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THE PACE OF A LACKLUSTRE
RECOVERY

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The quest for financial stability in the post-crisis global economy

Jonny Greenhill and Gianluca Riccio say that greater coordination is needed to strengthen financial stability, economic growth and returns on investment in what is a currently lacklustre recovery

“Unusually weak” were the words chosen in June this year by OECD Chief Economist Catherine Mann to describe the recovery from the 2008 global financial and economic crisis.¹ Broadly speaking, the world has been experiencing a strikingly slow, tepid, and uncertain return to growth and job creation. Business investment – a key driver of growth, jobs, productivity, and wellbeing – has not rebounded nearly as quickly or as forcefully as any of the other major recoveries witnessed over the past four decades, including the post-1973 oil crisis recovery.² The recent volatility in financial markets generated by China’s economic slowdown has also revealed the continued fragilities in the global recovery.

Since the outbreak of the 2008 crisis, countries have harnessed fiscal, monetary, and structural policy levers to steer their economies onto a more sustainable footing. At a global scale, these actions appear to be generating results: latest forecasts by the OECD, IMF, and World Bank all expect growth to gain some momentum in 2016.³ But, they say, the return to sustainable growth will be slow.

There is an urgent need to strengthen the pace of what is currently a lacklustre recovery. To do so, many discussions rightly focus on reducing policy uncertainty, cutting red tape, and introducing product and labour market reforms.⁴ But there is another key aspect in this debate that needs to be urgently understood and addressed: how to revive the financing of our economies.

It may be obvious, but let’s recall that all actors in markets – ranging from homeowners and pensioners to businesses and governments – use financial services to access credit and/or allocate money. Quite simply, financing is an integral part of growth and wellbeing. But in recent years the financial system has undergone profound change, mainly as a result of new regulatory initiatives. Could constrained financing be one of the main reasons behind the world’s meagre recovery?

Financial reforms and their combined consequences

The financial system was at the epicentre of the 2008 crisis. Unsurprisingly and rightly so, the reaction of G20 leaders was to strengthen financial stability. The main result was the internationally-agreed Basel III reforms in the areas of capital, liquidity, and leverage.

According to Mark Carney, Chair of the Financial Stability Board (FSB), the impact of the internationally-agreed reforms is that the financial system is now safer, simpler and fairer.⁵ Stefan Ingves, Chairman of the Basel Committee on Banking Supervision, similarly notes that *“the main components of Basel III are essentially done”*.⁶

Many countries and regions then took additional measures intended to bolster stability. In the EU alone, the European Commission has [proposed](#) more than 40 major legislative and non-legislative measures since 2008 (this does not include measures taken by individual European member states).⁷

Having championed international cooperation in the midst of the 2008-09 crisis, the G20 should rekindle that spirit to coordinate approaches for stability, growth, and investment

The worry is that the myriad post-2008 financial regulations around the world may cumulatively, and unintentionally, undermine the global economic recovery. While the focus on regulations for financial stability was needed, they are all-too-often uncoordinated. There also appears to have been an underestimation of their potential unintended consequences. Both the sheer volume and inconsistencies of such regulations may be hampering the ability and confidence of firms and individuals to invest, hence curtailing economic growth.

This discussion is not new. Since the 2008 crisis, the financial industry has been very vocal about the unintended consequences of financial regulations. But what is new is that other actors have also started to sound the alarm.

For example, Jonathan Hill, European Commissioner for Financial Stability, Financial Services and Capital Markets Union, recently highlighted the pressing need to *“understand the combined impact of our rules and the consequences, sometimes unintended, of interactions between different pieces of legislation, as well as the cross-border inconsistencies in rules or in their implementation”*.⁸

In addition, Randall Kroszner, former governor of the US Federal Reserve, has added that *“we always need to consider unintended consequences and cost-benefit trade-offs, even for extremely well-motivated rules”*.⁹

The issue is essentially one of coordination. Where financial regulations and economic policies are poorly coordinated, our economies and societies run the risk of regulatory arbitrage, competitive distortions, fragmented policies, unintended side-effects, and potentially destabilising bubbles.

A more coordinated approach for financial regulation

Imagine that the global economy sits atop a three-legged stool. The legs represent three pillars of the financial system: [1] financial stability; [2] economic growth; and [3] return on investment. The global economy can only sit sustainably atop the stool if the three legs are balanced in relation to the ground they stand on.

Figures 1 and 2 present the three legged stool in the form of a triangle. Figure 1 shows an equal balance between all three pillars, represented by the equilateral triangle. Figure 2 presents a situation where financial stability is over-emphasised to the neglect of economic growth and returns on investment, thereby skewing the triangle and generating unintended consequences.

- Where attention is only devoted to strengthening the pillars of economic growth and return on investment, to the neglect of financial stability, the global economy may at some point slip off the stool into a financial and economic crisis (as was the case in the run-up to the 2008 crisis).
- Conversely, where attention is only devoted to strengthening financial stability without equal attention to economic growth or return on investment, the result may be a safer financial system but the global economy may slide into economic stagnation.
- Where there is focus only on strengthening financial stability and economic growth, but insufficient attention to return on investment, the global economy may eventually topple as ultimately investments are not paying sufficient returns to support growth.
- Finally, if attention is only devoted to returns on investment, financial sector returns may not feed into broad-based economic growth, may lead to inequalities, and may generate instabilities.

The purpose of this analogy is simply to show that governments' policies for growth, regulators' approaches for financial stability, and the finance sector's need to generate returns on investment, are all inherently interlinked. To properly address any one aspect in this 'triangle', a coordinated and comprehensive approach involving all actors is needed.

Figure 1: Visualizing three factors necessary for sustainable economic growth, financial stability, and returns on investment

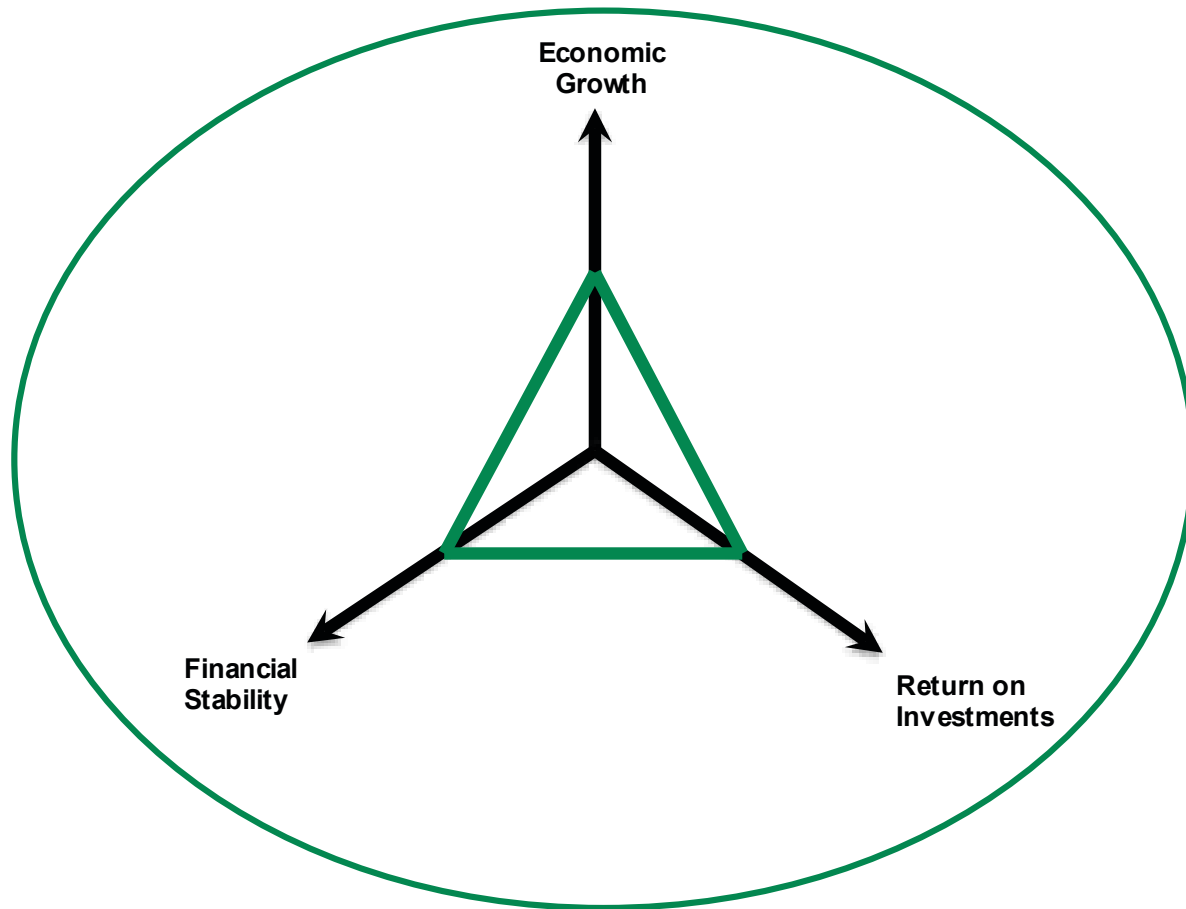
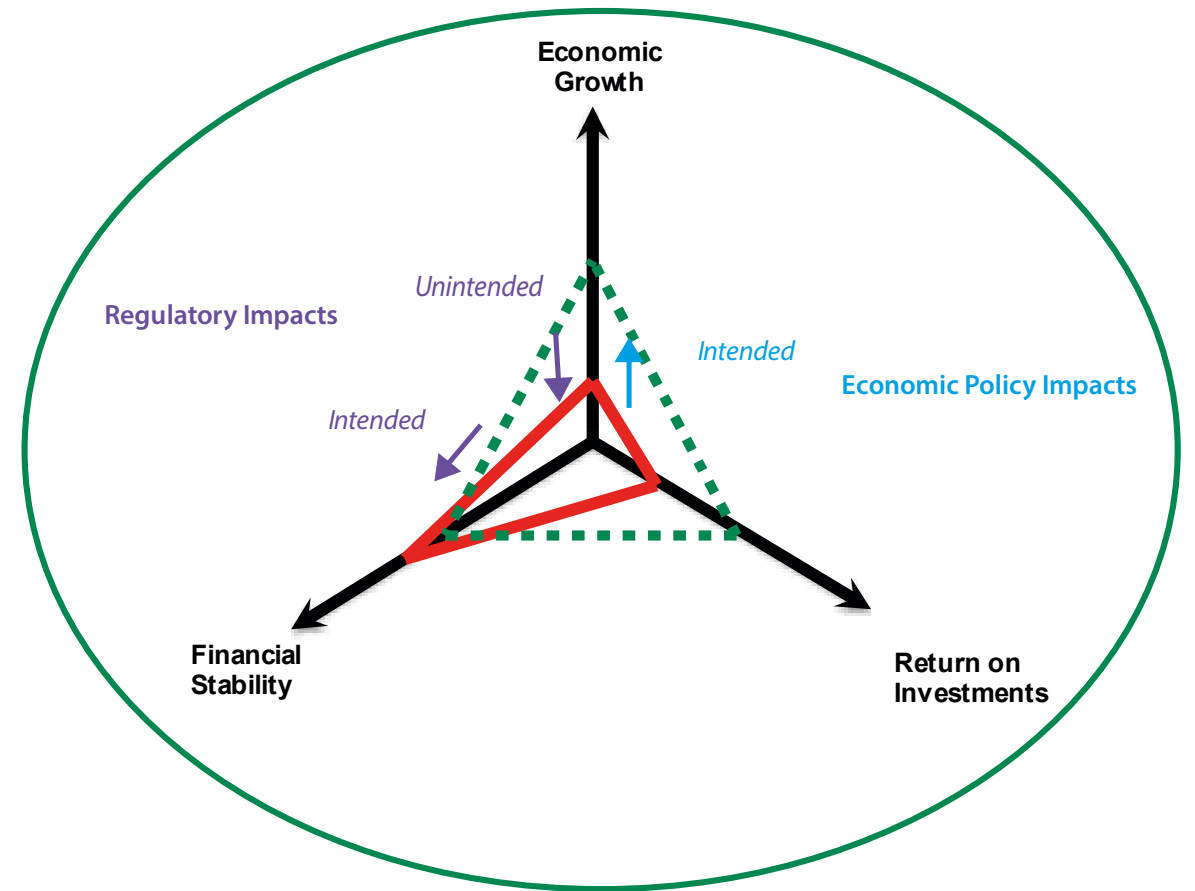


