreign-invested enterprises and through imitation effects; and greater competition and structural adjustment.** These benefits do not materialise automatically, but can be fostered by the **right policy and regulatory approaches** in both host and destination economies, as well as at the multilateral level, many of which are identified in the OECD Policy Framework for Investment as well as OECD's other investment-related recommendations.

24. **As for cross-border movements of people, evidence points, on balance, to clear beneficial effects of migration for both origin and destination economies, as well as for the migrants themselves.** The OECD has collected a wealth of evidence on the medium- and longer-term effects of migration on public finance, economic growth and the labour market (OECD, 2013). Immigration of both low- and high-skilled labour is found to boost the GDP per capita of advanced recipient countries (IMF, 2016), while successive OECD International Migration Outlooks (e.g. OECD, 2013 and OECD, 2016a) have shown that in almost all OECD countries, migrants contribute more than they take in social benefits, contrary to general perceptions among the host country population (Figure 8). A recent analysis of immigrants to the European Union (Eurostat, 2016) showed that second-generation immigrants had higher tertiary education attainment rates than those with a native background. Migrants boost the working age population and typically fill critical gaps in the labour force (e.g. in care for the elderly).

Figure 8. Average net direct household fiscal contribution by migration status of the household head, 2007-09



Source: OECD (2013).

25. **Economic globalisation has also been a vector for the spread of technological advances which in many cases have been transformative.** Digitalisation vastly reduces the transaction costs of communicating and coordinating globally, enabling fragmented production processes that can take advantage of expertise and comparative advantages that exist globally. It can also improve access to health care, skills development or other services.

26. Digitalisation and globalisation provide entirely new ways for people to connect, socialise and collaborate and participate in societies; they enable the production of more and better products and services at cheaper prices, thus increasing consumers' welfare; they foster the diffusion of knowledge and technology; they spur innovation, productivity and growth and have allowed millions of people in developing and emerging economies to escape poverty, get access to finance and improve their living standards. The Internet and information and communication technologies have reduced the cost of sharing knowledge and have allowed automation for trade facilitation, underpinned by the movement of data across international borders. Digitalisation has boosted competition in some industries (e.g. taxi services) and has created wholly new markets in others.

27. Moreover, the benefits of globalisation plausibly extend beyond purely economic gains, important as these have been. The process of global economic integration has coincided with **a spread of liberal democracy and a declining propensity to resort to military means to achieve economic or political aims**. The proportion of the world population living in democracies has increased from around 10% a century ago to some 60% currently, while the annual rate of battle deaths has fallen from nearly 300 per 100,000 people during the Second World War and 22 during the Korean War to about 5 during the mid-1980s and just 1.4 in 2014, despite a rise since 2011 driven mainly by the Syrian conflict. The idea of a negative influence of trade on the likelihood of war goes back at least to Montesquieu in the 18th century, and Polachek and Seiglie (2006) find that a doubling of bilateral trade leads to a 20% reduction in the probability of armed conflict between two countries. **In addition, globalisation has increased people's exposure to cultural diversity and improved their access to more varied media sources, enlarging the potential for citizens' democratic engagement. Moreover, the deepening of commercial relations between countries helps to foster and incentivise other forms of cooperation.** The development currently in process of joint responses to global challenges (e.g. tackling climate change and achieving the UN Sustainable Development Goals) can therefore also be seen as part of the benefits of economic globalisation.

28. Given the clear and substantial benefits that have come from greater international economic integration, it is evident that **a retreat from openness would be very damaging for the world economy**. The November 2016 OECD Economic Outlook considered a stylised scenario that assumes an increase in import tariffs vis-à-vis all trading partners of 10% across the board in Europe, the United States, and China. In this scenario, world GDP is estimated to be lower by 1.4% and global trade by as much as 6%. Moreover, the likelihood is that these costs would be only the beginning. A trade war scenario is also one in which international cooperation and openness in other areas is likely to be compromised. Harmful restrictions could follow with regard to flows of people, investment, aid and information. Cooperation on international rules and institutions could be set back. Such a scenario must not be allowed to unfold.

3. SOME DYNAMICS OF GLOBALISATION, INTERTWINED WITH TECHNOLOGICAL CHANGE, HAVE ALSO, HOWEVER, CONTRIBUTED TO THE STAGNATION OR REDUCED LIVING STANDARDS OF LOWER INCOME GROUPS IN ADVANCED ECONOMIES AND TO GREATER TOP-END INEQUALITY, AND INEQUALITIES IN DEVELOPING AND EMERGING ECONOMIES ARE STILL VERY HIGH

29. Despite the clear benefits that can be credited to globalisation in the modern era, there is also a variety of negative effects for which there is some evidence. Of particular interest is to assess the extent to which globalisation can rightly be blamed for the phenomena most closely associated with the recent backlash: the stagnation/decline of incomes for the lower deciles of the income distribution in advanced economies; job losses that have particularly hit workers in the middle of the skills' distribution (job polarisation); the increasing concentration of income and wealth among the top income groups; and the perception that national governments are less able than before to deliver public services, ensure fairness and serve the interests of their citizens. And indeed **the most plausible negative effects of economic globalisation, together with the processes of technological change broadly and digitalisation in particular, can be grouped under two broad headings: those that increase inequality at the top end of the distribution and those that depress the growth of disposable incomes for the middle class. These headings map directly to the foci of current discontent.**

30. **There are other possible negative effects** arising from globalisation which do not fit neatly under those two headings. For example, globalisation may have contributed to declining trust in governments, the 'elites', and globalisation itself. Discontent has been expressed about the use of **tax-advantageous jurisdictions by corporations to avoid taxes or shift profits and wealthy individuals to avoid or evade tax, preferential tax deals for particular companies and special arrangements for foreign investors to settle disputes, among other things.** In addition, globalisation has created **new opportunities for organised crime networks, illicit trade and corruption.** The greater geographic scope of illegally traded goods has increased their negative economic impacts, while illicit networks have adapted to the latest technology to commit crimes such as cyber extortion worldwide. **Counterfeiting, for example, is estimated today at USD 460 billion, accounting for about 2.5% of global imports** (OECD, 2016b), with various negative effects including injuries to consumers, degradation of environmental systems and biodiversity, erosion of government tax revenues and elimination of jobs in legitimate industries, as well as financing of some criminal networks.

31. Environmental impacts are also a separate issue. **There is an inherent tension in the relationship between globalisation and some environmental outcomes, since to the extent that globalisation succeeds in boosting economic growth it tends also to result in faster increases of environmentally harmful emissions.** While it is likely that societies will choose to reduce pollution levels as they become wealthier, this is not necessarily the case for all pollutants. Furthermore, growth pathways typically engender much higher levels of energy and materials intensity, though as recent OECD work conducted in the context of the German G20 presidency has shown, governments can pursue a growth agenda that both boosts economic growth and wellbeing while also ensuring that the growth is low-emissions and climate-resilient. The increase in emissions as a result of globalisation, meanwhile, has been amplified by the fact that a large part of the additional growth associated with the latest wave of globalisation has taken place in economies with lower environmental standards. Also, trade itself is relatively emissions-intensive. CO₂ emissions from international shipping doubled between 1990 and 2007, and global emissions from shipping and aviation for international trade, which are not subject to carbon taxes or cap-and-trade schemes, are roughly equivalent to the total emissions of Japan. 30% of the total global NO_x emissions come from shipping. In addition to the lack of pricing in of negative externalities related to emissions, maritime transport costs are also distorted downwards by a variety of subsidies (e.g. for shipbuilding and port infrastructure) and exemptions (e.g. social contributions). As a result, the average freight rate for transporting a container from China to Europe is less than the cost of transporting it

50 kilometres by truck in Europe. Nonetheless, the net impact of globalisation on the environment is ambiguous. The global fragmentation of production can be a positive force for progressive companies to export best practices and environmental technology and standards and be agents for change across countries. Also, OECD research shows that by increasing demand for environmental products and technologies, environmental policy can be used together with trade policy to support pollution-reduction efforts, not just domestically but also abroad.

32. **In emerging economies, where inequality levels are often higher than in OECD economies, and in spite of major decreases in poverty levels, inequality trends have also followed the same pattern as that in OECD countries during the earlier decades of the 1980s and 1990s, even if recent trends tend to be more encouraging in some countries.** Inequality has tended to decrease since the mid-1990s in several emerging economies, especially in Latin America and the Caribbean. Inequality decreased in particular in Peru, Mexico, Brazil and Argentina (since the 2000s), and to a lesser extent in Chile. Nevertheless, the decline of inequality in this region tended to be much more modest as from 2010, especially in terms of poverty alleviation. Inequality also decreased in the Russian Federation. By contrast, Indonesia and South Africa have become more unequal over time. Inequality has also increased over the long run in China, especially in the years following the opening-up of the economy in the 1990s, but has tended to stabilise since 2010. Inequality in India was broadly stable. These developments took place in a context of increasing real household incomes in many countries, such as the Russian Federation, Brazil, India and South Africa. In China, rapid economic expansion did not translate into equivalent gains in aggregate household disposable income until around 2010. This illustrates that income growth in the global economy as such is not a guarantee for smoothing the income distribution (OECD, 2015a).

33. **A number of the negative effects feeding discontent in advanced economies are more properly tied to the broad process of technological change rather than globalisation per se.** But these factors are closely intertwined and in some cases probably impossible to disentangle, not only in terms of econometrics but also conceptually. When an African herder makes an online order for an imported tool, is that an example of digitalisation or globalisation? When a call-centre is offshored to a developing country, should displaced workers in the advanced country blame globalisation or technological change? In the past thirty years, the more rapid pace of globalisation has indeed been facilitated by digitalisation. The effects of economic globalisation and technological change will therefore be considered together. There are several ways in which the growing degree of economic integration globally, together with technological progress, has plausibly contributed to the increasing divergence in incomes and well-being that is at the centre of the discontent that threatens to trigger a retreat from openness.

(i) The fall in labour's share in national income

34. First, **globalisation may have contributed to the reduction in labour's share in national income that has been observed in most OECD economies over the past two decades.** Standard trade theory provides one possible explanation for this phenomenon. The relatively scarce factor of production in each country is made worse off by opening to trade. For advanced countries, the relatively scarce factor (restricting factors to just capital and labour) is labour, so the theory would suggest that in opening trade with developing countries like China, wages in advanced countries would be pushed down. The corollary is that the return to capital in advanced economies will rise and the share of capital in national income will increase. Since capital income is more unequally distributed than labour income, any such shift from labour to capital income tends to contribute to rising within-country income inequality. Also, since wealth is the value of capital, rising returns to capital tend to push up wealth, which is more unequally distributed than income.

35. Such an explanation in terms of Heckscher-Ohlin-type trade based on factor endowments is at best part of the story – for one thing, the corollary to this explanation would be that the labour share of

income in China would have risen, which has not happened. There is, however, at least one other reason to think that globalisation has contributed to this shift. **Most OECD economies have seen a long downtrend in unionisation rates and the coverage of collective bargaining.** While the explanations for this downtrend are complex, there are at least two plausible mechanisms linked to globalisation: that trade has exacerbated the shrinkage of employment in traditionally highly unionised sectors (i.e. manufacturing); and that the threat of competition from imports and/or the attraction of offshoring production to countries with lower labour costs has weakened the bargaining power of labour in advanced economies.

36. In any event, recent estimates (IMF, 2017) of the impact of global integration and technological change on labour shares in advanced economies as a group indicate that jointly, these factors explain almost all of the observed trend decline in the labour share of income. The results for individual OECD countries also confirm the importance of globalisation and technological change, especially in countries with a greater initial share of jobs involving routine tasks.

