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**TOWARDS HIGH AND SUSTAINABLE ECONOMIC GROWTH IN THE
UNECE REGION: CHALLENGES AND POLICY RESPONSES**

Note by the Executive Secretary

Executive summary

The note highlights the future role of the UNECE, in the context of the proposed reform, in facilitating greater economic cooperation and integration among its member States as well as promoting sustainable development and growth in the region. Globalization is creating new opportunities for economic growth by achieving a more efficient allocation of resources. The increase in international competitive pressures and the resulting structural changes in the global and regional patterns of economic activity lead, however, also to adjustment costs, which can be quite large for specific locations. The main brunt of these adjustment costs is borne by the labour markets. Economic performance in the UNECE region over the past decade has been heterogeneous, and the main future challenges accordingly vary considerably from country to country, and from sub-region to sub-region. However, several common threads can be identified. To achieve sustainable high growth in a globalizing world, the UNECE economies will have to raise productivity and specialize in increasingly higher-value-added activities. This will require high rates of investment in education and knowledge creation. The challenge for policymakers is to create, among others, a regulatory environment conducive to such investment, while putting in place appropriate social protection schemes and training policies in order to avoid or reverse excessive income inequality. To make growth sustainable, the UNECE member countries will have to prepare for population ageing by increasing labour force participation rates and adapting social security and health care systems, and will have to create proper incentives for a sustainable management of the environment. The UNECE is supporting sustainable economic growth by disseminating best practices and developing norms, standards and conventions in the fields of environment, transport, energy, ICTs, entrepreneurship and good governance, and trade; while the UNECE's work on social sustainability focuses on ageing, conflict prevention and security, housing, social indicators and gender issues.

I. THE UNECE ECONOMIES IN A CHANGING INTERNATIONAL ENVIRONMENT

The changing global context

1. The overall economic context for the UNECE economies has changed significantly over the past decade or so against the backdrop of intensifying competitive pressures associated with globalization, i.e. the increasing international integration of markets for goods, services and financial capital.
2. International trade has been boosted by rapid advances in transport as well as information and communication technologies, which have significantly reduced transaction costs for the exchange of goods and services. Another factor stimulating the exchange of goods and services has been the further lowering of trade barriers (such as tariffs), as e.g. resulting from the conclusion of the Uruguay round. At the same time, there has been a closer integration of international capital markets, with investors searching for attractive yields and diversification outside their domestic financial markets. But capital flows can be very volatile and this is generally acknowledged to be one of the major risks of globalization, as illustrated by the severe financial crises in several emerging market economies in the second half of the 1990s.
3. There has been a huge increase in the global labour force with the reintegration of eastern Europe and the CIS into the world economy and with the more recent emergence of China and India as two major new players. These regions with abundant labour supply tend to specialize in labour-intensive activities, where they are able to exploit their considerably lower wage costs compared to the wage levels in the developed market economies. China has also achieved competitiveness in a number of higher technology products and has an export basket typical of countries with three times its per capita income.
4. The relocation of some parts of domestic production in the developed market economies to lower wage countries in other regions of the world economy (also known as outsourcing and offshoring) has increased job uncertainty in the developed market economies. This new fierce competition certainly has important effects on some industries and workers, predominantly those specializing in labour-intensive, low-skill activities. But the overall magnitude of job losses due to outsourcing and offshoring is difficult to gauge and appears so far to be relatively limited. One consequence of the intensified global competitive pressures has been an erosion of trade union bargaining power in the industrialized countries, which is reflected in pressures for workers to accept less favourable conditions in terms of wage incomes and working time.
5. A specific feature of the globalization process has been the surge in foreign direct investment (FDI), often, but not only, driven by differentials in relative labour costs between the home country and the host country, where the investment takes place. It is noteworthy in this connection that the bulk of global FDI is still occurring among the developed market economies, suggesting that considerations other than labour costs also play a major role in these investment decisions.
6. The major multinational corporations appear to have increasingly become stateless in the pursuit of their global competitive interests resulting in weakening national identities and loyalties. Major instruments in their operations are the creation of foreign subsidiaries, joint ventures, licensing agreements and strategic alliances.

7. The adaptation to the changes in the pattern of production and specialization associated with the globalization process constitutes a major challenge for the UNECE region. The dynamic growth of the emerging market economies is reflected in a declining share of the developed market economies in world output and world trade, a trend which is expected to continue in the years ahead.

8. More generally, this points to the fact that intensified regional integration and globalization, which has facilitated the relocation of certain activities to low-wage countries, has considerable implications for labour markets in the UNECE region. This is a challenge not only for the developed market economies but increasingly also for the economies in eastern Europe and the CIS, given the competitive pressures from firms in Asian emerging markets (especially China and India) and Latin America. As the labour abundant areas increasingly specialize in labour-intensive activities, the higher income countries are able to specialize in higher skill or capital-intensive goods.

9. This redeployment of resources requires flexibility in labour and product markets. While wage moderation (i.e. wage growth at or below increases in productivity) may be a short-term solution to these adjustment problems, the longer-term approach must be to raise productivity, which will allow specialization in higher value added activities. This is at the core of the European Union's Lisbon agenda, which aims at creating a competitive and more dynamic knowledge-based economy.

Competitiveness and the role of productivity

10. A key determinant of the long-term economic performance of countries is their international competitiveness. Although there is pervasive reference to this term in policy discussions, there is, in fact, no generally agreed definition. It has for example been argued that the concept makes most sense at the firm level, because it is the survival of companies that is at stake if they are not competitive. This is closely mirrored in the notion of price competitiveness, i.e. the ability to sell products in a competitive international environment. Main factors that determine the relative success of such efforts are the productivity of firms, the level and rate of change of factor costs, the quality of products and the exchange rate.

11. But the major focus of the international policy debate about competitiveness has been on the ability of countries to achieve sustained economic growth, leading to higher levels of real incomes and better living standards. A standard measure of this broader concept of competitiveness is the level of GDP per capita of a country relative to the country or countries operating at or close to the technological frontier. This measure is often complemented with indicators of the export performance of country.

12. The productivity performance is key for economic growth and welfare – as gauged by GDP per capita - in the longer term. This process can, in fact, become mutually reinforcing *via* the international trade channel and the transfer of technology and diffusion of knowledge. This points to other important dimensions of competitiveness such as the ability to compete successfully in markets for new products (technology competitiveness) and the capacity to exploit innovations economically (capacity competitiveness). The flexibility of a country's production and trade structure in the face of changes in the composition of world demand is a further feature of competitiveness.

13. For the advanced economies, which are at or close to the technological frontier, the main challenge is to constantly generate a sufficiently large stream of new ideas and to successfully commercialize their innovations. Key for this is a high rate of investment in knowledge creation. For the other countries the main challenge is to exploit the possibility to imitate and diffuse foreign technologies. Successful catching-up will largely depend on the so-called *social capabilities*. This is a concept with many facets, which include factors such as knowledge generation, economic openness, governance and an effective financial system.

14. Competitive advantages based on low labour costs and price competition are always vulnerable to the emergence of other potential production locations, where costs are even lower. There is, in fact, some evidence that some FDI has moved out of the UNECE emerging market economies towards countries where production costs are even lower. It is therefore important not to get trapped in a rigid specialization in labour-intensive activities but to gradually move up the value added chain, shifting to more knowledge-intensive industries. In fact, the more advanced emerging market economies in central Europe have attracted considerable amounts of FDI in medium- and high-tech sectors. There has been strong foreign direct investment in the automobile sector in central Europe, which appears to be developing into a major European hub of this industry.

15. In any case, there can be considerable adjustment costs involved for sectors that face a significant relocation of activities to countries with lower labour costs and/or a sudden surge in competitive imports of goods and services. This points to the need for a coherent scheme of transfer payments to help workers to better absorb these shocks in the short run and for training and education to improve occupational mobility in the medium and longer run.