Figure 2: The current state of play



Today's lifeless recovery may therefore reflect an imbalance in the triangle. Efforts to enhance economic growth may be unintentionally offset by measures to strengthen financial stability, and as a result the stool or triangle is unbalanced. The challenge is not to reverse the greater financial stability achieved in recent years, but rather to ensure that stability can proceed hand-in-hand with economic growth and return on investment.

Case and point: SME financing

Accounting for 60 to 70 percent of employment and over 50 percent of value-added in OECD countries, SMEs are vital for growth, investment, productivity, and jobs. They are therefore central to the recovery of the global economy. But to deliver much-needed growth, SMEs need to be able to access the financing they require to support their business growth and risk management activities – not only domestically, but also across international markets.

Worryingly, SME financing has still not recovered to pre-crisis levels in several countries. In Spain, for example, new lending to SMEs fell by almost 65 percent between 2007 and 2013.¹⁰ Research indicates that this widespread decline can be largely attributed to banks deleveraging to meet new banking regulations and reduce their risk exposure.¹¹ SMEs are hard hit because they rely mainly on bank financing in most markets around the world.

An SME expects the financing it receives to be safe and predictable – that's what financial regulations and supervision are intended to deliver. But an SME also expects that it can access financing without unduly burdensome costs or obstacles. Meanwhile, a bank lender expects the SME client to provide sound information about its creditworthiness in order to meet financial stability requirements. And both parties expect that their relationship should generate appropriate returns on investment relative to the amount of risk involved.

One example where regulation is having an unintended impact on SME financing is in the area of Know Your Client (KYC) conduct regulations. While these rules are of paramount importance, their insufficient coordination has led to costs for opening simple accounts in different markets to levels that are significant (and in cases unsustainable) for

smaller SME players. A vicious cycle therefore exists, whereby an SME cannot tap into global markets because it is unable to secure the necessary financing to do so, leading to negative impacts on its competitiveness and productivity.

The Business and Industry Advisory Committee to the OECD (BIAC) and the B20 Turkey are leading discussions on how to revive SME financing across global markets. A recent [BIAC-B20 Turkey publication](#) identifies three recommendations to G20 leaders to expand their focus from gatekeepers of stability to also being enablers of growth and investment:¹²

- Firstly, *focus on coordination, consultation, and impact assessment*. Policymakers should recognise the broader economic impacts and cumulative effects of policy and regulatory approaches – both domestically and across borders – within the nexus of financial stability, economic growth, and return on investment (think of the triangle mentioned earlier). Impact assessment and consistent implementation play an essential role in mitigating against unintended consequences of regulations, and thus an international principles-based implementation process for financial regulation should be introduced.¹³
- Secondly, *raise SME access to finance and skills* through an integrated approach that ensures seamless financing to SMEs along global value chains. This may include, among others, greater use of credit insurance, partnerships among financial service providers, high-quality securitization, guarantees, and equity crowdfunding. It may also consist of measures for investing in skills – both financial and digital.
- Thirdly, *maximise the sharing of information* through digital platforms to enhance the flows of financing, skills, and investment throughout global value chains. A central global online platform for data and information exchange could be introduced, while existing platforms could be reviewed to strengthen coordination.

Future directions

Financing has an invaluable role to play in supporting and enhancing the global economic recovery, yet there is too little known about the ways in which the unintended consequences of financial regulations may be affecting the recovery. The retreat of SME financing in many countries may be one such consequence.

Most crucially, comprehensive and coordinated approaches are needed to mitigate against such unintended consequences of regulations, built on close dialogue between regulators, governments, and the private sector. Having championed international cooperation in the midst of the 2008-09 crisis, the G20 should rekindle that spirit to coordinate approaches for stability, growth, and investment. Government leaders should seize the opportunity to put this dialogue into motion at the G20 Leaders Summit in November this year in Antalya, and to carry it forwards during the Chinese G20 Presidency next year. ■

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13. This approach is advocated by the Global Financial Markets Association (GFMA), among others.
14. The views expressed in this article do not necessarily reflect the opinions of BIAC or Lloyds Banking Group.

The background of the slide is a composite image. It shows a view of Earth from space, with the blue and white atmosphere of the planet curving across the frame. Overlaid on the continent of Europe is a large, green fingerprint, symbolizing the 'policy laurels' mentioned in the text. The text is in a clean, white, sans-serif font.

Time is up for a Europe resting on its foreign policy laurels

Daniel Schade explains why Europe's status as an economic giant but political dwarf simply isn't enough anymore

Little could Belgian's former Foreign Minister Mark Eyskens know how far his foresightedness extended when he uttered his now famous aphorism: *"Europe is an economic giant, a political dwarf and a military worm."* He made his comment amidst the political woes of the first Gulf War in the early 1990s, arguing that Europe's clout in the world disappeared almost entirely beyond the external effects of its internal market integration. 24 years later, the meaning of his words couldn't ring truer.

Despite various reforms to the European Union's foundational treaties since then, all partially aiming at giving Europe more political coherence and unity in the world, not much has been achieved in this realm. The assessment rings even more true when it comes to military issues, despite the creation of a dedicated European military presence with the creation of the Common Security and Defence Policy (CSDP). In a nutshell, when it comes to politics and the military, Europe today is pretty much what it was almost a quarter of a century ago.

Worse still, while considerable progress has been made to increase the EU's role in and for the international economy by giving it more powers with every treaty reform since Maastricht, this has been counterbalanced by an ever more complex international environment.

Where it was sufficient in the past for the EU to play its card as the world's largest economy to influence global policy, today's realities require a new European attitude. This is firstly due to the fact that Europe has always punched considerably below its weight. This is now combined with a second reality: that Europe is becoming less and less important in the contemporary world.

In an ideal world, a qualitative jump of Europe's powers would be required to tackle both of these problems. As this is likely to remain a pipe-dream in the medium term with the EU in introspective crisis mode, a significant increase in Europe's foreign policy visibility is the least that can be done.

Europe's role in structuring the global economy

Let us begin with the good news: despite the fact that Europe's economy has not grown significantly ever since it was hit by its worst crisis since the Great Depression, the 28-country bloc still remains the world's largest economy. It accounts for almost one quarter of the world's gross national income and one sixth of world trade.

It also holds considerable clout in some of the institutions governing the global economy. As the world's largest trading power, its influence at the consensus-driven World Trade Organization (WTO) is considerable, as the whole of the EU is represented with a single seat for the EU institutions, rather than 28 for its individual member states.

Through its sheer market power, the EU is equally able to significantly influence global product, as well as trading standards. Its ability to grant access to the single market is a further policy tool that can wield considerable power if used wisely. Take the example of the recent EU-Canada Free Trade Agreement (FTA). Through the agreement, Canada—which is a G7 power in its own right—will be required to accept some of the EU's protected agricultural product names and standards.