(ii) Local blight and regional inequality

37. **It has long been recognised that opening to trade involves transitional costs as factors of production are switched from import-competing sectors to export sectors.** Laid-off workers are often unemployed for a time before finding new jobs, some capital may have to be scrapped, workers sometimes have to move to another town or region to find work and so on. It was assumed that these frictional costs would be small in relation to the gains from trade, and while it was shown that it would be possible to compensate losers and still leave everyone better off, such compensation remained largely notional, with it being assumed that even the losers would quickly gain from rising national income. **Some recent evidence suggests, however, that such losses have been more widespread, larger, more region-specific and more durable than previously realised, at least in the United States.** Autor et al. (2016) examined the impact of expanded trade with China on local labour markets in the United States, finding that wages in affected localities remained depressed and local unemployment rates remaining elevated for at least a full decade after the onset of the China trade shock. Displaced manufacturing workers are not the only ones found to lose out. There are also job losses among service industries serving the former firms and workers and a loss of local tax revenue. This research remains to be confirmed by studies on other countries and with other trade shocks. Even so, it suggests that, notwithstanding the many unquestioned positive effects of trade opening, in some places it may have contributed to a stagnation or decline of living standards for some segments of the population in advanced economies in recent years.

38. **Immigration can also have locally negative effects, despite being found overall to convey net benefits.** Immigrants are nearly always concentrated in specific regions and urban areas – often the most disadvantaged ones. The local impact of large-scale immigration can be far stronger than what is observed at the national level, and may be working in a different direction. In particular, large sudden inflows of migrants can aggravate longstanding structural problems and bottlenecks in local infrastructure, such as housing, transportation and education. Similarly, although this is not usually the case, in some circumstances, large numbers of low-skilled migrants arriving in a particular area may have a negative impact on the local labour market prospects of already present low-skilled residents.

(iii) Disruption of labour markets caused by technological change/digitalisation

39. In addition to the effects of open economies, **the uptake of new technologies has been found to have been a core factor in the profound transformations in the occupational and industrial structures of OECD markets.** Like for every industrial revolution which has involved a process of creation-destruction, it is difficult to predict what will be the outcome of the process for workers. Nonetheless, with better tools for analysis and the sharing of experiences with different policies, it is hoped that the process will be better handled for people's wellbeing. The extent to which the current production

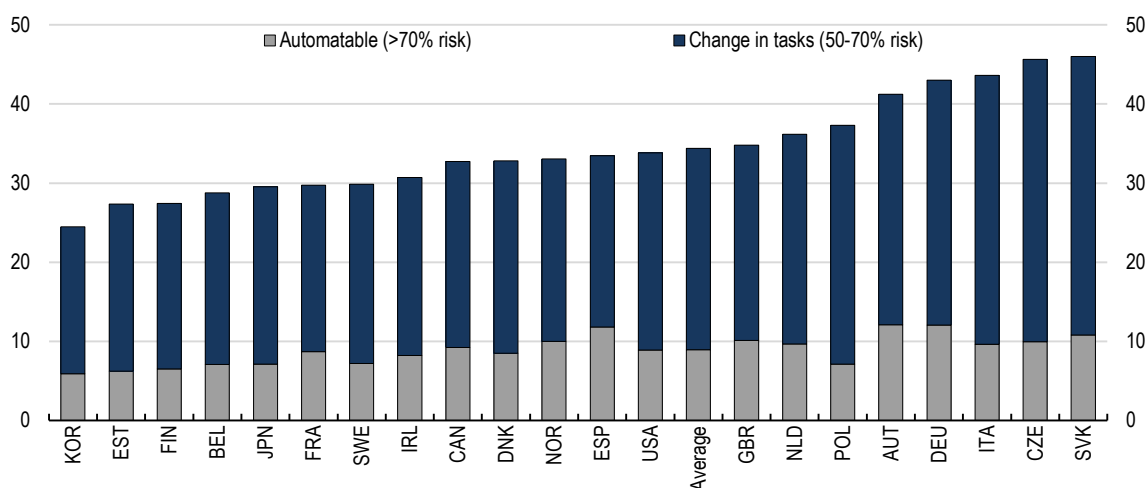
revolution will involve larger transitional costs and both a faster and larger change to the world of work is still being debated.

40. The current process of de-industrialisation in some sectors in many countries – which has seen significant shifts of employment from manufacturing to services – has taken place alongside that of “job polarisation”, whereby the number of mid-pay, mid-skill jobs has declined relative to the number of low-pay and high-pay jobs. While there is no evidence that technology reduces overall employment, these are fundamental changes, which cause significant disruption in workers' lives and raise significant policy challenges. In particular, **as employment is being reshuffled across occupations and industries, workers are confronted with a significant risk of job displacement and changing skill demands, and they experience difficult job transitions across occupations and industries.** The increasing ability of technology to perform easy-to-codify routine tasks has been singled out in existing studies as a key driver of job polarisation (Goos et al. 2014). This has given rise to a new wave of technological anxiety (Brynjolfsson and McAfee 2011; Mokyr et al. 2015). OECD work (Arntz et al., 2016) suggests that 9% of jobs are at risk from automation in OECD countries (Figure 9).

41. Forthcoming OECD work shows that of these different trends, **increased technology adoption displays the strongest association with labour market polarisation and de-industrialisation** (OECD 2017b). The association between integration in global value chains and changes in the occupational structure is less clear-cut, although the spread of global value chains has significantly contributed to changes in occupational structure in a number of countries, including the United States.

42. Many other “routine” jobs may also disappear or be significantly transformed in the coming years. Some jobs that in the past absorbed unskilled or low-skilled workers may no longer exist. Jobs will still be associated with providing these functions; however, many of them will require higher skills, for example, repair and programming of robotic functions.

Figure 9: High risk of job loss due to automation: percentage of workers in jobs at high and medium risk of automation



Note: Data for the United Kingdom correspond to England and Northern Ireland. Data for Belgium correspond to the Flemish Community.

Source: OECD calculations based on the Survey of Adult Skills (PIAAC) (2012) and Arntz et al. (2016)

(iv) The increase in market power for large enterprises and banks and the productivity divergence between frontier firms and the rest

43. **Firm-level data analysed by the OECD indicate a divergence in performance since the early 2000s between a leading group of “frontier” firms and the rest.** Frontier firms are found to be larger and more profitable on average, and to have had faster growth in value added per worker and in wage rates. Among the firms further from the frontier, a growing proportion is found to have become “zombies”, that is, firms whose earnings failed to cover interest costs for three consecutive years. While much remains unknown about the reasons for this divergence, these facts correlate with an upward trend in market power for leading firms in each sector.

44. **Globalisation can only bring its full benefits in an inclusive manner if competition is fair in a well-functioning market** which does not allow economic rents to accrue to some companies and sectors, and within which governments can implement the domestic policies they see fit for taxation and redistribution.

45. **There is no doubt that the large net economic benefits of globalisation are linked to the greater competition it has allowed.** However, **there is evidence, in some industries, of increasing market concentration,** and this development could both partly explain, and partly be explained by temporary market dominance due to innovation in a sector that is changing rapidly and be the result of healthy competition in a new industry. In some other cases, it may be linked to features of markets that tend to entrench the advantages of leading firms, while in other cases it may reflect successful rent-seeking behaviour by large incumbent firms.

46. The standard picture of trade is that it is pro-competitive, in that the initial effect of opening to trade is to expand the number of firms competing in each market. If, however, leading firms have market power before opening, globalisation gives them a larger market in which to exert that power. And if features of the market, including large fixed costs to export and/or productivity gains derived from exporting (which is typically done by a relatively small number of mostly larger firms), convey advantages to leading firms, then globalisation will tend to entrench the position of those firms. Such an entrenchment of the position of dominant firms may, at least in some industries, be contributing to a widening of the wage distribution and a rise in capital’s share in income – rising market power implies increasing rents accruing to capital. While care should be taken not to confuse market gains by more competitive companies and abuse of dominant positions, there is evidence that economies of scale may be a greater challenge for maintaining competition than previously realised.

47. This is an area that is difficult to measure and will require further research and analysis, but evidence is starting to build up of new dynamics. Autor et al. (2017) present some evidence for the United States in industries experiencing a rise in concentration, labour shares fell more than elsewhere. Moreover, they report an increase in concentration across all sectors between 1982 and 2012. And Berlingieri et al. (2017) find that globalisation and digitalisation are associated with higher wage divergence between firms within any given sector. Such divergence is found to be a greater source of growing inequality in labour income than growing differences within firms or across sector averages.

48. The digital sector is one where market dynamics deserve to be further researched **in view of the importance of the sector for future economic growth. While there is little doubt that the digital sector has** allowed many small start-ups to thrive, outcompeting old businesses in long-stagnant sectors, creating new business models and sometimes wholly new activities, or enhanced **consumer choices through internet search and ecommerce, some features of the sector can favour the emergence of dominant firms.** Scale without mass, coupled with the global reach of the Internet, allows firms to expand globally in a short time, even with limited human resources and tangible assets. Fixed costs are typically

significant but marginal costs close to zero, ensuring important economies of scale at least in some parts of the industry. In addition, the complexity of technologies may have increased the sophistication of complementary investments required for the successful adoption of new technologies. It is also possible that we are entering an era in which know-how is more difficult to acquire making it harder for other firms to catch up.

49. This tends to lead to the polarisation of production, with industries characterised by a few productive giants and a myriad of low-growth small firms. This is important not only for industrial dynamics, but also for employment and well-being. Wage and productivity dispersions appear intrinsically linked.

50. While some effects of digitalisation are undoubtedly democratising – giving a voice to the previously disenfranchised and allowing people to connect and participate in entirely new ways – consolidation around a few platforms or applications could also lead to new concentrations of influence. In particular, **the digital economy opens significant challenges for competition and its intersections with data protection and consumer policy. While Big Data can improve competition by increasing innovation and the creation of customised products, it can also become an asset or input used by firms to enhance their market power and engage in exclusionary practices.** Another issue is that digital technologies have made possible new business models which may derive competitive advantages by falling outside existing labour and social protection regulation.

51. **Ensuring market competition and an open Internet so that digitalisation can bring its full benefits are the priorities that require a closer look.** Understanding more about these dynamics and their key determinants, and the way they shape industries, trade, jobs, economic performance and well-being through improving the measurement of the digital economy and deepening the analysis of the challenges and opportunities created by digitalisation is the objective of OECD's *Going Digital* Horizontal Project.

52. **Another case is finance. Financial intermediation is crucial to the functioning of a market economy, facilitating the efficient allocation of capital and economic growth. At the same time, there is evidence of growing market power for leading financial companies.** For instance, in the United States Autor et al. (2017) found that the sales concentration ratio among the top 4 firms increased from 24% to 35% in finance between 1982 and 2012.

53. **And OECD research suggests that rents earned by financial companies accrue to both capital and labour in this sector.** The financial sector in most OECD economies has been characterised by high profitability and very high earnings (Denk and Cournède, 2015). The financial sector pays wages which are above what employees with similar profiles earn in the rest of the economy. This premium is particularly large for top income earners. New evidence for 18 European countries shows that finance and insurance is the industry most disproportionately represented among the top 1% income earners, followed by manufacturing and wholesale and retail trade (Denk, 2015).

54. A possible reason for growing concentration and market power in finance is that this industry exhibits increasing returns to scale, and some academic research finds evidence to that effect, including for the largest firms (e.g. Wheelock and Wilson (2012), Feng and Serletis (2009), Hughes and Mester (2013)). However, when account is taken of the implicit subsidies associated with some firms being too big to fail, evidence of scale economies for banks above some threshold tends to disappear (Davies and Tracey (2014)).