Common and diverging economic problems in the UNECE region

Western Europe is falling behind

16. In western Europe, the overall economic performance has been disappointing over the past decade. Growth of real GDP was significantly lower than in the United States (Table 1), but also developments in the labour market were less favourable. This reflects mainly the weak growth forces in Germany and Italy. In contrast, several of the smaller economies (notably Ireland, Greece and the Scandinavian countries) as well as the United Kingdom had a rate of economic expansion close to or even above the one of the United States.

17. To some extent, the weaker European growth reflects cyclical factors and perhaps also a less supportive macroeconomic policy stance. But structural factors appear to be playing a dominating role in the deteriorating European growth performance. This is also reflected in a pronounced slowdown of potential output growth to an annual rate of some 2 per cent for the EU15 over the past decade. But rapid economic growth in the United States over the past decade has gone along with the accumulation of significant internal and external imbalances, which are mirrored in a huge current account deficit and high and rising private household indebtedness and which, in turn, have helped to maintain a robust rate of global economic expansion. These imbalances are not sustainable and the possibility of their disorderly unwinding constitutes a major downside risk for the global economy.

18. Trends in productivity growth diverged widely between western Europe and the United States since the 1990s. Whereas labour productivity growth (measured as output per person employed) accelerated in the United States after 1995, there was pronounced slowdown in

western Europe. This was, in fact, the first time during the post-war period that labour productivity in the United States rose faster than in western Europe. This has partly reversed the previous long process of convergence, which had significantly narrowed the average productivity gap compared to the United States after World War II.

19. In 1995, output per person employed in western Europe amounted to 83 per cent of the United States level, while ten years later it had fallen to just 77 per cent. For the aggregate of the EU-15, GDP per hour worked corresponds now to some 88 per cent of US levels, down from some 97 per cent in 1995. But the average west European productivity performance masks quite some variation among the individual countries. Thus, GDP per hour worked in several countries (Austria, Belgium, the Netherlands) was about as high as in the United States or even higher (France, Ireland, Luxembourg, Norway) in recent years.

20. In western Europe, the average level of GDP per capita has fallen from 75 per cent of the US level in 1990 to 72 per cent in 2005. About one third of this real income gap is due to the difference in productivity levels, two thirds are accounted for by the lower hours worked per capita in western Europe. The latter, in turn, reflects in equal parts the lower number of hours worked per employee and the lower employment rate, i.e. the number of employed persons as a per cent of the working age population. In 2005, the number of hours worked per person employed in western Europe was 15 per cent lower than in the United States. Among the various west European countries, the rapid progress in real convergence in Ireland stands out, as real GDP per capita surged from 56 per cent to 91 per cent of US levels between 1990 and 2005.

21. The acceleration in US productivity growth after 1995 has been attributed in large part to three factors. First, rapid technical progress in the production of ICT products raised labour productivity growth in that sector. Second, the greater efficiency in the production process led to a sharp decline in the relative prices of ICT goods, which contributed to an economy-wide investment boom in ICT goods. This resulted in a rise in capital intensity, which, in turn, raised productivity per worker. Third, use of ICT in other sectors (such as retail and wholesale trade) led to more efficient methods of operation, which also raised productivity growth.

22. The available evidence suggests that in western Europe all three channels of productivity growth have, on average, been weaker. The ICT producing sector in the United States is relatively larger than in most west European economies. Business investment in ICTs has, moreover, expanded less rapidly in western Europe and the overall ICT investment rate has remained lower, which led to a lower contribution of ICT capital deepening to productivity growth than in the United States. Moreover, the level of penetration of the new technologies and their use in western Europe is much lower than in the United States, which further limits the scope for productivity gains.

23. The economic impact of ICTs –including on productivity growth– depends not only on the level of investment in the new technologies, but also on other features of the overall economic context. Thus, flexible labour and product markets and a strong competitive environment enhance the positive impacts of ICTs. Since these features are more marked in the United States than in many west European economies, ICTs make a stronger contribution to productivity growth in the former than in the latter.

24. Beyond the weight of ICT manufacturing, there are wider features of the economic structure that also explain the higher productivity growth in the United States as compared to western Europe, since the former has a stronger specialization in knowledge-intensive sectors

than the latter. Within manufacturing, a higher weight of industries with higher technological content allows faster productivity gains, as these two variables are strongly correlated. The United States manufacturing sector is more specialized in industries that are technologically more sophisticated, leading to higher productivity gains in manufacturing. In the tertiary sector, the United States has a stronger specialization in knowledge-intensive services, which use ICTs more intensively, generate higher value-added and allow stronger productivity gains than other service sectors.

25. There is a gap in investment in research and development (R&D) and in innovative activities between the United States and western Europe. Spending on R&D in that country is higher than in the latter region, particularly in terms of privately funded R&D. Consequently, the output resulting from this effort, as well as innovation activity, are stronger in the United States than in western Europe. The application of technological innovation to productive processes (including ICTs but also other technologies) results directly in stronger labour productivity gains. Therefore the stronger technological and innovative effort of the United States contributes to the widening of the gap in labour productivity between these two economies.

26. Against this background, the European Union has made the strengthening of R&D and innovation a major objective of its Lisbon agenda adopted in 2000. Another key goal is to further raise employment rates, a challenge shared also by the new Member States and the CIS. The average employment rate in the EU15 was some 65 per cent in 2005, compared to a target of 70 per cent for 2010. Higher employment rates would lead *ceteris paribus* to higher levels of GDP per capita. A particular problem, in light of demographic trends in western Europe (an ageing and declining population over the medium- and longer term) is the low employment rate among people aged 55 and above.

27. There is evidence that the lower employment rates in western Europe are only partly reflecting an intrinsic preference for more leisure time, but must rather be attributed to disincentives to create jobs and to seek work originating from the structure of tax and benefit systems and the regulatory environment. These problems are particularly acute in continental Europe. By contrast, the Scandinavian countries and the United Kingdom have employment rates comparable to that of the United States.

28. Though changing the pattern of incentives, including taxes and benefits, could play a role, reaching higher employment targets is not possible without increasing women's participation rates. It is one of the major sources of new labour, except migration, in most of the ageing European societies. Gender equality is an integral part of The European Employment Strategy, which has established gender specific targets and policy guidelines within the EU equal opportunities framework. It includes measures that increase the possibility of combining work with family responsibilities, such as child-care facilities and sharing care functions with men but also policies to close the gender-wage gap, eliminate discriminatory practices and ensure social benefits for atypical work arrangements (such as part-time).

Significant economic changes in eastern Europe and the CIS

29. The last decade and a half was a period of significant political and economic change in Europe. With the collapse of communism, the nations in the eastern part of the continent took the road towards establishing democratic societies and functioning market economies. The process of political and economic transformation has been difficult. It started with a recession, which was unprecedented in its duration and depth. Between 1989 and 1993 eastern Europe's aggregate

GDP and employed labour force decreased by 23 and 15 per cent, respectively. In the CIS region, the transformational recession was even longer and deeper: between 1989 and 1998 aggregate GDP in the CIS as a whole contracted by a cumulative 46 per cent while total employment dropped by 17 per cent.

30. But the bold economic and political reforms undertaken by the east European and CIS countries have injected new optimism and vitality into these economies. The overhaul of the existing institutional order in the direction of market-based business incentives contributed to greater economic efficiency and productivity. Business and consumer sentiment improved, reflecting the sharp upturn in expectations. Foreign direct investment poured into these emerging markets adding strength to their economies.

31. In recent years FDI inflows as a percentage of GDP has been roughly similar in the new EU Member States, south-east Europe and the CIS at around 3 per cent of GDP. Within each region, however, there has been a wide variation; this is especially the case in the CIS where the resource-rich economies have attracted large amounts of FDI. In southeast Europe, the prospect of EU membership for Bulgaria and Romania has raised FDI inflows significantly above that of the other countries in the region. In terms of the stock of FDI or the absolute nominal amount, FDI is higher in the new EU members.