... the domain of Europe's foreign policy remains even more bifurcated than in the realm of the single market or its development policy

The possibility of preferential access to the EU's single market is so attractive for third countries that the EU is currently overwhelmed by requests to either conclude completely new agreements or significantly update existing ones—if talks were to begin with all of these countries at the same time, the EU Commission's negotiating teams would not be able to cope anymore, rather than being simply overworked as they are now.

Beyond its market and trading power, the EU nominally equally holds a significant vote share at other institutions governing the functioning of the global economy. These are namely the International Monetary Fund (IMF)—of which the president is traditionally always a European—as well as the World Bank.

Yet, this is where similarities to the image of Europe as a trading power end. Where the EU holds a single seat at the WTO, its position at the IMF and World Bank is merely that of a sum total of the EU's member state seats, which are all represented individually. Rather than being a visible actor in these institutions, the EU is hence dependent on the clout of its individual member states, none of which remain economic superpowers in their own right. Even Europe's largest economy, Germany, accounts for only 5.81 percent of votes under the current IMF system, compared to the United States' 16.74 percent.

This is exacerbated by the loss of perceived legitimacy of the above institutions. The IMF's antiquated voting shares and rules are set to be altered to more adequately represent today's global economy by giving rising powers more influence. However, this reform, which was agreed to in principle by the G20 in 2010, has remained in gridlock ever since. This is due to a blockade of the reform by the United States of America, as well as a more tacit passivity on the part of Europe's IMF members. The former would lose its veto power with the reform, whereas Europeans are equally concerned about losing their possibility to nominate the institution's head. Even if the reform were to be adopted today, however, it would already lag much behind current economic realities, with the BRICS countries accounting for roughly 20 percent of the world economy.

The recent move by the BRICS countries (Brazil, Russia, India, China and South Africa) to create the so called New Development Bank (NDB) project is evidence of a loss of confidence in the existing institutions, as well as a gradual shift of power away from Europe and North America. Currently the above countries generate more than 20 percent of the world's GNI, whereas their vote share only accounts for little more than 11 percent at the IMF. The New Development Bank, which is modelled after the original example of the IMF, hence has the potential to significantly alter the functioning of the global economy.

Rather than play a more active role in reforming the existing institutions and adapting them to reflect current realities, the EU has remained largely absent from the debate. This is due to member states being reluctant to give up their individual seats at the above institutions, as well as their historically important voting shares. The EU's internal quarrels about rescuing Greece and the related role of the IMF certainly haven't helped either.

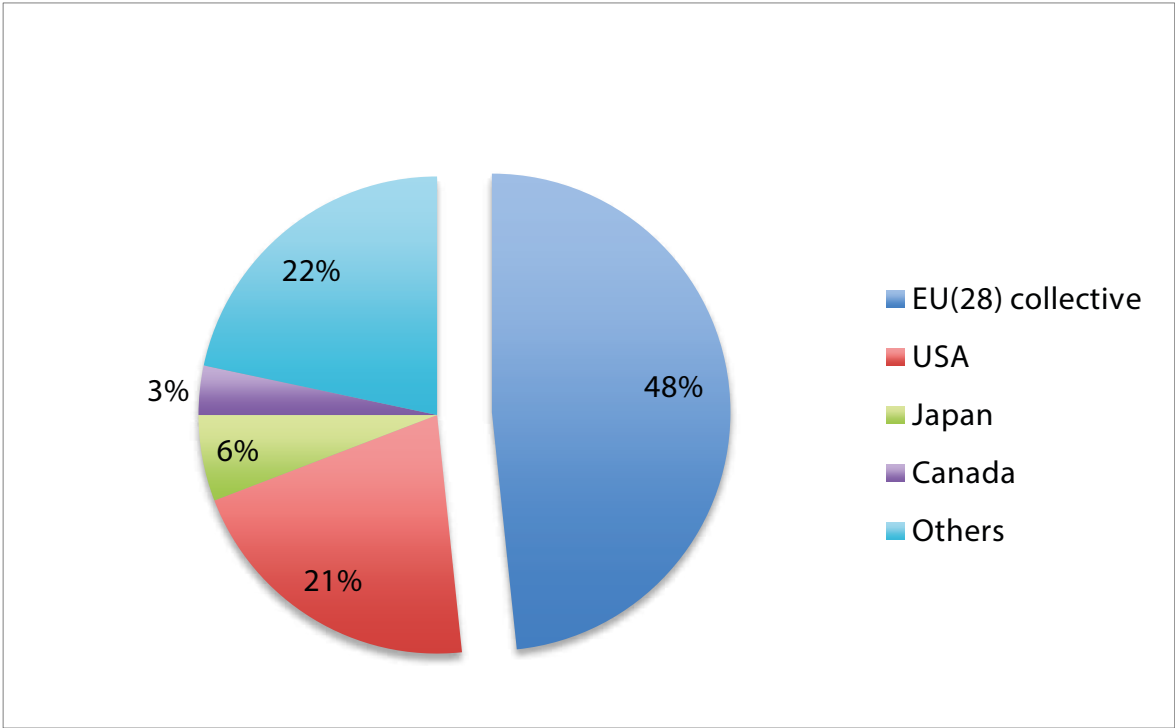
Without becoming more visible within institutions like the IMF, and accepting new realities, however, Europe may soon find itself side-lined from the most important decisions on the global economy.

Development policy dilemmas

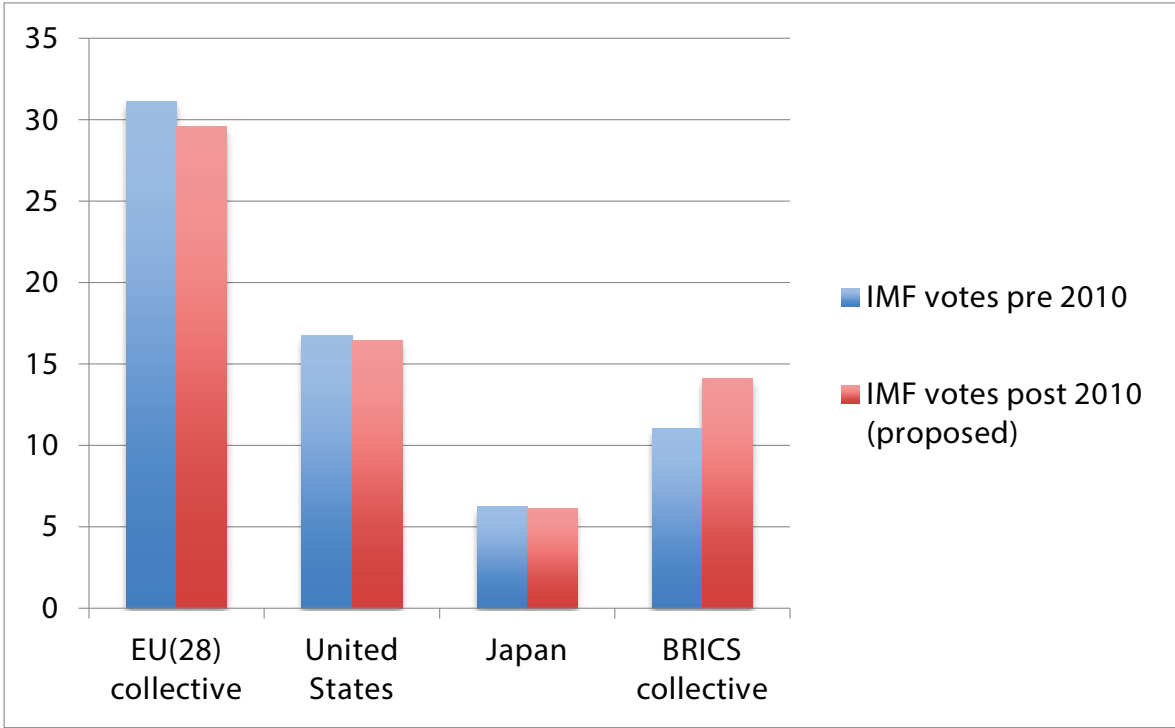
Another realm where the European Union would nominally appear to be a giant is that of development policy. With 58 billion euros the EU's combined Official Development Aid (ODA) in 2014 amounted to almost half of the total 120 billion euros reported, largely surpassing the United States' 25 billion euros.

Yet only a small portion of these sums, little more than 12 billion euros, were disbursed through the EU institutions, such as its development aid agency EuropeAid or the European Investment Bank (EIB). The remainder was distributed directly by member states, giving these an individual development aid presence. Aside from the obvious problems of maintaining dual structures and attempting to coordinate the different efforts, this once again poses important visibility problems for the EU.

ODA in billion €



IMF votes



Where European Development Commissioner Mimica boasted with the above impressive total numbers in the context of the recent Addis Ababa Conference on Financing for Development, the reality remains that aid is pledged and disbursed through a number of different agencies, ministries and institutions—making it more difficult to grasp Europe’s impressive collective role in development.

The EU is hence once again punching far below its nominal weight in this policy domain, as the individual contributions of its member states don’t generate the same clout or visibility that a truly European development policy would.

More so, the role of the EU institutions at international negotiations is somewhat bizarre. While Europe reiterated its goal to spend 0.7% of its Global National Income on official development aid in the future at the recent Addis conference, the EU is unable to modify its policy on its own and depends entirely on individual member state policies. If individual countries cut their ODA funding like Finland recently did, the EU institutions have no way to counteract or prevent such decisions.

While Europe’s position in the realm of development policy looks even stronger than its contribution to the world’s economy, a similar shift of importance of Europe’s position can equally be observed. Whereas Europe is the champion of ODA and will nominally remain so for much longer, the above statistics ignore the fact that countries like China pursue their own kind of development policy. These countries either chose not to report their numbers for political purposes, or conduct development policy in such a way that would not qualify for it to be officially classified as such.