(v) Market distortions

55. **Another phenomenon, the rise in cross-border cartels, might also have contributed to limiting competition at the global level and accruing rents in some sectors.** These cartels reduce the benefits from globalisation for productivity growth and consumers, especially for low-income families. The scale of the issue is significant: 240 cross-border cartels were detected and fined between 1990 and 2015, with affected sales totalling approximately USD 7.5 trillion (Connor, 2016). With an estimated average overcharge of approximately 20% (Connor, 2016), this translates to a total of USD 1.5 trillion in rents extracted from consumers, including in consumer staple sectors such as pharmaceuticals. Some harmful export cartels, which benefit from competition law exemptions in their home jurisdictions, can have similar effects on consumers in importing countries. Cartels are more likely to be formed when goods are homogeneous, there are multiple market interactions, fixed costs are high and demand is relatively inelastic. The repeated formation of cartels has been observed in several sectors with these characteristics, including construction, manufacturing, transport services and finance, insurance and banking.

56. **While cross-border trade can make the formation of cartels more difficult by injecting new competition into markets, it can also broaden the scope, and therefore the impact, of firm collusion.** This can create challenges for competition authorities, whose jurisdiction may not match the reach of international cartels. As a result, there is a need for investigative cooperation, effective information sharing and sufficient competition authority resources to tackle cross-border anticompetitive conduct. In particular, competition authorities may benefit from sharing confidential information obtained during investigations with other affected jurisdictions, as well as the application of positive comity principles to decisions in anticompetitive conduct cases. In some cases, there may be an opportunity for the organisation of multi-authority investigations, with a single authority designated as “lead authority.”

57. **Competition promotion can also address global market distortions resulting from regulatory restrictions or advantages granted to some state-backed firms.** In particular, regulations can inadvertently encourage collusive behaviour or the acquisition of market power, by creating barriers to entry and facilitating firm cooperation, with negative effects that may spill over beyond the jurisdiction in question.

58. The international competitive landscape can also be compromised by the activities of some state-backed commercial entities, artificially lowering prices or expanding their capacity. **The maintenance of a level playing field among state-owned and private businesses amid rapid internationalisation of SOEs remains a challenge** (OECD 2017f). In some countries with weak corporate governance standards for SOEs, SOEs benefit from preferential domestic treatment by their government owners, including weak budget constraints, concessionary financing and privileged domestic market positions. They also often benefit from relatively cheap finance from commercial lenders perceiving an implicit government guarantee. While this may be justified within their national jurisdiction based on the public services these SOEs are expected to perform, the internationalisation of their operations puts at risk the maintenance of a healthy competitive environment.

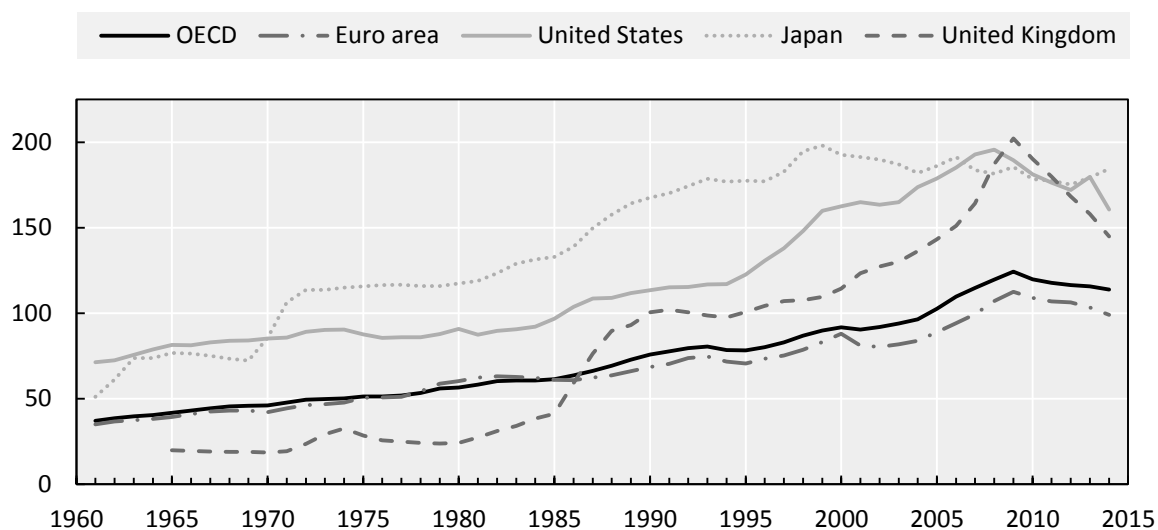
(vi) Financialisation

59. **OECD and other research confirm that credit and a well-functioning stock market are crucial for economic growth and that economies gain a lot from financial sector. Many emerging economies still lack a fully functioning financial sector to support their economic growth. At the same time, excessive credit creation can lead to financial fragility, making effective regulation and supervision critical.**

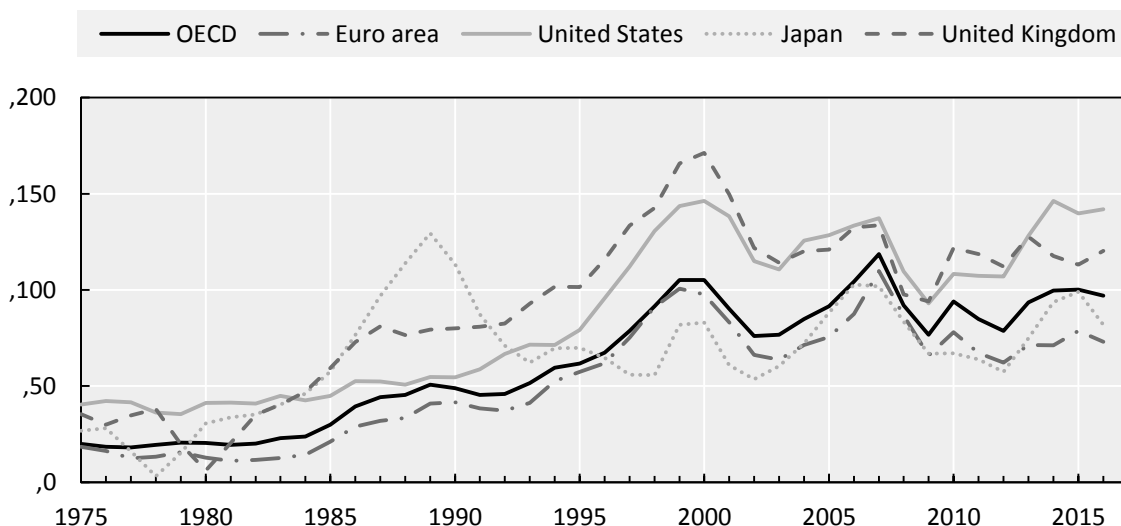
60. **OECD countries have experienced a strong trend increase in the value-added share of the financial sector over the past half-century. In addition, credit extended by banks and other intermediaries has risen strongly in nearly all OECD countries since the 1960s, on average more than tripling relative to GDP (Figure 10A), although credit-to-GDP ratios did come down after the onset of the global financial crisis as lending activity contracted and write-downs were taken on past loans (Bouis et al., 2013). The amount of stock market financing has also expanded considerably in OECD countries over the past four decades (Figure 10B).**

Figure 10.

A. Private credit by financial institutions over time



B. Stock market capitalisation over time



Source: Update of Cournède, Denk and Hoeller (2015), "Finance and Inclusive Growth", OECD Economic Policy Papers, No. 14.

61. The evolution of financialisation and the circumstances driving it vary by country and time period but globalisation has plausibly facilitated and encouraged these overall trends, and vice-versa.

Domestic financial deregulation and the removal of capital controls in many countries over the past few decades have been associated with a large expansion of foreign exchange trading and cross-border trading of financial assets, rapid growth of financial derivatives and other new products.

62. **There is increasing evidence that there is a threshold at which the private-credit-to-GDP ratio begins to have a negative impact on growth** (Denk and Cournède, 2015, Arcand et al., 2012, Cecchetti and Kharroubi, 2012). There are several possible reasons for such a declining impact of financial activity on growth, including an increasing danger of excessive leverage, resulting in greater risks of financial crises and balance-sheet recessions (Rajan, 2006, Minsky 1974); greater use of proprietary trading and other non-interest income-generating activities which are less growth-enhancing than the intermediation of savings and investment (Turner, 2010; Beck et al., 2013); the overallocation of human capital to the financial sector (Tobin, 1984; Philippon, 2010); a rising share of loans going to households (for consumption) instead of firms (for productive investment; Beck et al., 2012). When the financial sector is well developed, as has been the case in OECD economies for some time, further increases in its size tend to slow long-term growth.

63. **It has also been known for a long time that excesses in credit extension, especially when poorly regulated, make economies more vulnerable to crises** (Minsky 1974, Kindleberger 1978). The rapid growth of bank credit in many economies during the pre-crisis period – most notably as regards mortgage lending in the United States – is one explanation for the global financial crisis that erupted in August 2008. Deep recessions in general, and recessions caused by financial crises in particular, have been found to have “scarring effects” that leave potential growth rates depressed (Reinhart and Rogoff 2009, Blanchard and Summers 1988), and the effects of the crisis itself plausibly have a great deal to do with the slow productivity growth experienced in advanced economies since then. In addition, middle-income households have borne much of the burden of increased taxation to bring down public deficits (sometimes incurred largely to shore up the ailing financial sector). So overall, **there is some reason to believe that financialisation has played some role in the stagnation of disposable incomes in advanced economies following the financial crisis.**

64. **In addition, financialisation has exacerbated income inequality in OECD countries.** Empirical evidence suggests that **more finance in already well-developed systems, in the form of more bank credit or larger stock markets, goes hand in hand with higher income inequality across OECD economies** (Denk and Cournède, 2015). The negative growth effects of further expansion in bank credit from the levels observed in OECD countries are particularly acute at the bottom of the distribution, while simulations suggest that the top 10% benefit. Stock market expansion is linked with stronger household income growth, but the benefits are concentrated at the top, whilst the very bottom of the income distribution is simulated to lose out. These patterns are consistent with the experience on average across OECD countries over the past 30 years.

65. **The distribution of household credit is twice as unequal as the distribution of household income.** International experience shows that, in advanced countries, high-income individuals can borrow more, even relative to income, implying that finance, at the level it has reached in OECD countries, works to concentrate rather than equalise opportunities. In addition, financial institutions help people protect their consumption against temporary changes in their income. But they do so unevenly across the distribution, as a low-income household, lacking collateral, is more likely to be denied credit. **The further expansion of credit in many advanced countries in relation to the size of the economy over the past few decades may have thus widened income inequality by providing people with high incomes with more investment opportunities (including not only financial investments but also investment in human capital).**

66. Given that finance is characterised by some of the most extreme high-end pay and largest intra-firm and intra-sector earnings inequalities, and given also that the financial sector has grown as a share of the economy in most OECD countries in recent decades, its contribution to the widening of overall inequalities of income and wealth is probably significant.

67. Although this is as much related to corporate governance models as to the functioning of the financial sector, another related question related to the **shifts in the remuneration packages of top executives**, especially in the financial sector. Mishel and Sabadish (2012) report that when account is taken of the value of stock options granted to executives, between 1965 and 2011 the ratio of the pay of Chief Executive Officers (CEOs) to typical workers in the United States increased more than tenfold, exceeding 200 in 2011. While in terms of the number of people concerned this remains a limited externality, it plays an important role in people's acceptance of the rules of the game, and also has consequences on firms' investment decisions.