32. The EU's enlargement in 2004 marked an important and symbolic milestone in the process of economic transformation of eastern Europe. After a decade and a half of difficult and often painful economic and political reforms, eight former centrally planned economies together with Cyprus and Malta became full members of the European Union. This newly acquired status was recognition of the fact that, in the main, the transition from plan to market had been successfully completed in a large part of eastern Europe. The EU enlargement (which is expected to continue) not only turned a page in the history of the acceding countries but also reshaped the political and economic landscape of the continent.

33. With the end of the transformational recession, the east European and CIS economies embarked on a path of strong economic growth. In the period 2000-2005, the average annual rate of GDP growth in the CIS was 6.7 per cent, in south-east Europe this rate was 5.2 per cent, and in the eight new EU members it was 3.6 per cent (Table 1). At present the emerging market economies in eastern Europe and the CIS are the most dynamic parts in the UNECE region and among the fastest growing parts of the world economy. At purchasing power parity rates (PPPs), the combined GDP of these economies is greater than that of Japan, and in recent years their aggregate output has been growing at an average annual rate close to 6 per cent. In fact, together with China, India and south-east Asia, the UNECE emerging market economies have become a new engine of growth for the global economy.

34. While their recent growth performance is an impressive achievement, the UNECE emerging market economies still face important economic challenges. One of the key policy objectives for all these countries is to reduce the existing gaps in per capita income levels vis-à-vis the developed market economies. Despite the rapid economic growth in recent years these gaps are still quite large, especially for some of these countries (Table 1). Thus the average per capita GDP level (at PPPs) in south-east Europe and the CIS is only one fifth of that in the US and a quarter of that in the EU-15. Besides, the average figures mask considerable differences in per capita income levels within these sub-regions. For example, while GDP per capita in the Russian Federation is some 25 per cent of that in the US, the Caucasian and Central Asian CIS economies on average reach just one tenth of the US GDP per capita level.

35. The process of economic transformation also had some negative social side effects that have not been fully overcome yet. The most acute among them has been the rapid social stratification and the impoverishment of large segments of these societies, especially the female population. The incidence of poverty rose sharply during the period of transformational recession. With the post-recession recovery this trend has been partly reversed in most countries but high poverty rates and sharp income differentiation which are not conducive to social cohesion and future growth prospects remain widespread. According to the latest World Bank estimates, the share of the population that lived below the internationally adopted (second) poverty line of \$PPP 4.30/day in 2003 was 96 per cent in Kyrgyzstan and Tajikistan, 86 per cent in Uzbekistan, 85 per cent in the Republic of Moldova and Georgia, 93 per cent in Armenia, 70 per cent in Azerbaijan, 66 per cent in Kazakhstan, 58 per cent in Romania, 41 per cent in the Russian Federation, 33 per cent in Bulgaria.

36. While the rates of GDP growth in most CIS economies have been impressive in recent years, there are nevertheless serious concerns about their sustainability. The key factor behind the economic boom in the resource-rich CIS economies has been the expansion of their extractive industries (especially, the crude oil and natural gas sectors) coupled with a surge in world commodity prices in the last few years. The narrow base of the recovery exposes these economies to fluctuations in the highly volatile global commodity markets, making them vulnerable to external shocks. Besides, mineral extraction is a capital-intensive activity generating little employment and is likely to result in geographically unbalanced development and greater income inequality.

37. The disintegration of the Soviet Union triggered a collapse of much of the manufacturing industry in the CIS. As a result, the production and export structures in most CIS economies have become more concentrated, especially in the resource-rich economies. For example, in the Russian Federation the share of the top five export products in total exports increased from 62 per cent in 1996 to 68 per cent in 2003 (four of these five products were primary commodities and fuels) and the share of the top 10 products increased from 72 per cent to 77 per cent. A similar process of concentration towards commodity exports is observable in many CIS economies: the top five products account for 90 per cent of total exports in Azerbaijan; for 72 per cent in the case of Kazakhstan; 68 per cent in Armenia and 66 per cent in Kyrgyzstan. In almost all these cases commodities dominate the top export products. Much of the new investment in the CIS has been in the extractive industries, while relatively little has gone to other sectors of economic activity. Such a specialization pattern may be counterproductive for a balanced development path, especially for the low-income CIS countries.

II. POLICY CHALLENGES FOR ACHIEVING HIGH AND SUSTAINABLE ECONOMIC GROWTH IN THE UNECE REGION

The sources of economic growth and the trade-offs involved

38. Long-run economic growth is due primarily to the rate of human and physical capital accumulation and the pace of technological change. There are a host of additional factors associated with growth primarily through their effect on capital accumulation and technological change. These factors include peace, a stable macroeconomic environment, integration into the world economy, and good governance based upon the rule of law along with appropriate regulatory institutions.

39. Public policies that increase the resources allocated towards capital accumulation and innovation can increase growth, but they may also potentially redirect resources from current consumption and thus lower current living standards. Some growth promoting policies, such as policies increasing labour market flexibility, tax changes encouraging savings and investment, liberalization of product markets, and increased trade openness may also increase economic inequalities. These trade-offs must, therefore, be squarely recognized and addressed.

40. There is an increasing recognition of the complementarities between human capital formation and the accumulation of other types of productive assets. Of particular importance is the role of human capital in generating technological and organizational innovations, which in turn fosters long-term economic growth. Many high- and middle-income UNECE economies, including the new EU members, have invested considerable resources in increasing the average number of years of education of their work forces. Despite this favourable trend, Europe still spends only about one half of what the United States does on higher education. In addition, particularly in the lower-income UNECE economies, the adoption of a systemic approach in providing their population with sequenced educational choices (i.e., primary and secondary education, higher education/vocational training, on-the-job training, and mid-career training and retraining) remains a challenge.

41. For the UNECE countries to increase their international competitiveness, particularly in the high-wage high-skilled sectors, there is a need to intensify investment in higher education and continuous life-long skill upgrading. A way to achieve this is not just by subsidizing basic education (and to a certain extent tertiary education) but also by providing fiscal incentives (educational credits, tax incentives, etc.) to encourage individuals and private businesses to invest in human capital development. The formation of human capital encompasses, however, more than simply the formal education and training systems, it also depends on “social capital” acquired through the health and social welfare systems, families and communities, business and other non-governmental entities.

42. Investment in modern and productive capital equipment can boost growth performance. But capital accumulation in the west European countries over the last two decades has been inferior to its post-World War II historical trend and to that of the United States; these trends are largely reflected in the national rates of investment as a share of GDP. Therefore to return growth to the levels of earlier decades will most likely require a significant increase in the level of investment as a share of GDP. One of the most effective policy options to increase national savings is by running government surpluses (or reducing deficits). Maintenance of low real interest rates and acceptable profit rates encourages investment; further financial market deregulation with increased cross border competition may lower the costs of financing investment projects.

43. Improvements in technical knowledge are an important component of growth for all countries but are especially significant for countries near the frontiers of technology (i.e., higher income countries). Although technical progress can develop through a number of channels such as importing sophisticated capital goods or through “learning by doing,” an important component, especially one that can be enhanced through public policy, is research and development (R&D) activity. R&D may increase productivity through innovation of new products or processes and by enhancing the adoption of existing technology. This latter effect is more important for those countries further from the technological frontier (i.e., the lower income countries).

44. On average, the European economies invest a smaller share of their GDP in R&D than the United States or Japan or even some rapidly developing emerging markets such as the Republic of Korea. R&D can be performed by either universities, the public sector, or private firms; the US/European differential is especially large in the latter. Public policies can encourage this activity by providing tax breaks or subsidies; these are justified by the positive externalities created such as knowledge spillovers to other firms and enhanced worker skills, which the innovating firm is unable to fully capture. Improved education opportunities and liberal requirements for the immigration of scientific talent from abroad can promote R&D activities. Policies to encourage targeted and well designed FDI can be particularly important in increasing R&D in lower-income emerging market economies. A vibrant venture capital market, which encourages entrepreneur risk taking, can be helpful in order to commercialize the discoveries from scientific research.