Even with a close to 50 percent share of the world’s official development aid, Europe’s position in development policy is hence equally dwindling. Much as in the realm of managing the global economy, it is only by becoming more visible that Europe can counterbalance its ongoing loss of importance.

An incomprehensible foreign policy

Europe's visibility problems can perhaps be illustrated best in the case of more traditional foreign policy. Despite ever-increasing attempts to graduate Europe from its role as a political dwarf, none of this has led to any significant changes to Europe's visibility or influence.

While EU government now contains a proto-foreign minister, its problematic position within the EU's organizational chart has possibly rendered the EU's visibility troubles worse in this domain. Rather than limiting the number of people who can officially speak on behalf of Europe, the EU now has three different posts that can be considered to fulfil such a function. These are namely the High Representative (Federica Mogherini), the President of the European Commission (Jean-Claude Juncker), as well as the Head of the European Council (Donald Tusk).

Worse still, the domain of Europe's foreign policy remains even more bifurcated than in the realm of the single market or its development policy. For instance, while the EU now has a right to speak on its own behalf at the United Nations, its member states are not bound to vote in line with the position of the representative of the European Union itself.

At the regular summits between the world's most important countries, the G7 and the G20, the EU is also represented in its own right. Unlike any of the other participating states—some of which are EU member states themselves—it has to be represented by both the European Commission President, as well as the Head of the European Council due to the proliferation of its representative posts. Much as in the policy domains described above, it remains difficult to imagine for the EU itself to gain in visibility or influence at such meetings when its most important member states are also represented individually, and without giving the EU's institutions decision-making power over the kinds of issues discussed at such summits.

Once again, coordinating the positions of the EU's members partaking in such meetings could address parts of the issue in this domain in the short- to medium-term.

The overarching need for visibility

The above examples clearly show that the days where Europe could happily content itself with its role as an economic giant are numbered. While the list of policy areas which can be used to illustrate similar problems is much longer, the elements depicted above should give a clear overview as to what kinds of issues Europe is facing when it comes to its global role.

In an ideal world, the answer to these problems of Europe's waning influence would be simple, namely making sure that Europe does more of what states have traditionally done themselves. And this is indeed what needed to have happened yesterday for Europe to retain a significant voice in the world. However, as this remains a least-likely scenario for the time being, we should nevertheless look at interim measures to be taken.

The answer in most cases is a simple one: more visibility for what Europe is and what it already does. If member states voluntarily agree to coordinate the remnants of their influence in international organizations or policy fields like development, Europe's visibility and clout can be significantly increased without altering the functioning of Europe itself, or indeed that of the international system. In essence, Europe today needs to do more with what it already has.

We need to embrace this possibility now if we are to ensure that our values and our identity continue to play a role in shaping the world of tomorrow. While the recent downturn of the BRICS economies may give us some more breathing room, we should not waste this opportunity in idleness—we should not wait to speak up until we have already been excluded from the international conversation. ■

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On the road to Paris

A global deal is our business

PARIS2015

UN CLIMATE CHANGE CONFERENCE

COP21·CMP11

Emma Marcegaglia has 10 recommendations to ensure success in the COP21 international climate change negotiations

The stakes for European companies are very high in the run-up to the United Nations Climate Change Conference in Paris in December 2015 (COP21). After the missed opportunity in Copenhagen in 2009 decision-makers now must seize this chance to provide for ambitious global action, committing all parties to a legally-binding agreement.

Business is a significant part of the solution to addressing the impacts of climate change. It is therefore important that such an agreement can support business innovation and growth. The global market for low-carbon and environmental goods and services is expected to grow to over €4.8 trillion by the end of 2015. This shows the size of investment that must be encouraged and facilitated across the world. A legally-binding international agreement is the best way to stimulate investment and provide opportunities for companies in the research, development and deployment of existing and new technologies.

Such a multilateral agreement must also help to drive the competitiveness of European industry, supporting global emissions reductions in an efficient manner. To safeguard sound international competition for industry and to ensure effective protection for EU companies against carbon leakage risks, it is vital that non-EU industrial competitors operate under comparable climate protection rules to EU companies. This will allow a level playing field for European businesses competing globally.

Preparing for COP21, BUSINESSEUROPE has devised 10 recommendations to the international climate change negotiations. Let me briefly sum up them here.

A shared vision for long-term global action

All countries must sign up to long-term global action, consistent with science, and to a continuous political process to review progress towards the objectives. European companies have helped the EU become the most emissions-efficient economy in the world. It achieved a 19% emissions reduction between 1990 and 2013 while its GDP

grew by 45%. Now the EU only accounts for nine percent of global emissions and this share is still falling.

To achieve a truly global level playing field more effort is needed from the world's major economies, too. Countries with the highest responsibilities and capabilities need to reflect this in the ambition of their commitments. Today China is responsible for a quarter of global emissions, while the US accounts for 11%, thus having major economies on board will be crucial to tackle world emissions.

In addition, the new agreement should have as much geographical coverage as possible. This would bring obvious benefits not only for the global climate but - by being subject to similar standards - also for businesses trading globally. Besides mitigation efforts, all industrialised, emerging, and developing countries should draw up national adaptation strategies.

Legally-binding global climate regime after-2020

All major economies must sign up to a legally-binding agreement under the United Nations regime containing transparent, comparable, fair and ambitious emission reduction commitments. All countries will benefit from an agreement with such a legally-binding nature. By establishing a common system, such a new deal will provide the necessary trust that each country is implementing its long-term pledge, while encouraging global ambition, predictability and legal certainty for investors.

Although some progress has been made, many countries have not published their Intended Nationally Determined Contributions (INDCs) yet. European companies call for the prompt publication of INDCs from those countries that have not done so. An early submission is essential for a timely evaluation of the total contributions ahead of COP21. Regarding those that have already published their INDCs, in some instances there is still not enough clarity on how they will impact their industrial sectors exposed to global trade.

Emission-reduction efforts – also from emerging economies

The United Nations Climate Change Conference (UNFCCC) is based upon the notion of action based on the respective capabilities of individual nations. Given the urgency of the problem, all countries need to act without delay and collectively. Since the Kyoto Protocol was agreed in 1997, the geo-economic landscape of the world has changed. While some emerging economies still face challenges, their capabilities have also evolved.

Therefore, advanced developing countries should commit to setting their emission policies in a way that reflects their actual capabilities. This stems from the need for collective action but it will also be in the interest of these economies to be on the same global level playing field. For that purpose, a review process should also be established to encourage comparable efforts as much as possible.

Common regime of measurement, reporting and verification

To achieve the necessary confidence among parties, the new agreement must provide for robust transparency and accountability. The new regime must therefore include comparable national rules on measurement, reporting and verification (MRV) as well as a review process on an annual basis. An enforcement and sanction mechanism for non-compliance with reduction commitments must also be established.

All countries must sign up to long-term global action, consistent with science, and to a continuous political process to review progress towards the objectives

A common regime will be essential to provide the certainty that all parties are using the same reference not only to measure emissions but also to assess how they are on track to meet their respective commitments. This becomes even more necessary in the event of linkages between different regional carbon markets. In addition, the sharing of best practices should be encouraged. European industry has deep expertise in MRV and would be able to offer adequate capacity building to foster the implementation of an MRV regime in other economies.

Linkable carbon markets

The development of a global carbon market will help stimulate investment in innovative technologies, installations and products in locations where they deliver the greatest possible climate benefits at the lowest economic cost. Market-based mechanisms – like the current Clean Development Mechanism (CDM), providing incentives to business to invest in emission-reductions in developing countries and cap-and-trade systems such as a reformed EU ETS – must be recognised as important tools to achieve emission reductions at the lowest cost to societies and economies.

Policy-makers should make every effort to ensure that carbon markets become compatible, linkable and attractive for all participants. To this end, they need to be designed in a carbon leakage-proof fashion and anchored in the new agreement, enabling the creation of a global carbon market in the long run. Comparable framework conditions will encourage businesses to continue and increase their investment in research and development of new technologies. This will require setting up a global level playing field to ensure fair comparison and should encompass similar methodology, tools and standards; including clearly defined indicators to assess the performance/efficiency in different regions of the world, taking diverging local conditions also into consideration.

The UNFCCC and business engagement

Businesses wish to see the creation of a recognized channel to improve their participation in the UNFCCC process. The expertise of the business community is essential to achieve successful outcomes and implementation. As a re-

sult, an institutionalised channel for private sector engagement should be recognised in the implementation of the new agreement. Over the years individual countries and COP Presidencies have sought ways to enhance the participation of the private sector. That has been the case recently in Poland and now in France.

A recognised channel for business participation within the UNFCCC would improve communication, information-sharing and enhance dialogue. It should be established in a manner enabling broad business participation by companies and associations through affiliates in all nations.

Besides enhancing routine interactions, this channel would lay the foundations of an official business dialogue to ensure the transparent engagement of the private sector in UNFCCC decision-making and implementation.

Investment in climate action

To encourage investment in climate action, financial instruments such as the Green Climate Fund (GCF), alongside other targeted measures, should act as catalysts to private investments. Business participation will depend largely on the investment environment and the effectiveness of institutional arrangements, which should be evaluated by independent experts. Resources for the existing Adaptation Fund should also be increased, entailing a fair contribution by all parties to the funds' reserves.

Eligibility for finance should be determined by using results-based criteria, such as the contribution to transformational change in the recipient region. The Green Climate Fund should be a pot of concessional loans, risk-sharing financing instruments and other sources of financing such as carbon financing from multilateral development banks. This would provide a basis for the Fund to leverage the huge amounts of private financing that are required to deliver climate mitigation and adaptation action. The Green Climate Fund should also be results-oriented and closely monitored - even when implementation of projects is left to accredited entities. We believe these funds must be used in strict compliance with strong pre-defined transparency and environmental-integrity principles.