(vii) Declining progressivity of tax systems

68. Tax progressivity is at best one tool among others for delivering more inclusive growth, and different countries reveal varying preferences regarding the degree of tax progressivity. **That said, when assessing the effects of globalisation on inequality, it is necessary to assess the effects of globalisation on tax progressivity in the various countries. And with capital and high-income individuals being both more mobile than other factors and more mobile than in the past, moves to reduce marginal rates of personal income tax and taxes on wealth and capital income in some countries put pressure on other countries to follow suit or see an erosion of their tax base.** Changes in tax systems in the OECD in the last decades, while certainly not only driven by pressures arising from globalisation, have overall favoured the continued relative rise of top incomes. There has been a marked decline in top personal income tax (PIT) rates over the past 30 years among OECD countries. This has been accompanied in certain countries by base broadening to compensate for lower rates. The OECD unweighted average top PIT rate fell from 67% in 1981 to 49% in 1994 and 41% in 2009. However, the decline in top marginal PIT rates has not been uniform across countries (Table 1). In some countries, much of this reduction occurred in the 1980s but in some countries, like France and Germany, governments made more modest and gradual reductions. It is worth noting that the countries that made bigger and earlier cuts also saw bigger rises in the shares of top incomes, although the causal relationship remains unclear (OECD, 2011).

Table 1. Top statutory PIT rates (%), 1981-2014

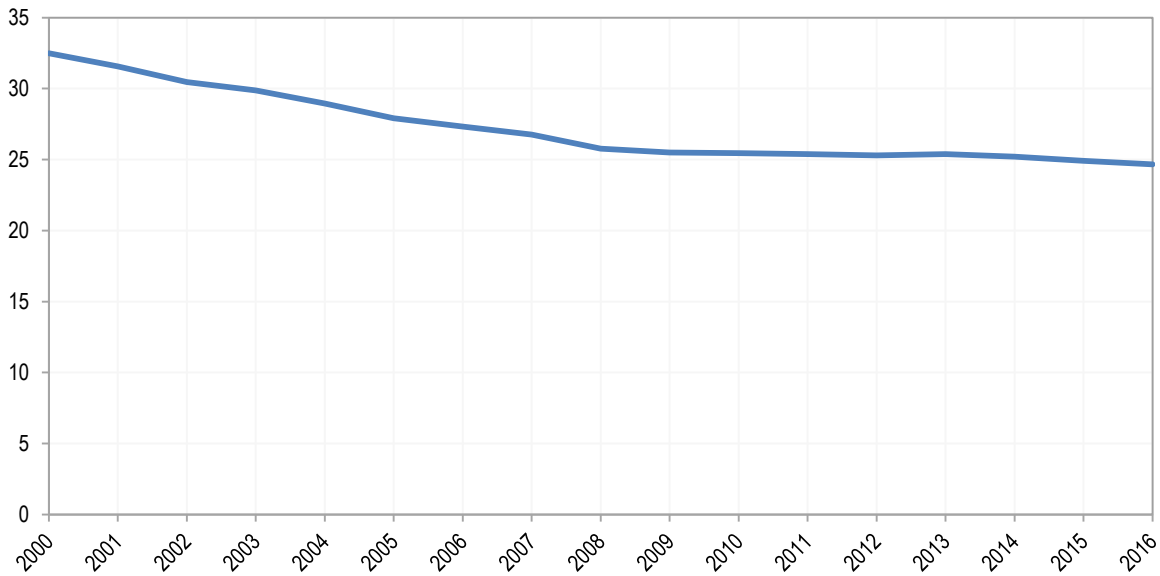
	1981	1990	2000	2010	2014
Australia	60	47	47	45	45
France	60	57	53	40	45
Germany	56	53	51	45	45
Italy	72	50	49	43	43
Japan	75	50	37	40	40
United Kingdom	60	40	40	50	45
United States	70	28	40	35	39.6

Note: Top federal labour tax rates used for the United States. The combined central and sub-central tax rates can be found in Table 1.7 of the OECD Tax Database from 2000 onwards.

Source: OECD Tax Database.

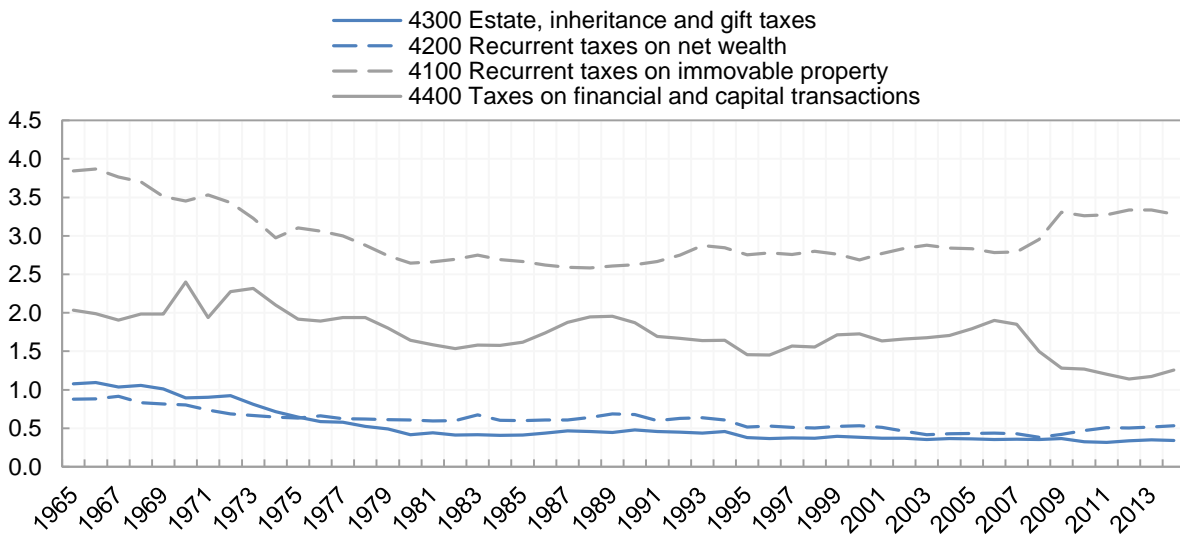
69. Other taxes affecting top income earners have gone down too, lowering the overall progressivity of tax systems (Figure 11) in addition to tax expenditures that tend to favour the wealthiest, although it must be acknowledged that it is difficult to assess the tax base when evaluating these other taxes. Some countries introduced dual income tax systems which tax capital income at flat and lower rates compared to labour income. The unweighted average statutory corporate income tax (CIT) rate declined from 47% in 1981 to 24.7% in 2016 and the unweighted average tax rate on dividend income for distributions of domestic source profits fell from 75% to 42%. Recurrent wealth taxes have been abolished in about a third of OECD countries since the mid-1990s (including Austria, Denmark, Germany, the Netherlands, Finland, Iceland, Luxembourg, and Sweden). In the few OECD countries that still tax net wealth, the tax only applies to a small fraction of the population. Taxation of inheritances and estates has also fallen as a share of the tax mix over the last 40 years. Finally, while inheritance and gift taxes are applied more widely than wealth taxes, several countries have reduced or abolished them since the mid-1990s (Joumard et al., 2012). Overall, total property taxes have fallen from an OECD average of 7.9% of the total tax mix to 5.6%.

Figure 11A. Statutory Corporate Tax Rates, OECD average, 2000-15



Source: OECD Tax Database

Figure 11B. Revenue from selected property taxes, as % of total taxation, OECD average, 1965-2014



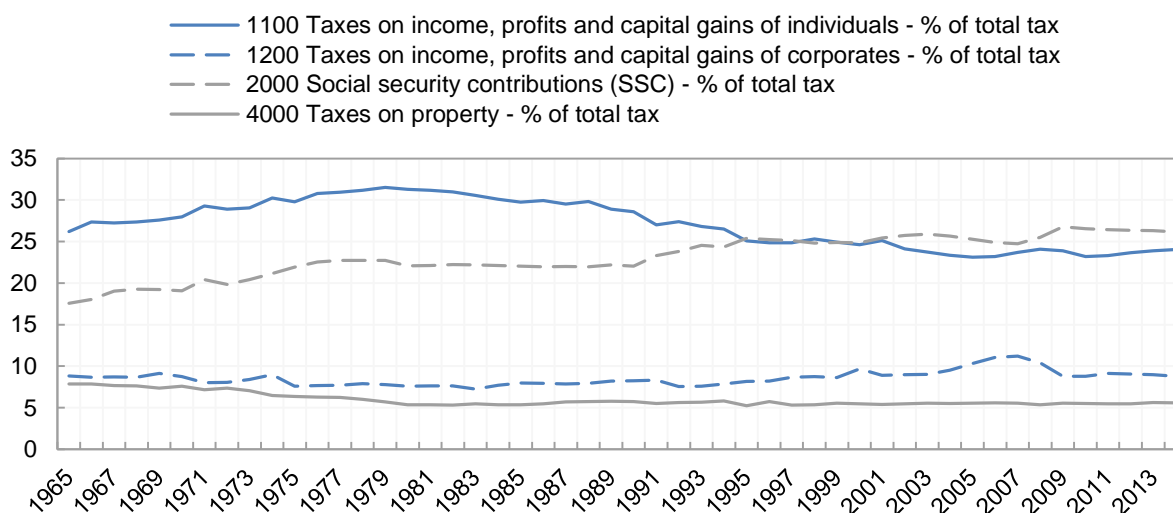
Source: OECD Revenue Statistics 2016

70. **There is evidence that globalisation has played a role in the reduced progressivity of taxation at the top end.** For example, Bartolini et al. (2017) show that with greater openness, CIT receipts react less to changes in rates, implying that for any given rate of CIT, greater openness erodes revenue. Moreover, the paper documents that lower effective marginal rates of CIT result in lower PIT receipts for given PIT rates, suggesting that firms and individuals use incorporation to optimise their tax bill in response to differential CIT and PIT rates, despite the existence of anti-abuse rules in some jurisdictions.

Thus, if international tax competition causes governments to lower CIT rates, they will also tend to be induced to reduce PIT rates to limit revenue losses through such tax optimisation behaviour.

71. The increasing use of more advantageous tax jurisdictions by the more mobile parts of the tax base has also meant that governments have increasingly sought to use taxes on less mobile bases to finance government expenditure (Figure 12). **Social security contributions and payroll taxes have increased by 4 percentage points of GDP in the G7 since 1970, accounting for 57% of the increase in the tax-to-GDP ratio over that period. Hence, expansions in the amount of tax revenue have been financed predominantly through taxes on labour, affecting relatively more the middle class.**

Figure 12. Revenue from selected taxes, as % of total taxation, OECD average, 1965-2014



Source: OECD Revenue Statistics 2016

(viii) Increased use of low or preferential tax jurisdictions for tax evasion and avoidance

72. The trend towards greater capital mobility has been accompanied by the increased use of tax-advantageous jurisdictions as a means to shelter income and assets offshore. Estimates of the size of offshore assets are in the range of USD 6.1-7.6 trillion (Pellegrini et al., 2016; Zucman, 2013). **This has increased tax distortions and reduced the overall progressivity of the tax system.** At the same time, tax competition has not been confined to capital income. There is evidence that jurisdictions are engaged in tax competition not only with respect to CIT, but also with respect to the personal income tax system, creating tax incentives to attract the tax residency of high-net-worth individuals for tax purposes, with a view to taxing their personal income tax at low rates (Kleven et al., 2013). This also drives down top tax rates.

73. Profit shifting and tax avoidance by some MNEs may have contributed to rising market concentration. Empirical evidence suggests that industries with a strong presence of tax-planning multinationals tend to be more concentrated than other industries. Large multinationals seem to use their tax savings to crowd out other firms and ultimately obtain higher mark-ups (Sorbe and Johansson, 2016). Although data are limited, estimates suggest that between 4% and 10% of global corporate income tax revenues, i.e. USD 100-240 billion annually (OECD, 2015b) are lost as a result of base erosion and profit shifting. Tax planning reduces the effective tax rate (ETR) of large MNEs by 4-8½ percentage points on average compared with the ETRs of domestic group entities with similar characteristics. The reduction

is even greater for very large firms and firms intensive in the use of intangible assets. Small MNEs also engage in tax planning, but to a lesser extent (OECD, 2015b).