45. Facing the challenges of globalization and the knowledge-based economy implies major economic change and restructuring in all the UNECE countries, both the industrialized west European economies and the emerging market economies. In a global perspective, successful economic restructuring or diversification (including west European industrialization in the nineteenth century but also the post-war rise of the south-east Asian economies and, more recently, the experience of Ireland) has almost always been facilitated by government policy. This implies a lasting and dedicated proactive government stance – both in developed and in emerging market economies – in pushing through the targeted reform agenda through appropriate policy instruments.

46. In order to promote investment, innovation and entrepreneurship a supportive investment climate must be created. This is dependent on a number of factors that can be grouped into four broad clusters: macroeconomic conditions, institutions, an educated workforce, and physical infrastructure. Prudent macroeconomic policies are those that result in low inflation, avoid excessive government and external debt, promote full employment, and maintain a competitive tax structure. In contrast, overly loose and unpredictable macroeconomic policies clearly raise business costs by increasing uncertainty and the risks of conducting business. A microeconomic and institutional framework conducive to productive investment centres on a legal and regulatory system that promotes competition, the rule of law, intellectual and other property rights, good governance and that improves access to financial services. The quality and availability of the physical infrastructure such as energy supply, transport network and telecommunication links play an important role and can have a significant impact on the incentives to invest.

47. There are two major labour market problems in the UNECE region. One is low and, in some countries, declining labour force participation rates and the other is high and persistent unemployment, and both of them are more acute in most of the region's emerging markets. To address these problems and hence to stimulate job-rich growth requires comprehensive reform of labour market institutions in tandem with growth--enhancing macroeconomic policies. These reforms should focus on improving the business environment by removing or reducing, inter alia, administrative and fiscal barriers to entry and exit of firms, non-wage labour costs, restrictions on hiring and firing of employees, and increasing the incentives to work while still maintaining an appropriate safety net for displaced workers. Part-time and flexible-time jobs have to be encouraged to increase, particularly, the female participation. Furthermore, in order to reduce skill mismatches and to support unskilled workers, job search assistance and training should be intensified. Active labour market policies have to be formulated also to increase the employability of the young and the long-term unemployed as well as the re-employment chances

of the older workers. Unemployment benefits, which help to reduce poverty, have to be better administered in order to reduce the scope for misuses. The emphasis of their redesign should be more on the tightening of the eligibility rules and enforcing job search rather than their levels and duration, particularly in the poorer countries of the region. Labour market flexibility can be further enhanced by improving public infrastructure, such as housing and transport, which would increase labour mobility.

48. Higher labour force participation rates and increased hours worked per week can increase national income (although not the long-run growth rate). For example, a significant component of the income differential between the West European economies and the United States is due to differences in the percentage of the population working and the number of hours worked per employed person. While low participation rates and hours worked may be the result of cultural preferences and involve a legitimate leisure-work trade-off which improves the quality of life, they may also result from poorly designed or overly generous social policies which do not create adequate incentives for people to find and keep jobs.

49. Regulation of product and labour markets is an important component of a market economy as a means of addressing market failures, promoting competition, and ensuring equitable outcomes. Regulations, however, impose costs on business and the economy more generally, and a balance must be achieved by assessing their costs and benefits. Over the last decade in the UNECE there has been a reduction of regulatory burdens as well as a trend towards convergence of regulatory practices. Given the large diversity of regulatory practices, each regulation needs to be assessed based upon its own consequences and fine tuned to achieve the largest net benefit.

Specific policy priorities in the UNECE emerging market economies:

50. Credible efforts to sustain macroeconomic stability are necessary for long-term growth in income and employment that raises living standards and reduces poverty. Large fluctuations in output, employment and inflation add to uncertainty for firms, households and the public sector, and can reduce the economy's growth potential. Stability allows businesses, individuals and the government to plan more effectively for the long term, improving the quality and quantity of investment in physical and human capital and helping to raise productivity. In an increasingly integrated global economy, financial and economic instability in one region or country can be rapidly transmitted around the world. The framework for monetary policy, fiscal policy and public spending should thus provide a coherent strategy for maintaining high and stable levels of growth and employment, and for minimizing the adverse effect of external shocks.

51. The development of public infrastructure is an important component of any growth strategy. Public infrastructure not only directly provides residents with needed goods and services which may be under-funded by a market system due to their externalities or public goods nature, it is also an important complementary factor that encourages and increases the productivity of private investment. In many countries, however, access to quality infrastructure is insufficient and significant financial resources are required to develop and/or enhance it. However, obtaining financing is a major challenge since the majority of infrastructure spending relies on public funding but in many countries budgets are subject to severe constraints. Moreover, private investment in infrastructure faces a challenging regulatory and institutional environment in many countries, particularly in the emerging market economies. Public-private partnerships are an alternative avenue for the development of public infrastructure. With PPPs, private financing and more competitive management practices can be used while also achieving social objectives.

52. Efficient dynamic markets require a suitable institutional and regulatory structure in order to ensure a competitive environment where participants are properly informed. Changing global competition and technological developments require this institutional structure to be continuously adapted. This complementary institutional structure has yet to be fully implemented in a successful way in many of the region's emerging market economies and needs to be fine-tuned in the advanced economies. Increased international trade is an additional mechanism for enhancing competition; this can be particularly significant for the smaller countries of the region.

53. A developed financial system is crucial for the efficient functioning of a market economy. This includes not only the banking system, which is at its core, but also the development of capital markets and the emergence of institutional investors such as insurance companies and pension funds. Macroeconomic stability is an essential ingredient for financial development, as it fosters increases in deposits and long-term lending. Fast growth in bank lending to the domestic private sector has been a common feature of most countries in the region in recent years. Prudent supervision needs to remain vigilant, especially in such expansionary conditions.

54. Mortgage lending, while attending to the needs of housing provision in the region, can foster financial development, providing new business opportunities to the burgeoning financial sector and encouraging the recourse by banks to the capital market to obtain long-term sources of finance. From the demand side, the design of pension funds (including asset allocation and guaranteed return rules) may have a significant impact on capital markets. Foreign participation can also make a positive contribution to drive the modernization of the banking sector and increase competition. However, there are different national choices regarding the sequencing and extent of foreign entry, which raises additional regulatory issues.

55. Poorly functioning public sector institutions and weak governance are major constraints to growth and equitable development in many countries. Thus, one of the necessary conditions for sustainable economic development is the establishment of institutions that support a market system. Market economies require property rights for assets from real estate to copyrights; these must be well defined and enforced. Corporate law must promote entrepreneurship while providing protection for shareholders, workers and the public against mismanagement and fraud through information and accounting standards. Financial law has to ensure safe, sound and efficient banking practices along with corresponding prudential regulations that minimize the risk of bank collapses. Competition law should prevent the establishment of monopolies, predatory market dominance and uncompetitive practices. In addition, appropriate laws are needed to regulate government activities such as tax, social and labour laws. All these various legal fields must interact with each other in a consistent fashion ensuring their overall coherence.

56. Apart from problems and issues that are common for all or most of the UNECE emerging market economies, there are region-specific problems, in some case related to the process of economic integration (the new EU members) in others – to common geographic location or similar historic tradition and legacies.

The new EU members

57. The prospects for EU membership had served as a powerful incentive and external anchor for the comprehensive market reforms undertaken in these countries. The accession negotiations played a disciplining role and served as a vehicle for pushing through a broad institutional, legislative and regulatory reform agenda. But with this ambitious mission successfully completed, the reform momentum associated with this major policy goal has weakened. As the

reform agenda in these countries is far from completed, a major challenge for them now is to avoid a “reform fatigue” syndrome.

58. EU membership raises a number of policy challenges. On the structural front, it implies a commitment to the so-called Lisbon agenda. On the macroeconomic front, the new members are expected to meet the fiscal rules of the Stability and Growth Pact pertaining to inflation, long-term interest rates, government deficits, public debt and exchange rate stability, and the Maastricht criteria for joining the Economic and Monetary Union (EMU). In recent years, the new Member States have been relatively successful in raising per capita income levels while moving towards the EMU nominal convergence targets. But one of the greatest challenges at present is to find the balance between real and nominal convergence.