Intellectual property rights versus compulsory licensing

Effective Intellectual Property Rights (IPRs) protection is key for technology to be developed, deployed and shared with others in global technology value chains as well as through trade and foreign direct investment. IPRs protection is critical for Europe's advanced manufacturing and clean technology sectors. It provides a key incentive for companies to invest in these markets and offers European companies a critical competitive advantage to our global trade. It also allows companies to work with business partners, suppliers, and customers around the world.

Successful technology transfer will be stimulated where companies can operate within a legal framework securing the protection of intellectual property and applying WTO-compatible rules. Global rules on IPRs have proved their value and should not be weakened in the framework of UN climate negotiations. BUSINESSEUROPE calls on the EU to ensure that intellectual property rights are fully protected within the current and future climate change agreements.

Clear measures to address forestry issues

The main deliverables of COP-18/CMP-8 in Durban on Land Use, Land Use Change and Forestry (LULUCF) which have since been transposed into EU legislation, should be included in the future International agreement in order to secure full accounting of emissions from forestry and land use change. These rules should be streamlined in a manner to ensure that more countries participate in proper forest accounting.

Global solutions for emissions from aviation and shipping

Given the specific nature of the aviation and shipping sectors, their emissions should be addressed as part of any post-2020 global climate change agreement. The international air transport and maritime organisations have been proactively involved in developing global solutions.

European companies' view is that imposing emission reduction burdens on European aviation and shipping unilaterally could lead to substantial carbon leakage in these sectors with little or no environmental impact. Non-harmonised national regulation could have a similar impact.

The new agreement shall ensure that it does not distort competition amongst aircraft or shipping operators and should treat both sectors indivisibly rather than by taking a country-by-country or a regional approach.

BUSINESSEUROPE's national member federations are convinced that a legally-binding agreement with comparable mitigation efforts from major economies is the best mechanism to provide the necessary certainty for business investments. Business is key for a successful and ambitious agreement in Paris as well as for its implementation. Therefore, if implemented, European companies' set of recommendations I've highlighted above will achieve adequate global climate protection as well as enable a true level playing field for European industry. ■

Emma Marcegaglia is the President of BUSINESSEUROPE



An opportunity to meet future challenges

2015 offers the opportunity to end poverty, reduce inequality and to avert the destructive effects of a global temperature rise, Petros Fassoulas writes

Three important summits taking place this year present the opportunity to decide on a new blueprint to tackle climate change, create a framework for the Sustainable Development Goals (SDGs) and deliver on development financing. As such 2015 offers the opportunity to end poverty, reduce inequality and to avert the destructive effects of a global temperature rise.

One integrated and comprehensive agenda

With one important summit having already taken place (July, Addis Ababa), two remain: Sustainable Development (September, New York); and Climate (December, Paris). The conclusions of the three summits should formulate, as far as possible, mutually beneficial goals and a coherent approach on development and environmental issues, and integrate economic, social and environmental aspects, so as not to work separately on interlinking problems.

Climate change and development are interlinked, with climate change exacerbating existing threats and environmental aspects relating to all parts of the development agenda. Global leaders have set ambitious goals, which will need binding agreements if they are to be met. From a civil society perspective the main goal of the climate objectives – to keep the rise in global average temperature below 2°C – and the main goals of the SDGs – including poverty eradication by 2030 – should be central to all measures and should not be compromised.

The Addis Ababa Conference on Financing Development held in July was the first step towards a coherent approach on development and climate change, laying the financial basis for the implementation of the Sustainable Development Goals. But the results were generally perceived as disappointing by engaged civil society organisations, thus stressing the need for more concrete and ambitious action at the summits still to come.

Stick to ambitious and binding goals

With the challenges ahead, action cannot be delayed. To start, ambitious and concrete pre-2020 climate action is essential. All countries, especially industrialised nations, should commit to step up their pre-2020 ambitions in Paris.

The same holds for the Intended Nationally Determined Contributions – national pledges to cut greenhouse gas emissions - that are falling short of the necessary cuts to keep the temperature rise below 2°C. But it is not all negative, with the G7 commitment to a decarbonised global economy by the end of this century in June, and the Clean Power Plan announced by US President Barack Obama this August. These developments create a positive momentum that hopefully results in a combined commitment that is adequate for the set task. But it cannot end at these commitments: a regular review and strengthening of commitments (every 5 years) should be adopted, with a regular upward correction of national contributions based on evolving global economic and geopolitical circumstances.

Further to presenting a far-reaching set of binding targets to all countries, support should be given to developing countries, ensuring that each country is able to meet its targets.

Stick to priorities

With regard to development, the European Movement welcomes the sustainable development agenda with 17 goals agreed by the UN member states on 2 August 2015, to be formally adopted at the New York Summit in Sep-

European institutions and member states must, together with all relevant stakeholders, define a strategy showing how these interlinked agendas will be implemented in Europe, and how our continent will reach the objectives set in 2015

tember. The post-2015 agenda is extensive, with no less than 169 targets to specify the overarching goals. Though this means many important elements are included in the SDGs, having 169 targets also runs the risk of having no priorities at all, and creates great challenges with regard to implementation and financing.

What should be the focus in the implementation of the SDGs - and climate agreement, for that matter - is to address the roots of poverty and inequality, with a basis on human rights. Equality, economic, social and cultural rights, good governance, the rule of law, and peaceful and inclusive societies – that also reach the poorest and most excluded – should be central elements.

A common European position

A key tenet for success across these conferences should be the promotion of a common European position, which will consolidate the position of the EU as a global actor and leader in the international arena. In order to do this, the EU should focus on its climate diplomacy, reaching out to as many partners as possible ahead of the conferences to promote the European position and act in response to other countries' priorities.

Following the conferences, the European Commission must ensure the implementation of the agreements and propose concrete measures to increase the interlinkage and coherence of relevant EU policies, enabling Europe to contribute to the attainment of global environmental and developmental objectives. The implementation of agreed and binding measures and targets on the European level will be essential – for reaching the set aims, as well as for the credibility of the EU. Here, much will depend on the ambition of the Juncker Commission and its ability to get all member states on board, especially in reaching the energy targets for 2030, which are binding at the European level but not necessarily at the national level.

Transparent multi-level monitoring

The climate objectives and SDGs should be implemented via a global partnership between all levels of govern-

ment, civil society, businesses and individuals. To ensure that participation and transparency are central elements in implementing, monitoring and evaluating both, an appropriate pressure mechanism will be needed, rather than a voluntary or state-led approach, to ensure national commitments are reached.

The genuine participation of citizens should be encouraged by ensuring the multi-tier approach proposed for SDG monitoring, including global, national, regional as well as local level accountability. Cities should be central in both implementation and monitoring of both SDGs and climate objectives. In addition, NGOs and other CSOs should be included in the design, implementation (where possible), monitoring, reporting and evaluation of specific objectives on which they are experts.

Furthermore, the inclusion of the local and regional level in the work towards all targets through the recognition, engagement and empowerment of local and regional governments is essential. This includes a central role for cities and urban development in the SDGs and climate objectives, as well as the 'localisation' of both to assess the impact on the local level and to increase local ownership and support for implementation. The Covenant of Mayors for local sustainable energy, or the climate pledge of the conference of mayors in July in the Vatican, are a case in point regarding the influence of local authorities, which often implement further-reaching measures than those agreed at the (inter-) national level.

Financing

Financing commitments are crucial for the implementation of the climate objectives and SDGs. The Addis Ababa Conference in July was not a promising start in this regard. The target of 0.7% of Gross National Income for Official Development Assistance spending by developed countries, endorsed in 2002 to be reached in 2015, was pushed back to 2030. The compromise on tax evasion, one of the main themes of the summit, was also disappointing without an agreement on a permanent intergovernmental tax body to lead international tax cooperation and stop illicit financial flows. With disappointing results on two key issues, the only solution is to put the question of develop-

ment financing back on the table in the context of the SDG summit. A political agreement on goals and targets with a great gap in the means of implementation would be worthless.

Climate finance is an equally important issue for the success of a new climate agreement. Developed countries agreed earlier to jointly mobilise \$100 billion per year by 2020 into climate financing through the Green Climate Fund. Adequate pledges were made to make the fund operational as of May 2015, but many governments – including European member states - are still expected to announce their contributions.

In addition to financing commitments, measures need to be taken to ensure that developing countries, especially the least developed countries, have access to finance, and receive support in terms of finance, technology transfer and capacity building, that will allow them to facilitate the implementation and achievement of the SDGs and climate objectives. An important agenda here will be to ensure that climate funding is also accessible for local and regional governments.

The development agenda further offers the possibility to set up the EU as a global leader by committing to more ambitious financial targets after 2015 and 2020. More financial resources are essential to the implementation of these agreements, and initiatives such as creating a European carbon tax or stimulating private investment would be potential ways of achieving this.

What legacy for the future?

This year's summits offer the opportunity to address the roots of poverty and climate change, as well as the causes of crises and conflicts in Europe and around the world. The proposed sustainable development agenda goes beyond 'helping the poor' and completing the unfinished business of the Millennium Development Goals, while the draft COP21 takes an innovative approach with the principle of 'common but differentiated responsibilities'.