4. HOW TO RESHAPE GLOBALISATION TO ENSURE THAT IT CONTRIBUTES TO MORE INCLUSIVE GROWTH

74. The previous sections have shown that the benefits of international economic integration are clear and large but also that there are some mechanisms through which globalisation, together with the intertwined process of technological change, may have aggravated problems that have been the focus of recent discontent in many OECD economies. **Top-earners have prospered in the era of rapid globalisation and the economic prospects for the lower deciles of the wage distribution have decreased in many advanced economies. Government policies have been unable so far to redress the situation in a satisfactory manner.**

75. **The fact that global exchanges need to be preserved and enhanced, together with the finding that some current globalisation processes have plausibly contributed to a range of problems that are causing popular discontent, provides good grounds for seeking to reform those processes to ensure more inclusive outcomes of globalisation.** For unless the various sources of dissatisfaction with economic globalisation are addressed, there is a strong risk that political pressure to unwind at least some aspects of globalisation will be irresistible, putting in danger the large net benefits that have been generated by growing openness to trade, investment and movements of people. **There is uncertainty about the various possible downsides to globalisation – relating to causality, the magnitude of effects and the size of contributions from globalisation per se versus other factors – but in current circumstances it is likely to be worthwhile to address the problems even before such uncertainty is resolved.**

76. **While the context for seeking to refashion globalisation is the threat of losing important past gains in the event of a retreat from international economic integration, the effort is only likely to succeed if it is set in the context of a new and better growth narrative that goes beyond the issue of “fixing” globalisation.** The aim of the policy response should be to improve well-being for all in increasingly open and digitalised economies, and to define a more people-centred approach to global rule-making. Going backwards to a less open and less digitalised world is not an option, since it is not only unfeasible but also would not deliver more broadly-based increases in well-being for citizens – on the contrary. The true policy challenge for OECD countries is to advance to a more open and digitalised world in a better way, addressing the shortcomings that have been revealed to date.

77. **Experience and analysis have shown that we need to replace the “growth first, distribute later” approach with one that is more integrated, one in which low-income groups are better placed to contribute to the growth process, and are also able to benefit from it.** We should avoid the silo approach with growth policies determined in one place while social issues are handled in another one. It is about providing people with the means to succeed, in line with the Productivity-Inclusiveness Nexus approach developed at the 2016 MCM.

78. **The drive for deregulation at the domestic and international levels, while bringing positive benefits in terms of growth, innovation and technological progress, has hit people and firms that were not well placed to compete in the global markets.** Relying on few metrics (such as GDP per capita) that provided with average information and on models that did not capture well the complexity of the global economy, has led to the adoption of insufficient or non-well-tailored policies that did not avoid the latest major economic crisis nor the increase in inequalities.

79. To the extent that there are some mechanisms through which globalisation and digitalisation are exacerbating inequalities, **the government’s role in ensuring equal opportunities is even more crucial in open and digital economies, while its leverage in terms of policy making is diminished. There is a need to ensure that this role evolves in such a way that the state can meet contemporary challenges and empower people.** One aspect of this is to prevent disadvantage being transmitted across generations,

which means not only removing barriers to opportunities but also furnishing people with the capacity to seize them. Investments in vital areas like education and healthcare should be seen as investment in people, helping them to live meaningful lives, which will also enrich and improve the lives of others.

80. **Also key is the question of the extent to which national states should work together to influence how globalisation works.** One challenge in this respect is ensuring that the process of designing international rules and standards is seen as having sufficient democratic accountability and safeguarding national sovereignty. With a few exceptions, such as the European Parliament, democracy is exercised at the national and sub-national level. One aspect of the rising tide of discontent about globalisation has been the perception that its design reflects the interests of a few rather than average citizens, and a related complaint is that the freedom of national governments to act to address citizens' concerns has been hemmed in, whether by international commitments or by the power of multinational enterprises.

81. It should be recognised, however, that **even if a country does not voluntarily pool any of its sovereignty to cooperate with others, national freedom for policy manoeuvre can still be constrained by globalisation.** The mobility of capital and high-income individuals, for example, means that making the tax system more progressive at the top end may be difficult to achieve without economic distortions. The notion of complete national sovereignty in a global and digital world is illusory. Rather, the choice is over how the domestic economy will be affected by developments in the rest of the world.

82. A number of ideas for policy action to develop a new narrative based around inclusive growth follow. These ideas draw on lessons learned from a wide range of OECD work, including NAEC, the *Inclusive Growth Initiative*, the work on the Productivity-Inclusiveness nexus and the *Next Production Revolution*, in addition to more specific sectoral work in particular on trade, investment, taxes, competition, anti-corruption and illicit trade. They form the basis for a Framework for Policy Action on Inclusive Growth that could be developed by the OECD as part of the Horizontal Project.

(i) Governments' domestic policy actions to enhance inclusive growth in open economies

(a) Improving people's ability to cope with change and succeed in a globalised and digital world

83. As discussed earlier, one focus of attention for those questioning globalisation has been the displacement of firms and workers in parts of the advanced economies. **The traditional approach to mitigating this sort of "transitional" cost associated with greater openness is to provide temporary income support to those who lose their jobs (combined with incentives for them to seek new work) and to improve education and training to allow displaced workers to quickly find new jobs at similar wages and conditions. But the finding that such costs have been larger, more localised and more durable than previously thought, and that this is one source of disaffection with globalisation, suggests that in many countries these approaches have not, in practice, been sufficient to address the problem.** In fact, benefit systems, like tax systems, have tended to become less progressive (Causa and Hermansen, 2017), with cuts to benefit levels, a tightening of eligibility rules to contain expenditures for social protection and a failure of transfers to the lowest income groups to keep pace with earnings growth (OECD, 2014 and 2015a).

84. Better assessing social protection systems is needed to evaluate what improvements should be made for the world of the future. And in some cases the task of making such improvements can itself be complicated by the process of globalisation.

85. **Entitlements should be linked to individuals rather than jobs** so that they can be portable from one job to the next. In the United States, Social Security accounts are already "multiemployer",

although they remain difficult to extend to platform work since they result from bargaining between unions and employers. France recently introduced the *Compte personnel d'activité* which allows workers to preserve accumulated training rights throughout their careers, even when they switch employer.

86. This approach would also encourage labour mobility, which has been declining in some OECD countries. **Countries will also need to determine whether their employment protection framework needs to be updated and adjusted in order to provide some form of minimum employment protection for all workers, without stifling innovation in the way work is organised and carried out.** For many countries, expanding access to unemployment benefits to workers in non-standard forms of employment is likely to be an important aspect of this.

87. Providing people with adequate income support in the case of negative contingencies is vital, but it is not enough. **What is needed is a state that serves its citizens by empowering them;** social protection systems must become social enabling systems. Part of this is ensuring access to good quality health and education for everyone, strengthening opportunities for the most disadvantaged. This includes in particular more attention to early childhood and education policies, providing opportunities to develop socio-emotional skills in education, and better support to disadvantaged students. It also means that the provision of social protection should be designed in conjunction with training and activation measures aimed to maximise the chance of re-employment and minimise disincentives to work. Effective activation frameworks should foster employability of displaced workers and expand their set of opportunities to be placed and retained in appropriate jobs, while also motivating them to actively pursue employment. Preventive activation measures should also be devised to take into account risks of job loss in different sectors, and provide workers with information and support ahead of their potential displacement.

88. The fact that some places have higher concentrations of inequality and low-skilled people calls for **locally adapted skills policies**. While in manufacturing and resource extraction sectors workers with lower levels of education can still achieve high levels of productivity, those same skills are not easily transferrable to tradable services that rely mainly on knowledge-intensive jobs. Smoothing the economic transition from manufacturing or resource extraction sectors to knowledge-intensive services is not straightforward and requires substantial adjustments in the skills of the existing and incoming workforce. This is among the main challenges for addressing the geography of discontent, as within regions, even those that are catching up, some individuals are nevertheless left behind.

89. **Insufficient or outdated skills are a more common barrier that needs to be addressed for the unemployed and employed alike.** Access to life-long learning is, however, typically most difficult for those with the greatest skill-related barriers. Because employers have a good sense of their skills needs, subsidies for training existing employees are most often paid to employers, and not to workers directly. However, low-skilled workers tend to receive much less training than their high-skill counterparts, and often remain stuck in poor quality jobs with low earnings, little job security and poor career prospects. Targeting training directly to such workers, often referred to as “retention and advancement” programmes, can increase their chances of retaining their existing job or moving to a higher quality one. Evidence from existing programmes (e.g. sectoral training programmes in the United States such as WorkAdvance, targeted training in Germany for workers employed in professions that are unrelated to their qualifications), show that they often target skills or occupations in high demand in the labour market.

90. To identify and foster the development of the skills needed to thrive in global labour markets requires understanding the new business models enabled by the digital transformation and by global production platforms, and to identify the conditions needed for an effective use of such platforms. Together, digitalisation and globalisation are challenging existing labour market institutions and models of social protection. Many countries were already struggling to provide adequate social protection to non-standard workers; the advent of the platform economy has added to these difficulties, increasing the

number of workers who only work occasionally and/or have multiple jobs and income sources, with no statutory working hours or minimum wages.

91. While improving existing systems of social support and activation would undoubtedly be useful, the question arises whether sustaining globalisation and reaping its efficiency dividends through broadly based gains in well-being requires considering new and ambitious ways of addressing the drawbacks that have been found to accompany it. **A more radical approach to ensuring that all citizens are protected from income insecurity would be to introduce a basic income guarantee or universal basic income (UBI), i.e. an unconditional income transfer that would replace other forms of public transfers without any means-testing or work requirement.** Such a possibility is being discussed in some OECD countries, and local experiments have been launched in a few.

92. A UBI has a number of advantages over existing social protection schemes. It is less prone to leave gaps in coverage, since there is no means testing. Benefits are received by all and therefore convey no social stigma. No complex systems for administering benefits and sanctioning abuse are needed. One possible disadvantage is its potential to have an excessively unfavourable impact on labour supply.

93. The major disadvantage is simply that providing a socially acceptable minimum income to all is very costly. OECD calculations confirm that merely replacing existing cash transfers up to retirement age with a UBI in a budget neutral way would imply a level of basic income that is below the poverty line and expose some vulnerable groups to higher risks of poverty. Providing a level of basic income sufficient to eliminate poverty would mean large rises in marginal tax rates.

(b) Boosting inclusive growth through structural reforms and investments in capacity

94. To fulfil promises to today's workers, tomorrow's retirees and the next generation, new sources of inclusive growth will be needed. Harnessing the benefits of the global economy requires domestic policy settings that enable benefits to flow and for people and firms to have the capacity to take advantage of new opportunities. While the precise menu of structural and fiscal reforms depends on each country's circumstances, the following broad aims could be pursued.

95. **Enabling people to seize the opportunities from globalisation requires investments in the capacity, underpinned by sound regulatory frameworks, to connect people to jobs and markets.** Productivity-enhancing public investments not only increase long-term supply capacity, but also boost demand in the short term (OECD, 2016c). With the right regulatory and institutional frameworks, such public spending can increase output by more than they increase debt, especially if they catalyse private investment.⁵ Investment in physical infrastructure, from roads to ports, affects not just economic performance but also social goals, for example by helping people access health and education. It is not, however, only a matter of improving the quantity of infrastructure; quality is equally crucial. Infrastructure with open and fair access, without any excessive differentiation for its use (e.g. on port charges), is an important aspect for achieving sustainable development through enhanced connectivity and further development of global value chains.