59. Similar to many developed market economies, fiscal consolidation remains an important macroeconomic policy challenge in many new Member States, and achieving it may have implications for their growth prospects. Fiscal consolidation is particularly urgent in order to set public finances on a sustainable path in the face of rapidly ageing populations, which will put added pressures on public pension and health-care systems in the medium to long term. However, the reforms of public spending should be done with great care so as not to jeopardize the future growth potential of the economy. In particular, these economies need to undertake a lasting effort to improve their public infrastructure, which is an essential precondition for a successful catching up to higher productivity and income levels. In addition, in line with the Lisbon agenda, they will need to mobilize considerable resources, including in the public sector, in upgrading their education systems and in facing the challenges of the knowledge-based economy. In view of the existing fiscal constraints, the reforms in public finances should thus aim at increasing the overall efficiency of public expenditure through its gradual internal restructuring.

South-east Europe

60. Similarly to what was observed in other countries, the prospects for EU membership have been serving as a key reform driver in the EU accession and candidate countries in south-east Europe. For the countries that aspire to EU membership but have still not reached the phase of being recognized as accession candidates a key policy challenge is to accelerate the reform process. In particular, progress in reforming the overall institutional framework must be maintained. Public institutions for a market economy in most of these countries are still underdeveloped and this is having a negative effect on the business environment: the protection of property rights, including law and contract enforcement, is generally weak; the public administration is widely perceived as inefficient and lacking in transparency; and corruption is still widespread. Health care and pension reforms are either at an early stage or have not yet started at all. Significant reform in these areas is a fundamental requirement for their economic integration with the EU in the future.

61. The lingering social tensions (partly related to the widespread poverty) in some of the south-east European countries will require a leading role for public policy if they are to be eliminated or defused. These problems are at least partly related to the deplorable situation in the labour markets: the unemployment rates in some of the western Balkan countries are the highest among all UNECE emerging market economies while employment rates are excessively low at present. In this regard, an integrated set of structural reforms focused on increasing employment is one of the areas where success could bring wide-ranging benefits. Besides, greater social

solidarity will help to create a general consensus about the nature and direction of the reform process, which, in turn, will increase the probability of it being maintained.

The Commonwealth of Independent States (CIS)

62. The CIS countries have made considerable progress in basic market reforms, such as price and trade liberalization and small-scale privatization. However, structural and institutional reforms – for example, of major institutions (the judiciary, public administration, health care, the pension system), labour markets, the banking system, competition policy, the establishment of effective bankruptcy procedures, etc. – have been much patchier. Moreover, the pace of institutional and structural reforms in the CIS has slowed down in recent years. Notably, in the absence of a strong external anchor (as the preparation for EU accession), the reform process in some of these economies risks to lack a clear direction. A major challenge for policymakers in these countries is to set ambitious – and socially acceptable – policy goals that would motivate them to maintain the pace of market reforms, and would convince their constituencies of the desirability of these goals.

63. Much remains to be done also to make the domestic environment more conducive to business investment. Weak “state capacity” (the capacity of the public administration to initiate and implement reforms) appears to be an important constraint on structural and institutional reforms in the low-income CIS countries.

64. Excessive specialization in a narrow range of commodities is a source of economic vulnerability. Once a supportive macroeconomic environment is created, a more active set of diversification policies may be considered. In addition, oil and mineral extraction are capital-intensive activities that contribute little to employment creation and tend to generate greater income inequality. On the other hand, with appropriate policies, resource wealth can make a positive contribution to economic performance and provide financing to carry out a development agenda.

65. In the resource-rich economies, a concerted, long-term policy effort targeting economic diversification is required for overcoming their currently narrow, resource-based specialization patterns. Spending on public infrastructures and education can increase the competitiveness of non-resource sectors. Due attention needs to be paid to the quality and efficiency of public spending, which may require reforms in other areas, including public administration. Public-private partnerships can be used as the basis of a strategic collaboration that avoids the pitfalls of traditional industrial policy. Public sector interventions can serve as the catalyst of private initiative, ensuring a competitive environment and adequate development of the human capital and business infrastructure. Fiscal policy can be used to smooth fluctuations along the commodity cycle, helping to avoid the boom-bust cycles associated with this type of specialization.

66. In resource-rich countries there is a need to avoid an excessive appreciation of the national currency driven by commodity exports given its damaging effect on the competitiveness of other economic sectors, the so-called “Dutch Disease”. In the Russian Federation in particular, the persistently large current account surplus associated with growing oil exports has led to an excessive appreciation of the rouble with possible adverse effects on growth prospects. Given their considerable dependence on commodity exports, other CIS economies also face similar problems. The Russian experience also shows that macroeconomic policy alone is incapable of dealing with the negative implications of the “Dutch Disease” for competitiveness. The focus of

the policy approach therefore needs to be considerably broadened in order to encompass a wider set of factors that have an effect on the competitiveness of the economy and its potential for growth.

67. In some countries, the so-called oil funds define rules governing the use of hydrocarbons revenues. These funds may play a mere stabilising role or may accumulate resources in a larger scale to redistribute them across generations. Choices depend on the size, durability of the resource boom and current population needs. Revenues can be used to directly reduce external vulnerability (paying off external debt) or financing reforms that would diminish future public liabilities (pension reform). This strengthens public finances and increases the capacity to deal with future downturns.

Strengthening pan-European economic cooperation and integration

68. Economic integration contributes to peaceful co-existence by fostering economic growth, creating shared interests, and promoting increased personal contacts which can increase societies' appreciation and understanding of different cultures and viewpoints. Open trade and financial flows, shared management of environmental resources, common regulations and standards, integrated communication and transportation networks, and open borders for work and travel are all components of integration. Economic and foreign policies have reduced significantly much of the constraints that had limited economic cooperation during the second half of the twentieth century but this momentum must be maintained. Economic and trading blocs should be as inclusive as possible, and further integration in one region should not come at the expense of other areas. Europe's objective should be open regionalism and not several preferential blocs. The agendas of the Common European Economic Space and the New Neighbourhood policy should work towards this objective.

69. The benefits of non-discriminatory, predictable and rules-based international trade are widely recognized. But a number of the UNECE countries still remain outside the WTO (Bosnia and Herzegovina, Serbia and Montenegro, Russian Federation and seven other CIS members). Since there is a strong sub-regional aspect in trade liberalization of the UNECE countries - EU-oriented and CIS/Russia oriented - there remains room for reducing discriminatory treatment between trade partners, particularly those not yet engaged in the multilateral trading system. The western Balkan countries have also created a web of bilateral free trade agreements amongst themselves, which however does not seem to prevent them from a wide use of various non-tariff barriers (quality standards, sanitary and phyto-sanitary standards, cumbersome custom procedures, etc.) and ad-hoc restrictions to intra-regional trade (surcharges, temporary bans, etc.). The CIS economies need to fully eliminate barriers to trade within the region and to simplify customs procedures in order to eliminate extensive border delays. Regional trade policy in these areas should work to ensure that these preferential arrangements operate more effectively and minimize their discriminatory and trade diverting effects against non-members.

70. The further trade liberalization in the UNECE region is closely related to the advancement of the multilateral trading system. The current Doha trade round which envisages improved market access across the board, including agriculture, services and non-agricultural products as well as addressing new areas including trade facilitation can provide further incentives for pan-European cooperation and integration. In addition, current members can provide technical assistance and promote "fair" concessions as a way to boost the WTO membership prospects for the UNECE countries not yet in the system.

71. Capital market integration provides access to a bigger pool of savings and facilitates risk sharing. It could potentially result in lower cost of capital and a reduction of economic instability. This beneficial effect requires that supportive domestic conditions are present. Policy interventions need to focus on the convergence of standards in order to reduce cross-border information problems and the creation of integrated clearing and settlement systems. Increased capital market integration also raises risks that need to be addressed, including money-laundering issues. Close collaboration between regulatory and enforcing authorities of different jurisdictions is required to reap the benefits of capital market integration but also to avoid its drawbacks.