Despite this, 'real commitments' are thin on the ground, illustrated once more by the July summit in Addis Ababa. European institutions and member states must, together with all relevant stakeholders, define a strategy showing how these interlinked agendas will be implemented in Europe, and how our continent will reach the objectives set in 2015. ■

Petros Fassoulas is the Secretary General of the European Movement International



People, planet, prosperity

With the countdown to UN Sustainable Development Goals well underway ICC lends a helping hand for businesses to foster their implementation

A major summit in New York this month is set to finalize a highly anticipated global action plan for ‘people, planet and prosperity’ that will require widespread engagement of companies large and small across the world. Comprising Sustainable Development Goals (SDGs), the plan was initiated by United Nations (UN) Secretary-General Ban Ki-moon some two years ago. UN member states will be expected to use the new, universal set of goals, targets and indicators to frame their policies over the next 15 years in what is the broadest, most ambitious development agenda ever agreed at the global level.

The SDGs have been developed through an extensive and inclusive consultation period lasting over three years and the global business community has played an important part in the process, with the International Chamber of Commerce (ICC) playing a leading role.

In what we believe is a major step change in international development cooperation, the SDGs place an unprecedented focus on the private sector as a driver of sustainable development. This approach mirrors the recently agreed UN Addis Ababa Action Agenda which emphasizes the need to better harness the power of the private sector to foster sustainable and inclusive growth across a broad range of areas – from project finance and encouraging foreign direct investment to supporting innovation and removing barriers to trading across borders.

The role of trade

Trade policy is central to the UN’s post-2015 development agenda and it is essential to ensure that the Addis declaration and the new SDGs kick starts a concerted push to deliver on three longstanding commitments. These are to implement the World Trade Organization (WTO) Trade Facilitation Agreement; to enhance the availability of trade finance; and to conclude the Doha Round of world trade talks before the end of the year.

The long-stalled Doha Round-launched in 2001-offers significant potential to reform the global trading system in support of the world’s poorest. While the official aim remains to conclude the Round by the end of 2015, WTO mem-

THE GLOBAL GOALS

For Sustainable Development



bers have made little progress to date in establishing a roadmap for the negotiations in key areas such as agricultural reform and services liberalization.

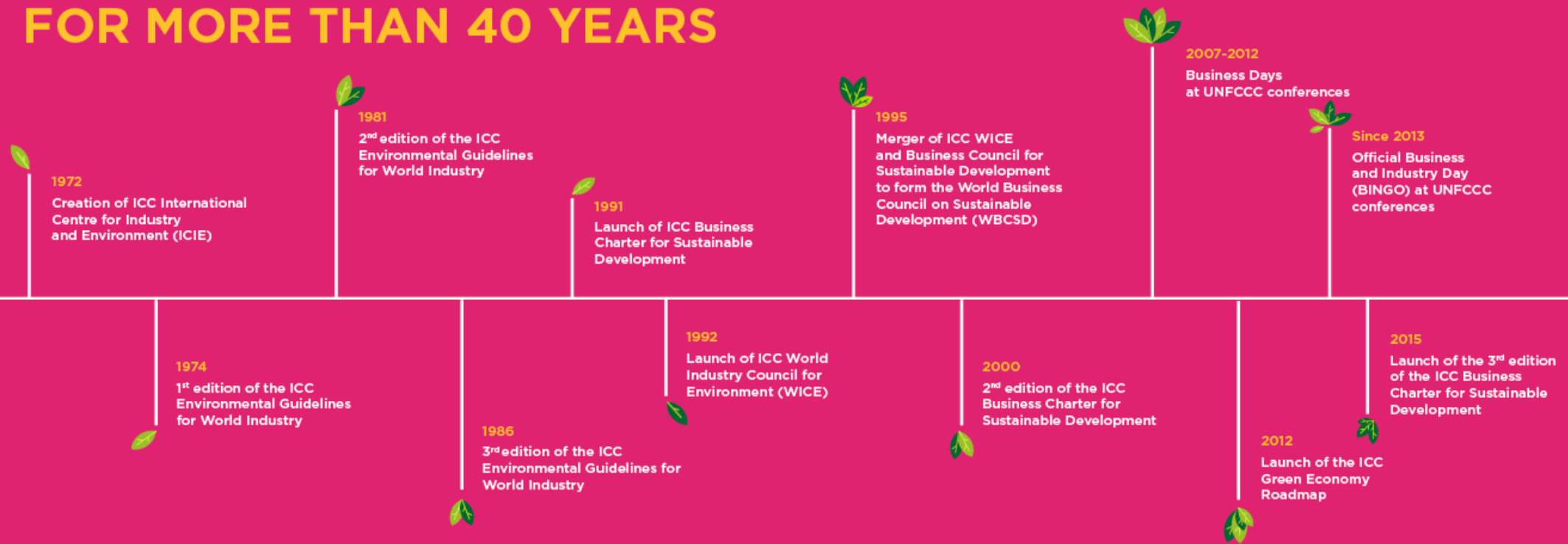
Engaging the private sector

Many leading companies are already taking action to put sustainability considerations at the heart of their business operations. Indeed, the role of the private sector is crucial for the progress of people and communities but Francisco Suárez Hernández, Corporate Affairs Officer for Coca-Cola FEMSA, an ICC member, says that sustainable development requires full commitment from all companies so that every action generates economic, social and environmental value simultaneously within its value chain.

To take just one example, recent research shows that companies with high ratings for environmental, social and governance factors have a lower cost of debt and equity – and frequently outperform the market in the medium and long term.

Becoming a sustainability leader requires changes in all relevant business practices, but at ICC we believe the effort to do so is most certainly worth it – in environmental, social and economic terms alike

ICC – PROMOTING SUSTAINABLE BUSINESS FOR MORE THAN 40 YEARS



A helping hand for business

Earlier this year at UN headquarters, ICC launched its new *Business Charter for Sustainable Development* which has been specifically designed to help companies take action and contribute to the implementation of the SDGs.

Martina Bianchini, Chair of ICC's Green Economy Roadmap was heavily involved in the development of the Charter and said that despite major strides forward on this agenda in recent years, SME engagement remains a challenge. Ms Bianchini notes while SMEs are the backbone of the global economy with potential for them to be the drivers of a new sustainability revolution, many existing tools are overly complex to fully engage small businesses.

Sustainability needs to be understood as a key business driver, rather than a luxury investment or a public relations tool. A growing body of evidence shows that developing a corporate culture of sustainability is a major source of competitive advantage in today's economy. The Charter will better enable SMEs — particularly those in emerging market markets — to integrate sustainability considerations into their operations and was carefully developed to provide a common and accessible starting point for companies to develop a business sustainability strategy.

The road ahead

The launch of the Charter represents ICC's initial response to the process with the aim of more fully engaging the corporate sector in the implementation of the SDGs.

The launch of the Charter is the start of a concerted push by ICC to ensure that the power and reach of the private sector is fully harnessed in the context of the post-2015 development agenda.

Becoming a sustainability leader requires changes in all relevant business practices, but at ICC we believe the effort to do so is most certainly worth it – in environmental, social and economic terms alike. ■



100% renewable energy: a tool for low- carbon development

Anna Leidreiter writes about the pioneers in the
renewable energy field

The world's energy system is shifting from fossil fuels towards renewable sources, adding more capacity for renewable power each year than coal, natural gas, and oil combined. Renewable energy technologies have passed a turning point, already providing about 19% of global final energy consumption in 2013 (REN21, *Global Status Report 2015*). The question is no longer if the world will transition to sustainable energy, but *how long* it will take and whether the transition can be made on our own terms, in ways that maximize the benefits today and to future generations.

This encouraging movement is especially driven by local governments. Hundreds of cities, regions and communities across the globe have set 100% renewable energy (RE) targets and are beginning the journey towards a fossil fuel free society. From the American continent to Europe, Africa, Asia, and Oceania, jurisdictions are demonstrating that making the transition to 100% RE is a political decision and an ethical imperative. This is an encouraging trend where the majority of people living in cities and urban areas today are responsible for 70-75% of energy related CO₂ emissions and 40-50% of global greenhouse gas (GHG) emissions.

What is most interesting about this is looking at the intentions that drive cities, regions and communities to embark on the journey towards 100% renewable energy. In most cases they are not environmentally driven but derive from the opportunities of local development and socio-economic value creation. Local governments are motivated by the idea of becoming independent of finite and polluting energy sources and to benefit from the added local value

Renewable energy technologies have passed a turning point, already providing about 19% of global final energy consumption in 2013

created through the development of RE and other energy efficiency measures. As renewable energy technologies are decentralized by nature, their impacts are unfolding mainly locally and regionally. Therefore, more and more local governments embrace the opportunity to extend their scope of action to address crosscutting environmental, social and economic sustainability challenges.

Pioneers of the global 100% RE movement

The [City of Frankfurt](#) for example is well on track to shifting to 100% renewable electricity by 2050. The German city has reduced emissions by 15% since 1990, while its economy grew by 50% for its approximately 700.000 inhabitants. Further energy efficiency measures have saved Frankfurt €100 million in energy costs, a number that is projected to rise. In fact, Frankfurt is not alone. In Germany, a network consisting of about [140 100% RE regions](#) already includes more than 80 regions and municipalities that have reached 100% renewable energy targets.

The rural district [Rhein-Hunsrück District](#) with about 102,000 inhabitants living in 137 settlements, is also a member of this network. As of early 2012, Rhein-Hunsrück began producing more than 100% of its electricity needs, crossing an important milestone on the way to creating a truly 100% renewable energy system. In early 2014, it was estimated that Rhein-Hunsrück already produced over 230% of its total electricity needs, exporting the surplus to the regional and national grid, or re-directing it into local transportation, hydrogen or methane production. Through improvements in energy efficiency and the extension of renewable energy, the district has converted energy import costs into regional jobs and added value. Within 15 years, Rhein-Hunsrück District's CO₂ emissions were reduced by 9,500 tons, the cost savings amounting to €2 million.