96. Additionally, to enable firms to take advantage of new opportunities in the global economy, **reforms can tackle unnecessary trade costs** which pose particular challenges for SMEs and young firms.

⁵ OECD estimates that, in the current environment and with monetary policy unchanged, a permanent investment-led stimulus of 1/2 a percentage point of GDP that would be debt-financed for a few years is estimated to increase output by 0.4-0.6% in the first year in the large advanced economies. Over the long term, output gains can rise to 2%, if the stimulus is financed after 3-4 years through non-distortionary taxes or a cut in other spending, with neither of these factors affecting potential output. See *OECD Economic Outlook November 2016*, p77-80.

Reforms to slow or cumbersome border procedures can cut the costs of trading by 12-18%, depending on a country's level of development (OECD, 2015c). Lower tariffs and trade facilitation reforms mean that more firms, and smaller firms, can benefit from exporting into, or sourcing high-quality inputs from, global markets.

97. **Ensuring access to efficient, high-quality and affordable services** is essential for both firm competitiveness and individual wellbeing. Yet in many of the services that underpin economies, from telecoms to transport and power, competition is limited and the playing field is not level, especially for foreign investors, holding back potential economy-wide productivity gains and stronger growth⁶. Restrictions on services trade impose costs on local firms that make them less competitive in export markets; this impact is estimated to be equivalent to a sales tax of between 3% and 38% depending on the sector⁷, particularly disadvantaging SMEs. Services are key for the performance of manufacturing, accounting for over 30% of the value of total manufacturing exports (up to 40% for motor vehicles and chemicals), and even for food and agriculture, where they account for 24% of the value added in exports.

(c) Facilitating technology diffusion and broadening the gains from digitalisation

98. **Increasing the diffusion of technology and its associated knowledge across the economy would be helpful in helping firms catch up with productivity leaders.** Since most knowledge is created abroad, maintaining **an open system of trade and investment is an essential element** of any effort to increase diffusion (Alvarez et al., 2013). **Migration – particularly of high-skilled individuals – can also help push the frontier** and enhance diffusion. **Brain circulation** – which stimulates knowledge flows, collaboration and ultimately high-impact research – is hindered by visa restrictions (Appelt et al., 2015). To this effect, the implementation of the Ministerial Declaration on the Digital Economy (“Cancun Declaration”) is important to facilitate the free flow of information.

99. **Diffusion of technologies must include the intangible investments and know-how needed to fully exploit technologies, ranging from skills to new forms of business organisation.** Here, the efficient deployment and reallocation of resources is an essential element, as new firms will introduce many of the new technologies and business models. Framework policies must promote product market competition and remove disincentives for firm exit and barriers to growth for successful firms.

100. In order to make better use of new discoveries and increase diffusion of technology, **domestic investment in R&D, both public and private, should be increased in some countries.** Some aspects of new technologies such as artificial intelligence are difficult to codify and require practical investigation before they can be properly incorporated into production processes and thus rely on researchers that can de-mystify “tacit” knowledge. OECD work finds an important role for public research and university-industry collaboration in helping countries learn from the global frontier.

101. **Institutions dedicated to technology diffusion can also help.** Especially among SMEs, a major challenge will be the digital transformation of firms which were not born digital. Institutions with specific remit to aid diffusion, such as technical extension services (which provide information and outreach, especially for SMEs), tend to receive low priority in innovation policy overall, but could play a more significant role if well designed, incentivised and resourced.

102. Special efforts are also required to spread the benefits of digitalisation across the economy. **Broadband policies** designed to improve social inclusion can be a catalyst for expanding the “digital

⁶ See OECD FDI Regulatory Restrictiveness Index.

⁷ Using mark-ups over costs as an indication of the strength of competition.

dividends” which stem from broadband access and use. **Promoting Internet access for all** would help people in rural areas and lagging and disadvantaged groups to benefit from the opportunities offered by digital services. Delivering access for all individuals and businesses at an affordable price requires sound framework policies, telecommunications policies that reflect the need for a wide diffusion of digital networks, and additional measures, such as national broadband strategies, that can help reach disadvantaged groups, firms and rural or remote areas. Ensuring competition, including through market openness, is also key. **Demand-side policies are important too:** facilitating ICT adoption by businesses, creating digital content accessible to local populations, and promoting of digital entrepreneurship can all increase demand and improve digital services.

103. But mere access to digital networks is not enough. **Policy will also need to help equip people with the skills to use the technology, enable complementary investments in organisational change and process innovation, and foster competition and sound firm dynamics.**

(d) Reconsidering the decline in progressivity in the national tax systems

104. The decline in the progressivity of income tax at the top end, the drift away from taxation of wealth and capital income, including through tax benefits, and the shift of the burden of taxation towards labour in many OECD economies, while often introduced to strengthen productivity and economic growth, have also had the effect of hindering the growth of real disposable income for those in the bottom 40% of the income distribution while favouring the growth of income and wealth at the top end. In view of the effects of inequalities on growth (OECD, 2015a), this is naturally a trend that also requires consideration. However, the level of progressivity of the overall tax-benefit system is a matter of national preference ; moreover, government may favour a different balance between redistribution through taxes and redistribution via social benefits.

105. As already noted, globalisation may have played a role in the downtrend in tax progressivity in OECD countries over the past few decades, and international tax competition may limit governments’ ability to reverse that trend. Nonetheless, **some tax reforms could both increase progressivity and further economic efficiency.** Moreover, it is unlikely that a strategy for inclusive growth, aiming at improvements in multi-dimensional well-being for all groups, can succeed without some rebalancing of the tax burden so as to provide greater equality of opportunity. Another benefit of strengthening the taxation of those at the top end of the income and wealth distribution is that women, minorities and other disadvantaged groups are underrepresented, so that the redistribution also addresses a number of societal imbalances.

106. **Many possibilities exist for restoring some of the lost progressivity in tax regimes, and further international cooperation on the taxation of mobile tax bases would also help.** Should individual countries favour greater tax progressivity at the domestic level, the recent move towards the automatic exchange of financial account information for tax purposes between tax administrations gives them greater room for manoeuvre to revisit the way they tax savings at the individual level and shift some of the capital income tax burden from the corporate to the individual level. Other measures could include increasing the progressivity of the personal income tax, introducing or increasing taxes on capital gains, levying recurrent taxes on the market value of immovable property, and introducing or increasing recurrent taxes on net wealth. Another option is to remove regressive tax exemptions, such as the common practice of offering mortgage interest tax relief.

107. **The fact that labour tends to be taxed more heavily than capital not only directly contributes to inequality (since capital income is generally more unequally distributed than labour income) but also implies a higher tax burden on SMEs, since smaller firms tend to have more labour-intensive production processes than large firms** (OECD, 2015a). The burden of labour taxation

could be eased by unifying general taxation and social security contributions. This also has the potential to improve incentives for both labour supply and demand. Earned income tax credits at lower incomes can also improve progressivity of the system and encourage labour force participation.

(e) Better gender policies

108. In 2015, recognising that gender equality is a cornerstone of inclusive growth but that progress towards that goal remained slow, the OECD Council passed a Recommendation on Gender Equality in Public Life. The first progress report since that decision confirms that further progress on gender equality has been made, reaffirming the relevance and utility of the Recommendation, but observes that much remains to be done to narrow – and eventually close – gender gaps. Adherents to the OECD Gender Recommendations must extend recent progress through sustained campaigns, monitoring and evaluating policies, exchanging best practice, optimising legal measures and public investment. **Countries should build on good practices such as the various STEM initiatives across the OECD; experiences with developing a work/life balance supports with parental leave and ECEC for parents with children in Nordic countries and France; the many pay transparency initiatives to reduce gender pay gaps; different policy pathways towards greater representation of women in public and private leadership; efforts to obtain a better sharing of paid and unpaid work among partners in Germany (OECD, 2017c); initiatives to improve access to finance for entrepreneurs; and efforts to promote good governance for gender equality in Mexico (OECD, 2017d).**

109. No single road leads to gender equality, and the “best” policy options are country-specific; policy changes should reflect existing gaps in gender equality and will be influenced by broader institutional, historical, and cultural contexts. Given the prevailing gender gaps, all countries should continue to implement and strengthen the policies embedded in the OECD Gender Recommendations.

(f) Small and medium-sized enterprises

110. There is a strong case for better enabling SMEs to enhance their productive capacities and increase their participation in the global economy, recognising the multiple contributions small businesses make to inclusive growth. Innovative start-ups and young firms contribute disproportionately to job creation, and established medium-sized enterprises that innovate and scale-up are the driving force behind growth in many OECD economies. There are also many viable small enterprises in manufacturing and ‘low-tech’ sectors with strong potential to increase their contribution to growth, employment and social inclusion, if enabled to strengthen their management skills, upgrade their workforce, access external finance, join business networks, introduce small-scale innovations, and consider exporting opportunities.

111. **While some SMEs are at the productivity frontier and are amongst the most innovative companies jump-starting entire new industries, many others lag in the adoption of digital technologies and are far from the productivity frontier.**

112. Enabling SMEs to boost their productivity growth requires addressing the market and institutional failures that create a non-level playing field for businesses. In particular, there is a need to pay closer attention to potential synergies and trade-offs across policy areas, and to regulatory uncertainty, complexity and inconsistency, which affect SMEs disproportionately. This calls for a cross-cutting approach which recognises the heterogeneity of the firm population.

113. Some SMEs lack the necessary human or financial resources which can spur productivity growth (OECD, 2017d). For many start-ups and SMEs, credit access and conditions deteriorated in recent years, and access to long-term finance in the appropriate forms continues to be hampered by a range of demand- and supply-side obstacles (OECD, 2017e). For instance in the EU, only 2% of SMEs access equity

financing and only 1% finance investments through debt securities (SAFE, 2016). Implementation of the G20/OECD High-Level Principles on SME Financing can help address SME financing gaps by strengthening SME access to traditional bank financing and supporting the diversification of financing instruments and channels for these firms (OECD, 2015d).

114. **Fostering SME integration in global markets is especially important.** SMEs with access to larger markets and wider business networks perform better in terms of innovation, knowledge spillovers and technology diffusion. Lack of information and resources to scope new markets, build partnerships and scale up are typically important barriers to SME internationalisation. Also, insufficient access to finance and workforce training place many SMEs at a competitive disadvantage in the global and digitalised economy. Policies that facilitate access to finance and SME engagement with competency centres and/or technology extension services can be helpful in this regard.

(g) Better integration of immigrants

115. **Measured against most indicators, immigrants enjoy worse socio-economic outcomes than the native-born on average.** Some exceptions are noticeable with regard to employment rate, labour force participation rate, share of self-employed and perceived health status. With regard to access to the labour market, immigrants tend to make greater efforts to compensate for any disadvantage in the labour market and tend to accept jobs that do not always match their skills leading to a significant overqualification rate (10 percentage points higher than for the native born). Differences between immigrants and native-born remain large, OECD and EU-wide, in a number of other areas as well, including job skills (share of migrants with only basic literacy skills 19 percentage points higher than the native born), relative poverty (13 percentage points higher than among the native born) and household overcrowding (10 percentage points higher than for the native born – OECD/EU, 2015). The prospects for migrants also depend on their status, with labour migrants having better prospects than more vulnerable migrants such as humanitarian migrants and asylum seekers.