72. FDI can play a significant role in increasing economic efficiency and promoting the integration of firms into global networks that can increase trade. A reassessment of some existing regulatory obstacles to foreign ownership may be warranted. Costly and cumbersome administrative procedures, including the fragmentation of decision-making on FDI issues, are obvious deterrents. Direct promotion incentives (tax breaks, land allocation, etc.) bring costs that must be carefully weighted against the actual benefits of FDI. Policies that improve the overall business climate will have a positive impact on both foreign and domestic investors.

73. There can be considerable adjustment costs involved for sectors that face a significant relocation of activities to countries with lower labour costs and/or a sudden surge in competitive imports of goods and services. This points to the need for a coherent scheme of transfer payments to help workers to better absorb these shocks in the short run and for training and education to improve occupational mobility in the medium and longer run.

74. The access to and development of common infrastructure is crucial for pan-European cooperation and integration. The increasing recognition that Europe's economic competitiveness, trade and cultural exchanges as well as environmental sustainability depend on border-crossing transport corridors (rail and road, water and pipelines), telecommunication systems, transnational electrical power transmission networks, etc. have led to the development of several trans-European infrastructure projects. The need for a continued integrated approach to infrastructure development stems also from the previous separation of the main infrastructure networks of eastern and western Europe. Although many European countries receive financial support from the Cohesion and Structural funds of the EU, the building of new high-speed transport infrastructure, integrated electricity transmission grids or ensuring sustainable water resource usage is very slow and is often delayed by the lack of an integrated approach in planning and funding of cross-border infrastructure.

75. From an economic point of view regulatory harmonization helps to eliminate barriers that exist between countries and regions and brings benefits by reducing transaction costs for businesses and administration expenses for governments in dealing in the global environment. Harmonization facilitates market access, increases competition and helps to ensure regulatory outcomes. Internationally it is most frequently done over a spectrum of mechanisms like standard settings, rules enforcement or dispute settlements.

76. Workers tend to move from regions where their productivity and wages are low to areas where they are high; as a result there is an overall increase in economic output. However, workers with the same skills or skill levels as those immigrating into a region are likely to suffer wage declines from the increased relative supply of that type of labour. Thus low-skilled workers in the more advanced economies may be negatively affected by immigration of low-skilled workers from lower income nations unless complementary policies are enacted. Immigration of youthful workers might marginally improve the financial implications of an ageing Europe.

77. Immigration also has important consequences for the country from which they leave. In a number of the UNECE emerging markets remittances provide an important and relatively stable source of foreign exchange, which can allow increased imports of consumption and investment goods. Immigration can help alleviate unemployment in countries of origin where it is excessive and thus improve the labour market outcomes for similar workers who remain by increasing their chances of obtaining employment as well as higher wages. Immigration also promotes the establishment of personal contacts between people in different countries, which can promote trade and foreign investment. Immigrants can return with enhanced job skills and knowledge and thus act as a mechanism for transferring technical know-how.

Making economic growth sustainable

78. A high quality of life is dependent on a clean healthy environment where resources are used in an efficient and sustainable manner. This can only be achieved with appropriate regulation given extensive externalities and the public goods nature of many environmental resources. The transboundary nature of many of these systems suggests the necessity for regional if not global cooperation. Institutional weakness and budgetary constraints have created a deficiency in the management of environmental resources in the emerging markets of the UNECE, especially in the areas of water resource management and energy efficiency.

79. Economic growth in neither the advanced nor the emerging market economies is currently environmentally sustainable. Resources are being depleted and some types of pollution and other by-products of economic activity are increasing significantly; these trends are having and will continue to have serious environmental consequences. Public policy should therefore attempt to ensure that resources are used efficiently and are priced at their appropriate social value (whether they are private or common property) and that the necessary scientific research is undertaken.

80. The decoupling of energy consumption and economic growth serves to reduce environmental pressures and diminishes economic vulnerability to price increases and supply disruptions. The active use of the price mechanism is a basic instrument to encourage the adoption of decisions that reflect the actual scarcity of resources. Taxes can be used to capture externalities not included in prices, promote the consumption of environmentally friendly sources of energy and encourage energy efficiency. Emission trading schemes serve to ensure that energy savings are achieved in the most cost-effective way. Public subsidies to public transport may also be considered, in view of its favourable impact on energy consumption. Economic instruments can be used in combination with regulatory standards in relevant areas (such as vehicles technical requirements or building construction) to achieve desired policy targets. Procurement practices can also be used to effectively promote energy savings through suitable standards.

81. Europe is in a situation without parallel in its demographic history. Fertility is well below the replacement level, populations are ageing rapidly, and most countries face an imminent or anticipated population decrease. Migration flows may intensify or mitigate these trends but they create a number of new challenges for the security and economic stability in the UNECE region. According to United Nations projections, the combined population of Europe increased by over 180 million between 1950 and 2000; it is projected to decrease by about 96 million between 2000 and 2050. This decrease will be most pronounced in Central and Eastern Europe. It is also expected to strongly affect Southern Europe.

82. The shift from sustained population growth to marked decline will have far reaching social and economic implications. The decrease of the European populations will be accompanied by rapid shifts in their age structures, notably a significant decline in the working-age population. This progressive population ageing has important consequences for public and private savings and spending and for future macro-economic performance in general. There are fears that the anticipated huge deficits in public pension schemes could inflict serious macroeconomic damage, both on the domestic economy and, in the case of large industrial countries through international linkages, on the world economy. These trends may be exacerbated by the differences in reproductive behaviour and rates of growth among different population sub-groups and may put a strain on social cohesion. Even though these differences are diminishing, they may still alter sensitive cultural and ethnic balances.

83. Social cohesion is an important ingredient of sustainability. In the long run, the most effective approach to poverty reduction is fast and stable economic growth. However, it is not enough to have high growth rates and rising income per capita to eliminate poverty; income inequality and unemployment must also be addressed. To increase the employment responsiveness of growth and thus to facilitate the redistribution of income in the short and medium term requires structural reforms in labour and product markets. In the longer term, promoting investment in human capital is needed in order to reduce the skill mismatch between labour demand and supply. This would further increase the association between output and employment growth. A well-designed pro-poor fiscal policy without increasing the overall tax burden can also be an important tool to eradicate extreme poverty. Furthermore, social transfers are also necessary in cases of extreme poverty. However, they have to be extremely well targeted in order not to create more inequality by dividing the poor into insiders and outsiders. For the redistributive policies such as social transfers and unemployment benefits to be less costly and yet be efficient tools of poverty and inequality reduction, they need to be closely monitored in order not to hamper incentives to work.

84. Economic growth accompanied by well-designed social protection systems to fight poverty and social exclusion underpins social cohesion. Together with effective education and training systems, progress in social cohesion in turn is a key factor in promoting growth. This virtuous circle implies that macroeconomic policies and structural reforms that enhance job-rich growth also can reduce poverty and income inequality. However, there are also various other factors that affect social cohesion which have to be addressed by the policymakers such as beliefs and attitudes towards people with disabilities, ethnic minorities and immigrants. These beliefs and attitudes only change slowly and must be addressed mainly through education and legal enforcement.

85. A strategy for achieving sustainable economic growth must also take into account various provisions for improving the health care system. While some health care indicators (e.g., the immunization rate) show a comforting positive trend in several UNECE emerging market economies, others appear to be worsening over time, e.g., life expectancy in most CIS countries. This could be attributed to worsening maternal health, persistence of the rapid spread of old diseases (e.g., tuberculosis) and the proliferation of new ones (e.g., HIV/AIDS). Increased economic vulnerability and cuts in publicly provided health services have hampered the improvement of health conditions for the population in the lower income strata. Governments need to improve the effectiveness of their health care spending. Primary health care services tend to have the strongest impact on the improvement of health indicators. It is therefore on the provision of these services that the public health expenditure should focus. In particular, health

care priorities should include provisions for improved maternal care and reproductive health, control of the spread of major endemic diseases through better diagnostics and immunization and innovative programmes to combat the spread of HIV/AIDS. The possibility of a bird flu pandemic would not only result in many deaths but would also have serious economic consequences; regional cooperation including financial and technical assistance for those experiencing the initial outbreaks could prove decisive in controlling this disease.