Germany's neighbour Austria is also building on a bottom-up approach to reach the Government's target of becoming energy self-sufficient by 2050. In 2007, the Austrian Federal Government founded the Climate and Energy Fund to develop new, innovative ways of climate protection and sustainable development. Today, 104 regions have

become independent from fossil resources by drawing on the regions' own natural resources and meeting their energy demand with a smart mix of renewable energy generation, enhanced energy efficiency and smart controls.

Since its foundation, a total funding volume of €930 million has been made available for the Fund's activities. Part of this budget is spent to employ energy managers in each region. Each energy manager is in charge of implementing the roadmap, coordinating projects and initiatives and hereby ensures coordination and commitment from the local government. This is one of the key elements, which has made this national initiative so successful.

But this bottom-up movement is not only happening in Germany: [Perpignan Méditerranée](#) in France, a region in a nuclear dominated country, that intends to become a true role model by aiming to be the first urban territory in Europe to meet all its electricity needs by means of local projects. Today, 75% of the region's electricity needs are already met by renewable energy. The approach is expected to reinvigorate the local economy, agriculture and tourism in a certain inland part of the region called Catalonian Ecopark: a space where new synergies are created between the region's economic and agricultural activities, its respect for the environment and landscape and its position as a tourist destination and quality of life.

Such case studies are not only a reality in Europe. The city of [Greensburg](#), Kansas, US powers all local homes and businesses with 100% renewable energy, 100% of the time. The story of Greensburg is a story that has gone from tragedy to triumph: a tornado destroyed or damaged 95% of the town's homes and businesses on May 4, 2007. The community – with a strong leader in [Mayor Bob Dixon](#) – turned disaster into an opportunity and created a vision to rebuild Greensburg as a sustainable community. Building efficiency combined with local wind power and complemented by small solar installations and biogas, are the cornerstones of their [master plan](#). The town has gathered a diverse group of experts to turn their vision into a reality.

Looking at North America, one city that leads the world towards a more sustainable future is [Vancouver](#). Widely recognized as the most liveable city in the world, its environmental footprint is currently three times larger than it can sustain. Mayor Robertson and his team are committed to changing this by putting the city on track to meet all its energy needs via 100% renewable sources as part of a grand plan to make Vancouver the greenest city in the world.

By 2050, Vancouver will obtain 100% of the energy it uses from renewable sources and emit 80% fewer GHGs than in 2007. But it is not only the climate and environment that motivates Mayor Robertson to take this action: the city of Vancouver is a great example on how climate and environmental protection on the one hand and economic growth on the other hand can complement each other. A study by Brand Finance estimates that Vancouver's brand is valued at \$31 billion due to its reputation as a 'green, clean and sustainable' city. Additionally, by steering the city towards 100% renewable energy and focusing on local sustainability, Robertson has helped create more than 3,000 new local green jobs in only 5 years.

Challenges across the world are diverse. Looking at African communities, the key challenge is first and foremost to provide people with access to energy in order to sustain their daily living. The [District of Kasese](#) in Uganda (affecting approximately 130,000 households) is radically transforming itself by supplying the energy needs of its population only via renewable energy sources by 2020. According to the Mayor of Kasese, this ambitious target will be achieved by adopting a wide variety of different renewable sources such as biomass, solar, geothermal and mini hydroelectric technologies.

Kasese aims at becoming a model that other municipality will be able to adopt to eradicate poverty which is strictly related to the lack of access to energy. Furthermore developing an energy supply based on renewable energy sources will help the region overcoming issues related to local deforestation, land degradation as well as health issues which are strongly connected to the uncontrolled use of charcoal, firewood and kerosene, the main energy

sources used in the region for cooking and for domestic electricity production. In fact, only 7% of the households in Kasese have access to the electricity grid while 97% of the people use firewood and charcoal for cooking and 85% of households use kerosene for lighting.

Finally, independency from energy imports has also inspired local governments in Asia. The Korean province [Jeju](#), a province consisting of several islands with over 600,000 inhabitants, intends to meet the islands energy needs with 100% renewable energy. By setting this target the province intends to become completely independent from the electricity imported from the Korean Peninsula and meet all its internal electricity demand by using only renewable energy sources from within the islands.

This initiative includes the replacement of the current fossil-fuel fired generator with offshore and onshore wind turbines, solar panels, small hydroelectric power plants, and power storage systems. Electric cars, house energy management system (HEMS) and other technologies will also become available for the residents of the islands. A total of 168 companies are participating in the project, which covers approximately 6,000 households throughout Jeju Island. Jeju's smart grid will become the world's largest smart grid community that will allow the testing of the most advanced technologies, offering great opportunities for R&D within the field of renewable energy and energy storage as well as for the development of new business models.

Indicators for a sustainable and future-just transition to 100% RE

By pioneering this 100% RE movement in diverse geographical, social and political contexts, local governments have been incubators of regionally appropriate best practices and policies. Learning from these examples is therefore valuable not only for other local governments but also for national governments in order to achieve the necessary energy transition globally.

With more and more cities, communities, islands, states and countries joining, new questions arise: what does 100% RE mean? How do we measure success? And how do we ensure that this is a future-just transition that spurs development for the people?

Converting our energy system is about more than replacing fossil resources with sun and wind as new sources. It would be an illusion to believe that simply fuelling the same system with different resources will lead us in the right direction and keep the planet habitable for current and future generations.

In fact, the true transformation starts in the fundamental way our energy system is structured. And with it comes a battle, as power and profits shift hands from the few to the many. Our current fossil fuel based energy system is characterized by complex centralized infrastructures where a) the fuel is transported to the power plant, and b) energy production and distribution is held in one hand. The supply chain is vertical, and the benefits are shared only among a few stakeholders.

In the necessary transformation towards 100% renewable energy, this is changing. By nature, renewable energy technology is decentralized, has a horizontal supply chain, and requires an entirely different infrastructure and market. New actors and stakeholders, including individual citizens and small businesses, enter the system, claim rights, and have direct impacts. New ownership models are required, as different stakeholders become directly involved in the transformation. Similar to the telecommunications and computer industries in recent decades, a true energy transformation towards 100% renewables has to ensure a wide participation of all stakeholders. The case studies from around the world show that community and people-centred solutions enable our society to convert our energy production and supply industry at the required speed and scale.

In order to facilitate this transformation, there is a need for standards and indicators that allow measuring and assessing policies and implementation and hereby provide some guidance on what a sustainable transition to 100% RE entails.

Therefore members of the [Global 100% RE campaign](#) have initiated a consultation process to develop indicators and quality criteria that guide policy makers on how to reach a sustainable 100% RE vision. The overall goal is to set a global standard for 100% RE in local governments and hereby creating the first label for local government`s action in this field. This will help to monitor and assess implementation toward 100% RE. A global network of 100% RE regions and cities has been established that brings those local governments together who commit to these standards and hereby inspire by example. ■

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Innovation, decarbonisation, and Europe's economic transformation

Martin Porter writes that it is the time for Europe to lead
– not just at COP21, but in its economic approach to the
industrial innovation and the transition to a new economy

If there is one constant in the workings of the global economy, it is change. What is perhaps novel is the pace and scale of the economic, technological, social and ecological changes that are now shaping the evolution of the global economy – and which should therefore preoccupy the thinking of the world’s political leaders. Whether from developed or developing economies, their response to these mega-trends must fashion a rapid transformation of the economy that harnesses the power of data and communications networks, materials technology, and process design and creativity. This will help to deliver economic growth at the same time as the dramatic resource efficiencies and deep decarbonisation so urgently needed, not to mention addressing growing social concerns around inequality.

The good news is that transformation is already starting to happen. From growth in renewables up-ending traditional energy utility business models, to 3D printing and the industrial internet revolutionising manufacturing, old economic models are under assault. Even the challenge posed by new entrants such as Uber, AirBnB and Spotify to the established transport, accommodation and music industries can be interpreted as signs that the low-carbon, eco-efficient, sharing economy is starting to erode its more polluting, wasteful and selfish version.

But there is a long way to go. This transformation needs greater urgency, direction and support if it is to succeed in tackling the challenge of climate change in particular, where the scale and time-frame of the necessary transition is especially clear. And disruptive innovations such as those above do not happen in a vacuum. They need market frameworks to be established by public actors with a view to enabling systemic innovation of technologies, business models and behaviours; and disruptive innovations will need public intervention to foster collaboration early on and socialise benefits downstream, as well as to incentivise private actors to compete and succeed through their enterprise.

An important part of that enabling framework must be established at international level, and a key element of that is, of course, the UN’s climate change convention. In December, the world’s governments will meet in Paris for the

latest round of UN climate talks – the crucial COP21 conference. COP21 is intended to forge a new global climate convention, with a view to steering the world on to a path to meet the internationally agreed goal to limit global average temperature rises to no more than 2°C above pre-industrial levels.

To the frustration of many, including the European Union which has taken on a role as a climate leader internationally, the UN climate process has been marked by rancour, dispute and – at best – incremental progress towards this objective. But there are important signs that the politics of these negotiations may be changing as major economic players make significant commitments to decarbonise.

Recent bilateral climate agreements between the US and China, and the US and Brazil, have closed historic rifts. The communiqué from the G7 meeting in Germany in June included a pledge to eliminate the use of fossil fuels this century, promising an end to the energy source that has fuelled the world's prosperity since the Industrial Revolution. If the Paris meeting is able to maintain this momentum towards such a clear destination, and further encourage more collaboration to increase the confidence in our collective ability to successfully reach it, we shall find attention naturally focusing even more intensely on how best to do this.

Now is the time for Europe to lead – not just at COP21, but in its economic approach to the industrial innovation and the transition to a new economy

And this is where our ability to harness the power of data and communications networks, materials technology, and process design and creativity will be the key to success – and why those who successfully lead the economic innovation process will reap disproportionate economic and social benefit whilst solving the world's most pressing environmental problem.