116. **While integration systems have substantially improved in many countries in recent decades, much remains to be done to make sure that migrants, and especially for vulnerable migrants such as refugees to become fully integrated members of society.** Lessons learnt from the past show the importance of **training and education for the outcomes of migration.** Higher levels of education for children of immigrants greatly enhance their employment rates, and training is particularly beneficial for immigrants. Studies also show the need to provide specific services to vulnerable migrants related to activation and integration services, labour market access, provision of settlement in areas with the best job prospects even if housing prices are relatively higher, tailor-made approaches, support to mental and physical health, support programmes specific to unaccompanied minors who arrive past the age of compulsory schooling (OECD, 2016e).

(ii) Governments' sub-national policy actions to enhance inclusive growth in open economies

117. Given the existence of large regional imbalances currently, and the knowledge that technological change and globalisation will continue to impact different localities differentially, policies need to be re-assessed from a regional perspective.

118. Fragmentation of policymaking across sectors and across levels of government remains an obstacle to the development of policies that are adapted to the complexity of the challenges that we face. Particular care needs to be taken to avoid the entrenchment of vested interests. One aspect of this will be ensuring that policy recommendations take regional and local circumstances into account. Regions and cities have a key role to play by adapting economy-wide policies to the characteristics of local

communities, as well as by promoting local policies that reduce or remove the barriers limiting access to opportunities.

119. A number of things can be done to that end.

120. **Regional development policy approaches should focus on building up a region's own advantages.** A regional policy approach based only on redistribution creates dependency, not development. It also creates tensions within countries, particularly when resources are constrained, as richer regions may become reluctant to support lagging regions. Another challenge to avoid is having regional policies provide disincentives for firms and workers to be engaged in tradable sectors. Policies could also do more to anticipate changes to regional economies to reduce future adjustment costs, such as through Finland's "Proactive Structural Change" programme.

121. **Urban development policies should seek to improve how cities function and how they are linked as a system.** Many OECD countries are seeking to develop national urban strategies and/or are creating ministries or new committees to address urban issues. While national urban policies have typically focused on reducing the social and environmental costs in cities, they have paid less attention to the economic role of cities and their relations in a network of cities that supports growth with their hinterland and nation-wide. In addition, the development of cities and the mismatch between administrative borders and the scale of commuting and other flows requires better metropolitan governance arrangements to overcome the productivity penalty associated with municipal fragmentation (6% for a doubling of fragmentation, only 3% if there is a metropolitan governance body – OECD, 2015e) as well as the negative impacts for inclusion, such as residential segregation by household income.

122. **Rural development policy approaches should go beyond a narrow focus on agriculture.**⁸ Non-farm economic activity represents a large share of rural economies. In an increasingly digitalised world, access to broadband is therefore critical for firms and people in more peripheral locations to benefit from openness. Policies for rural areas, by targeting them in isolation, often neglect ties between rural areas and cities. The importance of local community engagement, including the private sector and civil society, also needs to be recognised in such policies.

123. **Employment and skills policies should provide sufficient latitude for places to respond to local labour market challenges.** There is considerable diversity in the occupational and industrial profiles of local economies, which impacts their ability to create jobs and diversify into new economic opportunities. Many OECD countries are seeking to build the implementation capacities of local employment services and vocational education organisations to ensure that they are connecting people to quality jobs, while also developing skills that are well aligned to the world of work. Mayors and other local government leaders can foster strong partnerships with employers to build a skilled workforce that is adaptable to technological change, including digitalisation.

124. **Local strategies for entrepreneurship and innovation should respond to locally-specific barriers to economic diversification and adjustment.** Entrepreneurship and innovation are critical drivers of regional competitiveness and growth. They are fundamental in enabling the adjustment of regional economies to global and national structural change. There can be many locally-specific bottlenecks to industrial diversification, in areas such as skills development, the environment for entrepreneurship, and networks for knowledge exchange. Local strategies need to identify and respond to these barriers. This is particularly important for low-income and declining regions, where greater policy efforts are likely to be required in order to reduce spatial disparities.

⁸ For a description of elements of rural policy 3.0, see Chapter 4 of OECD (2016d).

125. **The governance arrangements to manage regional and local development (the “how”) can be as important as the policy itself.** Reforms of regional and local governments can also lay the groundwork to improve conditions for productivity and social inclusion. Of particular importance is the need to foster policy co-ordination across sectoral areas, vertically across levels of administration, and horizontally among jurisdictions at the same level of government.⁹ The Council of Australian Governments is an example of a governance arrangement to support such policy co-ordination.

126. **Sectoral policies and structural reforms can have greater impact if complemented by regional development policies and local programmes.** Pro-growth structural reforms, and those to support digitalisation and openness, affect leading and lagging regions differently. For example, removing barriers to entry in product markets of particular sectors will have a greater impact on those regions with a greater specialisation in the economic sector being regulated. Labour market regulations, measured by indicators of employment protection, have a stronger effect on rural regions because of their thinner labour markets. Improved transport options can increase the effective size of a local labour market and can complement a particular labour market reform to increase its impact, notably in cities (OECD, 2016d and D’Costa et al., 2016). Many of these issues, particularly for low-skilled workers, may involve efforts to tailor worker training to the needs of firms located in their region.

127. There are several things the OECD can do to help. One is to improve the breadth of data available for regions and cities in OECD databases to go beyond national averages and better track economic performance and the well-being of residents in all places. Another is to further assess the effectiveness of different types of regional, urban and rural and local development policies on regional performance, including the role of local employment, skills, entrepreneurship and innovation policies. Finally, it will be important to understand how the organisation of governments across all levels, including fiscal arrangements, can underpin better capacity of regions to manage their response to the changing global landscape. **Regional and local governments are in charge of 40% of total public spending and 60% of public investment in the OECD on average.** The OECD can help further support all levels of government better assess the strengths and weaknesses of their investment capacity and set priorities for improvement.

(iii) Actions at the international level

128. The greatest challenges countries face today transcend national borders. The threats posed by climate change, excess capacity in some industrial sectors, disease epidemics, terrorism, tax evasion, rising protectionism and illicit financial flows, as well as the crises generated by social and economic unbalances all have global causes and effects. Coordinated action is more than ever necessary to redress the view that globalisation has undermined governments’ ability to implement policies that benefit all fairly and to level the playing field, as well as to address common challenges, manage global goods and ensure shared prosperity and security.

129. However, finding common approaches on a multilateral level, always a challenging task, is perhaps more difficult now than it has been in a long time. Facing growing discontent with globalisation and scepticism with established institutions from their citizens, some countries are shifting further away from multilateralism, reinforcing a tendency to regional, bilateral, and unilateral approaches. The rules-based multilateral trading system embodied in the WTO is critical in levelling the playing field in international trade, allowing trade relations to be governed by agreed rules rather than the law of the jungle, providing the certainty and periodic market opening that has underpinned the growth in world

⁹ The *OECD Recommendation on Effective Public Investment Across Levels of Government* and its accompanying toolkit for implementation recognise the importance of governance for effective implementation.

trade. Continued support for the WTO is critical, and the best way to support the system is for countries to implement their commitments. Moreover, in this context, transparent and inclusive global economic cooperation tools, as well as effective implementation, are essential to rebuild trust in public action and in the multilateral system.

130. In this context, multilateral approaches continue to be the only avenue which allows all countries to have a voice. Alternatively, plurilateral, and regional arrangements should be designed to be as open and transparent as possible, allowing for additional countries to join, as and when they are able. There is much unfinished business in the international trade arena. Progress on agriculture, on trade facilitation and on removing or reducing restrictions on services trade, all have potential to spur growth, while being inherently pro-poor.

(a) Broadening OECD international standards¹⁰ and making them more effective

131. International cooperation on setting rules of the game, both for economic activities and in other spheres, has proved its worth on many occasions. Prominent recent examples include the adoption of the 2030 agenda, the Paris Agreement on tackling climate change, and the setting up of the Global Forum on Steel Excess Capacity. The OECD has a significant role to play in ensuring successful implementation of all of these initiatives.

132. **Despite the numerous successes of such cooperation, the threat of a damaging retreat from globalisation suggests the need to reform and strengthen some of the mechanisms through which it is advanced.** The system of international rules needs to be further developed through processes seen by citizens as legitimate, which address some of the shortcomings perceived to date. Such rules should not be seen as widening “democratic deficits” or being imposed on countries with no say in their design and implementation. Process can be as important as content in ensuring broad acceptance, and leaving scope for variation of national preferences within the constraints set by international agreement is important to avoid harmful backlashes.

133. **International organisations are a central pillar of global governance.** Their work supports national efforts to establish rules that support globalisation. Over the last four years the OECD has spearheaded a partnership with 50 international organisations to reflect on and strengthen the evidence base and the internal disciplines that underpin the quality of international norms and standards. This collaborative work has resulted in in-depth stocktaking work (OECD, 2016f) mapping the normative practices of international organisations and identifying areas for collective efforts.

134. International cooperation can take many forms, whether it is legally-binding agreements, voluntary guidelines and codes of conduct, “best endeavour” measures, or simply shared commitments to improve policy transparency and dialogue. There is scope for all such forms of cooperation to improve outcomes. It is clear, however, that there are currently gaps in the framework of international rules. **The relative lack of mechanisms to ensure that such rules are widely respected is a shortcoming in many cases. Globalisation of economic activity has outstripped the globalisation of policy, and this is one source of popular discontent in OECD countries.** At the same time, there is also clearly concern about a perceived loss of democratic control (generally exercised at the national level) and international rules and processes. International governance can be strengthened, but for its mechanisms and institutions to be sustainable it is likely that **more engagement, consultation and transparency will be needed.**

¹⁰ The definition of rules and standards in this section does not refer to the WTO definition, but rather to their meaning in the OECD context.

135. There are numerous domains where scope for more robust international rule-making exists, including several in which the OECD is the leading standard-setter currently. Work is currently being developed to review these standards through OECD Committee structures.

136. **Since its creation in 1961 the OECD has developed some 270 legal instruments to create a more level international playing field.** A number of those standards already reach well beyond the membership, being endorsed not only by OECD countries but also by the largest emerging economies, and in some cases by the majority of countries in the world. Also, some have been endorsed or used as references by other international organisations and global fora. This is the case for the G20/OECD Principles of Corporate Governance, the OECD Anti-Bribery Convention and the OECD Guidelines for Multinational Enterprises. Promising recent examples include the BEPS project, for which the Inclusive Framework was launched in 2016 and which already has 94 members, and the OECD's standard on exchange of information on request, which is being implemented by the 139 jurisdictions members of the Global Forum on Transparency and Exchange of Information for Tax Purposes, 100 of which have also committed to automatic exchange of information.

137. There are several areas where the OECD, through its Committees, could build on its already prominent role to expand international cooperation and help to ensure that globalisation is consistent with agreed minimum standards.

Competition policy

138. **Globalisation can only bring its full benefits in an inclusive manner if competition is fair in a well-functioning market which does not allow economic rents to accrue to some companies and sectors.** Maintaining competition is thus crucial for the outcomes of globalisation in terms of growth and inclusiveness. At the same time, globalised business activity is challenging the capacity of domestic competition authorities addressing global market concentration or international cartels (OECD, 2017fg). While competition authorities around the world have expanded their networks and tools to increase cooperation, **cooperation will need to continue to be enhanced notably in order to prevent businesses from taking advantage of jurisdictional inconsistencies.**

139. This can be done by **ensuring a broad-based adherence to existing recommendations**, and by ensuring a global commitment to common principles and standards with respect to competition promotion, enforcement powers, information-sharing and investigation assistance to handle cross-border legal challenges, as recommended in the *OECD Recommendation concerning International Co-operation on Competition Investigations and Proceedings*.

140. Legal frameworks are needed to enable better sharing of confidential information across borders, as well as to ensure that notification, co-ordination and mutual assistance are enabled in competition law investigations.