III. THE ROLE OF THE UNECE IN CREATING A SUPPORTIVE ENVIRONMENT FOR SUSTAINABLE ECONOMIC GROWTH IN THE UNECE REGION

86. The UNECE region faces new and important economic challenges at the start of the twenty-first century. Policymakers in all the UNECE economies need to devote increasing attention to the revitalization of their economies in order to be able to face the growing global competitive pressures. This calls for more efforts in boosting competitiveness through human capital development and the propagation of knowledge-driven technologies. Moreover, the impressive growth of national income and the associated poverty reduction achieved in recent years in many countries of the UNECE region may well be unsustainable in the long run unless policies manage to cope better with adverse trends such as population ageing, environmental degradation with rising levels of energy consumption and harmful emissions, geopolitical instability, and inequitable distribution of income and wealth.

87. Such long-term policy challenges in the context of the ongoing European integration through the EU expansion and rapid globalization outlined in the previous parts of this document have led the member States to refocus the work of the UNECE while restructuring its existing resources and adapting its programmes to changing international conditions. This ongoing reform aims to better focus the UNECE work on these challenges in order to support pan-European cooperation and integration, subject to additionality or complementarity with activities of other international organizations and agencies. The main direction of this reform is to concentrate the limited available resources on fewer but major common long-term policy challenges related to the sustainability of economic development and competitiveness in the UNECE region.

88. To this effect, the main thrust of the UNECE reform is the strengthening of its comparative advantages in serving its member States to address some of these challenges. In particular, it will continue to provide them with adequate instruments to address certain transboundary market failures and information asymmetries. Accordingly, and given the ongoing changes in the global environment and in the UNECE region, the UNECE will be placing a greater emphasis on the provision of demand-driven regional/international public goods in its areas of specialization, notably knowledge-sharing initiatives, dissemination of good practices, policy dialogue, capacity building, implementation of international UNECE agreements, surveillance, forms of “soft” regulation, operational activities, etc. With these and other forms of innovation-driven development, the UNECE will contribute to the promotion of closer and more efficient pan-European economic cooperation and integration on fair terms.

89. In view of these objectives and, taking into consideration the three main pillars of sustainable development – economic prosperity, environmental balance and social progress – the UNECE faces some specific challenges in its future work.

The economic pillar

90. The UNECE continues to provide a forum for high-level policy dialogue and knowledge-sharing initiatives as well as a focal point for the development of practical solutions to important issues of concern to both the economically advanced members and the emerging market economies within the region. These discussions, exchanges of views and development efforts focus mainly on the sectors in which the organization has developed unique expertise over time, particularly environment, transport, energy and trade. The policy initiatives, as well as other work, are aimed primarily at governments but, in some cases, also encourage the participation of other stakeholders, such as businesses, civil society representatives, other international organizations and NGOs.

91. In the area of land transport, the UNECE has traditionally played an outstanding role in the design and harmonization of sectoral norms, standards and policies. The organization continuously initiates new activities that are needed to create a more robust and extensive transport infrastructure for pan-European economic cooperation and integration. For instance, the planned introduction of on-line retrieval of rail data in key European transport corridors will be conducive not only to a better implementation of existing UNECE standards but also provide policymakers with a significant planning tool to achieve the environmentally desirable shift from road to rail transport. Further, the planned computerization of the Transports Internationaux Routiers (TIR) procedure, led by the UNECE, aims to strongly reduce the transaction costs associated with international trade, thus contributing towards further regional integration.

92. The UNECE also promotes enterprise development and technological upgrading in the emerging market countries of the region. To this end the organization undertakes policy analysis, and provides technical cooperation pertaining to the use of new technologies –particularly ICTs and the Internet– as a means to develop vibrant small and medium enterprises. The UNECE elaborates policy recommendations aimed at creating a business environment conducive to economic development, private investment, entrepreneurship and innovation. The organization also facilitates the transformation of its member countries into knowledge-based economies, which is done through international benchmarking and the exchange of experiences and best practices. It publishes country studies and elaborates cross-country comparisons, facilitates policy dialogue, formulates policy advice and strengthens national policy-making capacity aimed at increasing the knowledge intensity of national economies and further spreading the use of new technologies in the countries of the region, particularly the emerging market economies. Similarly, the UNECE promotes better corporate and public governance, rule of law and public-private partnerships while establishing relevant guidelines.

93. As a result of the tightening of world energy markets, concern over energy availability and security of energy supplies has re-emerged as a pressing issue. There are currently three programme elements within the UNECE sub-programme of work on sustainable energy that directly address issues raised by concerns over energy availability and security of supplies. First, the Committee on Sustainable Energy, the main UNECE intergovernmental body in the field of energy, periodically examines issues related to energy security. In 2003, the Committee established the Energy Security Forum to assess and better understand key supply factors, promote dialogue among governments, the private sector and relevant international organizations, and to propose options for reducing energy security risks. Second, the Working Party on Gas, the main UNECE intergovernmental body in the field of natural gas, frequently holds roundtables on various issues, including on the security of natural gas supplies. At its

annual session in January 2007, the Working Party will hold a Roundtable on the security of natural gas supplies in the context of sustainable development. There are also three task forces under the UNECE Gas Centre addressing the issues related to natural gas transportation and cross-border trade. Participants in those task forces are drawn from the twenty-four major European gas companies that support the Gas Centre financially and through their participation in its activities. Third, there are other elements and activities of the sub-programme on energy that indirectly address matters related to energy security, such as, activities to assist Member countries to improve energy conservation and efficiency, maintain well-balanced energy networks to optimise operating efficiencies, and identify best practices and share knowledge regarding new environmentally-sound and economically-viable technologies, particularly for fossil fuels. Indeed, the growing concern of the UNECE countries about energy availability and security of energy supplies might well call for activities in this area to be strengthened.

94. The UNECE is involved in a number of activities aimed at facilitating the international trade of its member countries. These activities aim to support trade by: recommending policies and best practices for facilitating trade and improving trade efficiency; developing and promoting international norms and standards as well as simple transparent and effective processes; and contributing toward a harmonized regulatory environment. In this context, the UNECE has developed several areas of specialized expertise. Trade facilitation tools and e-business standards are developed by the UN Centre for Trade Facilitation and Electronic Business (UN/CEFACT) in close cooperation with the World Trade Organization, the World Customs Organization and other international organizations. The adoption of this work by member States and the private sector results in increased efficiency, improved market access and stronger participation of less developed economies and small and medium-sized enterprises in the global economy through simplification of the trade transaction process.

95. The UNECE is also involved in developing recommendations on how countries can best harmonize regulations on a bilateral and multilateral basis as well as promoting the use of international standards in regulations and identifying best practice for the enforcement of product regulations. Standards work is done in close cooperation with ISO as well as international organizations active in certification and mutual recognition. Trade in agriculture products in the region makes extensive use of the UNECE agricultural commercial quality standards which determine the different categories referenced in contracts (and presented to the consumer). Work on these standards is done in close cooperation with the OECD and the FAO. In all of these areas, the UNECE also provides capacity building to less advantaged member States. At the regional level, these contributions to trade infrastructure facilitate and strengthen the economic integration of member States, and especially the emerging market economies into the European and global economy.

96. The forest and timber sub-programme addresses the issues of sustainable development in a specific sector, aiming to promote sustainable forest management through monitoring and analysis of forests, markets policies and institutions, and seeking balance between the three pillars. It has helped in the development and implementation of indicators of sustainable forest management, as support for decision-making at the national and regional level.

97. Measuring economic development and progress of countries in a comparable way is not possible without reliable official statistics produced and disseminated in an impartial and sustained way. The UNECE is contributing to closing the gap between the statistical capacities of the countries in the various sub-regions of the UNECE through a number of activities that are

part of its statistical programme. Through the Conference of European Statisticians, it has a well established network with national statistical offices that allows it to develop and revise statistical standards (in most cases jointly with other organizations), to identify leading practices of implementation of these standards at national level, and to provide assistance to countries on request in a selected number of areas where the UNECE has expertise such as national accounts, informal economy, price statistics, business registers, industrial production, and rural development. The UNECE also provides a selected number of key economic series through its publicly accessible database. In addition, the UNECE is involved in the assessment of the institutional and legal frameworks of official statistics in transition economies, and in assisting countries in improving these frameworks, using the UNECE Fundamental Principles of Official Statistics as a benchmark. In doing so, it continues to help promoting the importance of official statistics, and the need for adequate resources for this public good.

98. With the reform, the UNECE will devote more and concentrated efforts to promoting and fostering pan-European economic cooperation and integration. In addition to the traditional channels related to its areas of specialization and technical expertise it will contribute to a demand-driven policy dialogue and exchange of experience and best practices among member States on economic growth and innovation-driven development and will contribute to the elaboration of recommendations and guidelines to this effect.

The environmental pillar

99. The aim of the UNECE work on the environment is to reduce the pollution burden and improve environmental management. The main tools are legally binding instruments, guidelines, recommendations and capacity building activities. The UNECE member States have negotiated five environmental treaties and 12 protocols to them. These treaties provide forums for both policy discussions and technical solutions for improving the environment. The environmental performance reviews of the emerging market economies provide a good example of soft regulation. These reviews provide in-depth knowledge about the environmental situation in a given country as a basis for recommendations for improvements. Cross-sectoral cooperation like that on health and environment, transport, health and environment, water and health and education for sustainable development bring in a new dimension of integration of environmental concerns in economic and social sectors. The work to improve the environmental situation across the UNECE region also promotes a level playing field for economic actors by harmonizing environmental rules.

The social pillar

100. All the UNECE programmes contribute to policies of the member States aiming at the achievement of the Millennium Development Goals (MDGs) by 2015. Such contributions are reviewed in another document (E/ECE/1438). The UNECE work pertaining to social sustainability in the longer term focuses on ageing, conflict prevention and security, housing, social indicators and gender issues.

101. The pan-European strategy for coping with the issues posed by ageing is based on conclusions of the Ministerial Conference on Ageing held in Berlin in 2002. It is organized in 10 commitments, which emphasize the importance of mainstreaming ageing into various policy fields, and underscore that policies for different sectors, systems and groups ought to be comprehensive, well coordinated and mutually supportive. Within each of the commitments, specific policy objectives that need to be fulfilled are identified. Moreover, the UNECE has

recently started an interactive policy-oriented project to assess the effects of ageing on sustainability of social-security systems in the CIS and southeast European countries. It strives to complement similar projects carried out by the EC and OECD in cooperation with their respective member States, thus providing the authorities in the participating CIS and south-east European countries with comparable diagnostic tools that can be used to develop evidence-based policies to address proactively the longer term social-security imbalances resulting from the ageing process.

102. Economic and social development cannot proceed under conditions of violent conflict or war. Following a pattern of cooperation that has become well established since the mid-1990's, the UNECE is working closely with the Organization for Security and Cooperation in Europe (OSCE) to develop more effective strategies for conflict prevention and security, and looking at new policy responses to risks in the economic and environmental dimension. The recent Report of the UN Secretary-General's High-level Panel on Threats, Challenges and Change noted economic and social threats and environmental degradation among the six main clusters of threats with which the world must be concerned now and in the future. It also urged the United Nations to cooperate more closely with regional and sub-regional organizations. The close, cooperative and fruitful cooperation between the UNECE and OSCE over the last few years is a good example of an effort consistent with the latter recommendation.

103. The housing stock is one of the most important assets in European countries. The investment in, the renovation and management of the housing stock have a great impact on the economy and the social well-being of the tenants. In particular, the state of the housing stock after mass privatization in countries in transition is of concern as the renovation is miniscule and the management insufficiently professional. In many such countries social cohesion is jeopardized by dilapidating housing areas combined with high unemployment and inadequate social support systems. These problems have a potential of creating unrest and bitterness. To improve the situation the UNECE has drafted guidelines on condominiums, social housing and housing finance. The implementation of the guidelines is supported by sub-regional and national workshops. Also, the programme on country studies promotes improvements through concrete recommendations. The mass privatization of the housing stock and land made establishment of a functioning land management urgent. Using country studies and guidelines the UNECE is helping countries in transition to move forward. One of the tasks for the UNECE is to highlight the economic importance of adequate housing and land management while stressing the social urgency of tackling the underlying problems soon. The exchange of good practices and experience of challenges throughout the region can provide crucial benefits.

104. The social pillar is very much present in the statistical programme of the UNECE. As with the economic pillar, development and progress cannot be assessed without reliable official statistics. Compared to economic statistics, social statistics are much less harmonized between countries, and the availability of good quality official data remains patchy, and has even deteriorated in some cases. The adoption and implementation of the Recommendations for the 2010 Round of Population and Housing Censuses, jointly developed with the Statistical Office of the EU, is a priority activity in the coming years. In selected cases, this may include an involvement of the UNECE as part of an official census monitoring exercise carried out jointly with the Council of Europe and the Commission of the EU. Other areas of work towards standards include guidelines to improve the collection and the harmonization of statistics about health and victimization. The UNECE is about to review the capacity of the emerging market economies to produce MDG indicators as a regular part of their statistical activity, and is

involved in technical cooperation pertaining to MDG indicators and gender statistics, including the training of users to make good use of such data, in cooperation with UNDP and UNICEF. The UNECE maintains a publicly accessible database on gender statistics, and will soon release, jointly with UNDP and UNICEF, a set of MDG indicators for CIS and south-east European countries. Discussions with partner organizations to set up a joint sustained endeavour for an MDG database concerning the UNECE region have started.

105. Furthermore, the UNECE develops policy advice concerning the property rights of the poor. In this context, it supports social stabilization in the UNECE emerging market economies. The gender dimension continues to permeate all areas of work of the UNECE and each work programme takes into account the gender implications of its activities. Apart from that, the UNECE also undertakes a series of activities dealing specifically with gender issues.

TABLE 1

Average annual changes in real GDP and per capita GDP levels in the UNECE region, 1995-2005
(per cent and indices)

	Average annual percentage change in real GDP			GDP per capita, 2004	
	1995-2000	2000-2005	1995-2005	(United States=100)	(EU=100)
United States	4.1	2.6	3.3	100	138
EU 15	2.9	1.6	2.2	72	100
of which:					
Euro area	2.8	1.4	2.1	71	98
France	2.9	1.6	2.2	74	102
Germany	2.0	0.7	1.4	72	99
Italy	1.9	0.8	1.3	69	96
United Kingdom	3.2	2.3	2.8	79	109
Central Europe	4.2	3.4	3.8	36	50
Baltic States	4.8	7.4	6.1	31	43
South-east Europe (excluding Turkey)	0.6	5.2	2.9	19	26
CIS	1.4	6.7	4.0	19	26
of which:					
Russian Federation	1.6	6.0	3.8	25	34
European CIS	-0.7	8.2	3.6	16	22
Caucasian CIS	6.3	10.1	8.2	10	13
Central Asian CIS	3.2	7.7	5.4	9	13
<i>Memorandum items:</i>					
New EU-10	4.2	3.6	3.9	36	50
EU-25	3.0	1.8	2.4	67	92
Industrialized western Europe	3.0	1.8	2.4	67	93

Source: UNECE secretariat calculations based on data from the UNECE statistical database, stat@unece, and World Bank, *World Development Indicators Online*.