State-owned enterprises

141. The globalisation of SOEs brings challenges regarding the maintenance of **a level playing field among state-owned and private businesses (OECD, 2017f)**. It is also increasingly being raised in the context of the regulation of international investment. Relatively few OECD countries maintain screening or review mechanisms for inward FDI, but those that do have in recent years paid increasing attention to the ownership of would-be investors. The issues involve once again maintaining a level playing field, but also national security concerns linked with state ownership as well as the transparency and disclosure of the objectives and operations of companies held closely by foreign governments. **The OECD Guidelines on Corporate Governance of State-Owned Enterprises, following their 2015 revision, contain provisions**

that if fully implemented would address these concerns. However, broader country coverage of the recommendations and the establishment of enforcement mechanisms would help enhance the effectiveness of the Guidelines.

Strengthening business accountability

142. The concerns about international trade and investment are indeed aggravated if the playing field is uneven due to differences in legal and regulatory frameworks for corporate governance and responsible business conduct (RBC), or in their effective implementation and enforcement. There has been much **progress with respect to the promotion and uptake of RBC standards in recent years, but major gaps in approaches and coverage across countries and sectors persist.** While RBC standards primarily intended to maximise the positive contribution of business to sustainable development, and to minimise adverse impacts, there is also a considerable body of evidence showing that RBC is good for businesses. And while many companies are embedding RBC in their practices, some companies are still perceived as operating irresponsibly or with scant regards for stakeholders and affected communities. Irresponsible conduct by some companies can not only give rise to risks for these companies, but can also lead to competitive disadvantage between companies e.g. when competitors engage themselves or through their suppliers in irresponsible practices, such as using child labour or ignoring environmental safeguards. The uneven level-playing field in this regard represents a threat to businesses, societies, and ultimately to globalisation itself.

143. Governments have been developing innovative policy initiatives aimed at filling these gaps. **The OECD has played and continues to play a central role in promoting RBC, through the Guidelines for Multinational Enterprises, which form part of a broader OECD instrument, the Declaration on International Investment and Multinational Enterprises, as well as its more specific due diligence guidance for responsible business conduct in specific sectors, including the minerals, extractive, agriculture, garment and footwear, as well as the financial sectors.**

144. By enlarging the membership of the OECD Declaration on International Investment and Multinational Enterprises and expanding the coverage and implementation of due diligence guidance to all sectors, giving priority to those sectors in which risks to society are the highest, and by working with individual countries to ensure that an enabling policy framework is in place, and with companies and other stakeholders to support implementation of Responsible Business Conduct on the ground, the OECD can contribute to restoring public trust in international trade and investment. Governments and business have a role to play in promoting responsible conduct and thereby protecting and making globalisation work better for people and societies.

Fighting corruption

145. It is often alleged that globalisation increases opportunities for crimes across multiple jurisdictions and the chances of impunity, which is among the factors contributing to public distrust toward international business. The **Convention on Combating Bribery of Foreign Public Officials in International Business Transactions**, which has been ratified by 41 OECD and non-OECD countries so far, was designed to address this "dark side" of globalisation. Under the Convention, the parties are required to criminalise bribery of foreign public officials in international business transactions and to subject themselves to rigorous implementation monitoring. **More work remains to be done to enhance the implementation of the Convention among the existent parties and to encourage all countries participating in the global marketplace to take part in this instrument.** In addition, a wider approach aiming at strengthening integrity continues to be needed to fight against corruption in key areas.

146. **The changes in the international tax environment driven by the OECD/G20 work on Base Erosion and Profit Shifting (BEPS) and Automatic Exchange of Financial Account Information for Tax Purposes (AEOI) can make the international tax system fairer and more transparent by reducing evasion and avoidance, and as such, also contribute to reducing inequalities.** In the future, it could also allow further cooperation with respect to the taxation of capital income. Since avoidance and evasion in the international tax system disproportionately benefit those with higher mobility and wealth, these changes create tax policy opportunities to reduce inequality as well. They also help with the objective of boosting domestic resource mobilisation in low-income countries.

147. International cooperation is essential for continued efforts to crack down on tax avoidance at the international level. Strengthening tax transparency since 2009, in particular with the perspective of introducing Automatic Exchange of Financial Account Information for Tax Purposes (AEOI) has already yielded more than EUR 80 billion through to the introduction by countries of voluntary disclosure programmes and similar initiatives (OECD, 2017g). The introduction of AEOI as well as ongoing efforts to enhance the effective implementation and use of Exchange of Information on Request (EOIR) mark a step change in tax transparency, but further efforts are required. Reducing overall tax avoidance and strengthening growth in an international context also requires implementation of the recommendations of the OECD/G20 BEPS project and the International VAT/GST Guidelines. This will require International Organisations and the more advanced countries to provide assistance in a coordinated manner to those countries that lack the capacity and capability to implement these recommendations on their own.

148. **The tax challenges raised by the digital economy** have been identified in the OECD/G20 BEPS Project. As digitalisation increasingly permeates all sectors of the global economy, crossing national borders and facilitating new business models, international cooperation to confront these challenges will be critical. Work will continue on this issue under the Task Force on the Digital Economy, including by monitoring emerging developments, with an interim report to be delivered by the Task Force by mid-2018.

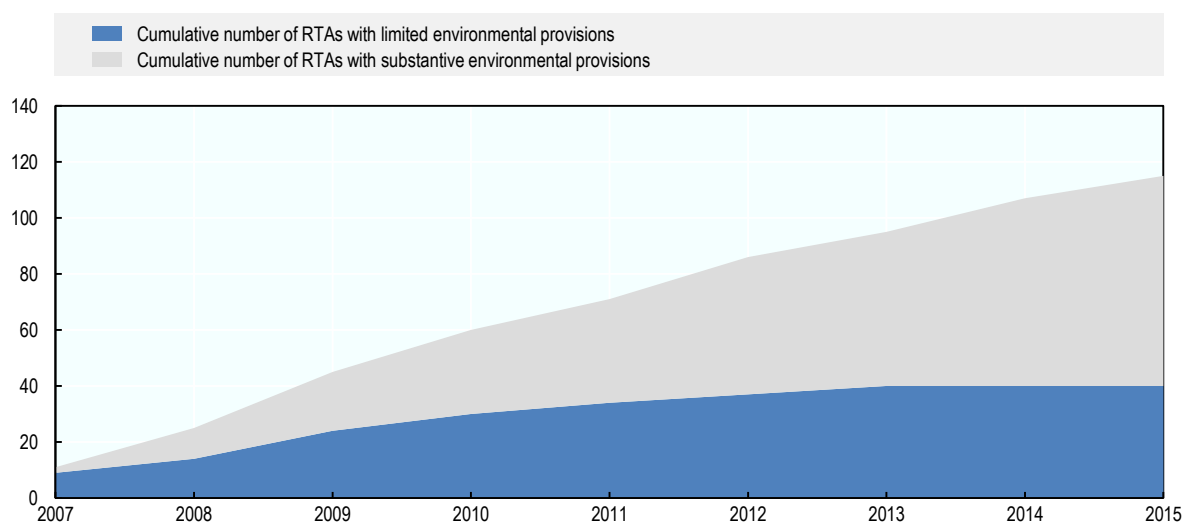
(b) Improving international trade and investment

149. **One theme of the popular discontent expressed about trade and investment agreements has been that, via an overly narrow focus, they have delivered insufficiently inclusive outcomes.** There is also the perception within some countries that they are seen as having been concluded with insufficient consultation, transparency and democratic oversight. **In many places, trade policy-making needs to become more open, a process in which more people can debate the issues, assess the pros and cons and feel a greater sense of confidence that the trade-offs inherent in reaching agreements make sense.** This also requires changes to *how* engagement takes place. In the impact of trade, context matters, geography matters. Government officials should be encouraged **to consult with their constituents and other impacted stakeholders on trade and investment policy; engagement at the local level would help to improve understanding of the likely impact of trade and investment reforms on communities. Thorough cost-benefit analysis allows policy-makers to take into consideration the broader effects of international agreements on domestic policies concerning inclusive growth and other related areas.**

150. **Another common concern for opponents of trade and investment agreements has been that national priorities in other areas, such as labour or environmental standards** may be compromised. Many modern trade and investment agreements have started to address issues such as these by including provisions on labour and environmental standards (Figure 13). Their form and aim can vary: some aim to promote higher standards, (e.g. requiring countries to introduce new domestic labour laws); or to promote greater adherence to existing international norms (such as ILO Conventions); or to strengthen their enforcement by linking them to trade dispute settlement; or simply by creating a new avenue for bilateral

dialogue and pressure. Some exhortatory provisions are aimed at signalling the importance of issues (such as human rights).

Figure 13. Inclusion of environmental provisions in regional trade agreements



151. Some have voiced concerns that adding such provisions creates opportunities for them to be misused for protectionist ends. Such concerns cannot be dismissed out of hand and there are also issues about who determines compliance with international labour or environmental standards, and the legitimacy of trade negotiators to handle other issues. Higher standards requiring capacity to implement may also give rise to requests for financial or other assistance. In parallel to these concerns, the creation of some bilateral and regional agreements is on hold, and some existing deals are being rejected or reopened owing at least in part to concerns over non-trade issues.

152. **For these reasons, governments would benefit from reflecting on how to support free, open and fair trade and strong adherence to international standards and agreements, particularly on issues such as labour and the environment.** How can linkages and coherence across the international system be strengthened? In which circumstances and to what end is it desirable and beneficial to include other issues in trade and investment deals?

153. With increased public debate about investment treaties and investment disputes, governments have been and are engaged in a wide range of actions to achieve balance in investment treaties. The OECD can play a useful role as a forum to share experience and practices with respect to investment treaties.

154. The overall aim is to ensure that international trade and investment agreements are part of an integrated policy approach, are governed by fair and transparent rules and that all businesses adhere to high standards of conduct, that cross-border tax arrangements are transparent and fair, that corruption is combatted, and that labour and environmental standards are respected. In this way, trade and investment can help deliver better lives for more people, through international cooperation, by delivering market opening in areas that matter to low-income households, and through the domestic policies that help people to cope with change and seize opportunities.

(c) Helping developing economies achieve the Sustainable Development Goals

155. Attaining the Sustainable Development Goals (SDGs) is a task for all countries, advanced or emerging. But there remains much that OECD member countries can do to assist lower-income economies to achieve the SDGs. Financing the SDGs is one important aspect of that cooperation, and this means not only continued increases in official development assistance but also innovative ways of mobilising private sector resources. Governments need to be able to play a catalytic role to unleash private investment on the necessary scale, as well as to permit developing countries to mobilise sufficient domestic resources to maintain effective government services and provide the necessary institutions and infrastructure for a smoothly functioning market economy.

156. The global demand-supply gap of infrastructure investment is widely considered to be a bottleneck for sustained, inclusive and sustainable economic growth and an impediment to the effective resolution of development challenges around the world. According to World Bank estimates, the annual infrastructure investment gap for emerging markets and developing economies is USD 452 billion per year over the period 2014-20. While effective mobilisation of resources to fill this gap in quantity is imperative, focusing solely on quantity is not sufficient to address current global development challenges. It is now widely recognised that it is necessary to promote quality infrastructure investment.

157. The G7 Ise-Shima Principles for Promoting Quality Infrastructure Investment provided the basic elements for the alignment of the international community's infrastructure investments: 1) economic efficiency in view of life-cycle cost, safety and resilience; 2) job creation and capacity building; 3) addressing social and environmental impacts; 4) alignment with economic and development strategies; and 5) effective resource mobilisation. The G20 Hangzhou Summit and other relevant international fora confirmed the importance of these principles. Sharing such principles more widely internationally will greatly influence the quality of infrastructure investment in developing and emerging countries.

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