The opportunities from the transition to this new economy are huge. Consider the figures cited in the New Climate Economy report: investment in infrastructure alone is expected to \$90 trillion globally and \$16 trillion in Europe in the next 15 years to meet global growth expectations.¹ So large is the potential value of the digital economy economists struggle to quantify it. Every business sector and value chain, from construction to mobility, food and drink to energy services, will be profoundly disrupted by new technologies, business models and consumer behaviours driven by decarbonisation, eco-efficiency and digital revolutions.

Of course, as in any transition, there will be winners and losers, at least in the short term. While it will be essential that our policy-makers find ways to alleviate the negative impacts of that transition, they will need resist the temptation to embed established players still further, but instead embrace the benefits of disruption and of innovation.

Some of the world's leading economies have already demonstrated that they understand this imperative in relation to decarbonisation in particular – and, furthermore, are acting upon it. South Korea, for example, has since 2009 forged a 'Green Growth' strategy that seeks to build competitive advantage in emerging environmental technology sectors, at the same time as enhancing South Korean's quality of life and contributing to international efforts to address climate change. China's government is working to move its economy from one that manufactures high technology for third parties, to one that designs and produces its own high tech products. It is beginning to direct its vast resources to this end: the country doubled its spending on research and development between 2008 and 2012.

And private sector companies are working with governments to respond to these imperatives. In July, 13 leading US companies – including tech giants Apple, Google and Microsoft, retailer Walmart and even industrial corporations Alcoa and General Motors – signed on to the government-led American Business Act on Climate Change Pledge. They made new commitments to make at least \$140 billion in low-carbon investments, in addition to company-specific goals to cut emissions as much as 50 percent, reduce water intensity as much as 15 percent, purchase 100 percent renewable energy, and pursue zero net deforestation in their supply chains.

These are not acts of corporate philanthropy. They are rational investment decisions that recognise the direction of travel: that successful businesses of the future will need to operate in a low-carbon environment and, by starting to decarbonise now, they can position themselves for competitive advantage in the future.

Europe, too, has its pockets of economic innovation, such as in those Nordic countries where industrial policy priorities are orientated towards fostering innovation and servitisation – recognising the increasingly close links between industry and the service sector, enabled by high technology and Internet connectivity. Sweden, for example, spends 3.41% of GDP on R&D, the fourth highest percentage globally. Denmark is in the top five in the OECD in terms of public expenditure on R&D. Finland boasts a strong and sustained technological specialisation in information and communications technology.² And Europe's three largest economies have all developed strategies which seek to harness the digital potential with other industry trends to promote innovation – Germany's 'Industrie 4.0', France's *l'Industrie du Futur* and the UK's latest industrial strategy.

But this is about much more than technology R&D. These examples of state-enabled industrial innovation suffer from problems of co-ordination, consistency and credibility; and attempts to integrate industry and innovation policy remain the exception in Europe, rather than the rule. Industrial policy too often remains tainted by the mistakes of the 1970s and 1980s, where governments attempted to identify and promote national champions from one or other manufacturing or industrial sector. While this old-fashioned policy led to some industrial successes, like Air-

bus, it did not foster innovation across the entire economy. The justifiable reluctance of government to try to 'pick winners' has left EU lacking a coordinated approach to innovation.

Europe is therefore currently ill-equipped to address these challenges. European industrial policy making suffers from the 'silo' approach followed in many countries, where responsibility is split between different parts of government. As we have seen in EU climate change policy, narrow, short-term competitive considerations have too often inhibited the longer-term innovation needed to transition to a decarbonised economic model.

Fundamentally, there is a lack of common understanding and collaboration as to how to harness Europe's industrial potential, and ensure its competitiveness, in the face of decarbonisation, global value chains, technological revolution and social change.

It is to help build this common understanding that a new platform called i24c – Industrial Innovation for Competitiveness – has been created. The platform aims to develop a systemic, forward-looking approach to European industrial policy based on innovation.

i24c brings together economic policy-makers, new and established industrial entrepreneurs, cities and academic institutions. It is guided by a High Level Group of including the former Director-General of the World Trade Organization Pascal Lamy, former European Commissioner for Research, Innovation and Science Máire Geoghegan-Quinn and CEOs of leading European industrial companies.

The platform will work to identify the priorities for industrial transition, including by: producing research to build the evidence base for the necessary transition; developing industrial innovation roadmaps and indicators to help policymakers prioritise investment and policies, and track progress; and establish working groups and high-level stakeholder meetings to move the debate forward.

Our mission is to develop a new European Industrial Compact that aims to ensure industrial leadership for Europe as the world transitions to a new economy. This compact would prioritise the promotion of innovation, ecosystems and multi-stakeholder dialogue.

We believe that the establishment of i24c is timely. Within policymaking circles, thinking is fast developing around a new approach to industrial policy – or the agenda that Europe’s last Commission referred to as an ‘Industrial Renaissance’ for the EU. Opportunities exist in Europe to re-energise economic transition through industrial policy focused on innovation such as the review of the EU’s growth strategy, the Energy Union initiative and other flagship activities designed to increase economic growth at the same time as decarbonising and achieving its social objectives.

Now is the time for Europe to lead – not just at COP21, but in its economic approach to the industrial innovation and the transition to a new economy. ■

Martin Porter is Executive Director of Industrial Innovation for Competitiveness (i24c)

Endnotes

- 1. New Climate Economy (2015), Seizing the Global Opportunity, page 9*
- 2. OECD (2014), Science, Technology and Industry Outlook 2014*

European political preferences for decarbonisation

CO₂

The MSR vote as a litmus test for support from the European Parliament and the European Council for the ETS, Georg Zachmann writes

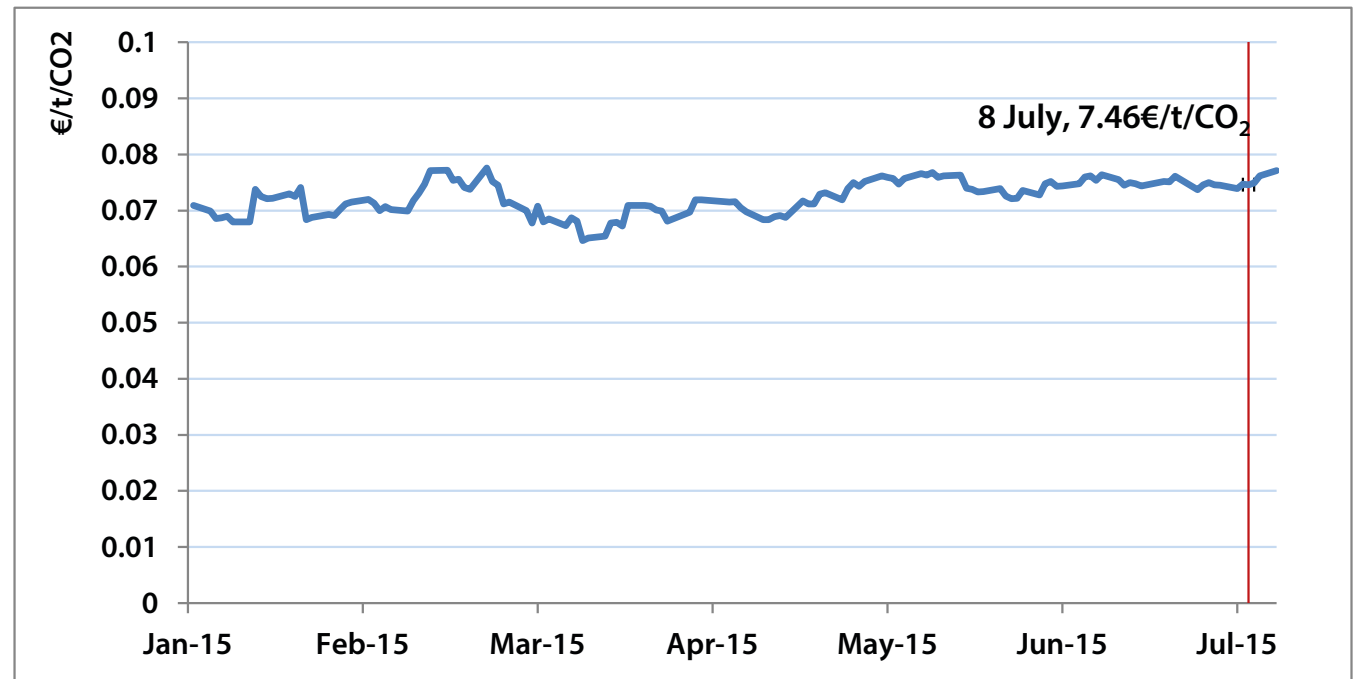
On 8 July the European Parliament – after a year-long saga of failed committee votes and rejected reports – finally voted to introduce a mechanism to stabilise the European emissions trading system (ETS). The [Market Stability Reserve](#) (MSR) adopted by the European Parliament is a measure to temporarily adjust the supply of emission allowances in order to boost the carbon price. As I [argued back in 2013](#), I think the mechanism itself is inappropriate for ensuring an investible carbon price. The main value of the tool is thus not the mechanism itself, but the political signal of support from the European Parliament and the European Council for the ETS.

It is therefore interesting to look into the voting results – the most visible political signal. The main observation is that the carbon price did not markedly move after the [European Parliament strongly voted](#) in favour of the MSR (495 MEPs voted in favour, 158 against, with 49 abstentions). This signal was evidently anticipated, as there was almost no reaction on the day. Indeed, it was not strong enough: emission allowances are still trading at significantly lower prices than initially envisaged. This weakness of the political signal might be partially explained by the complicated parliamentary history of the MSR.

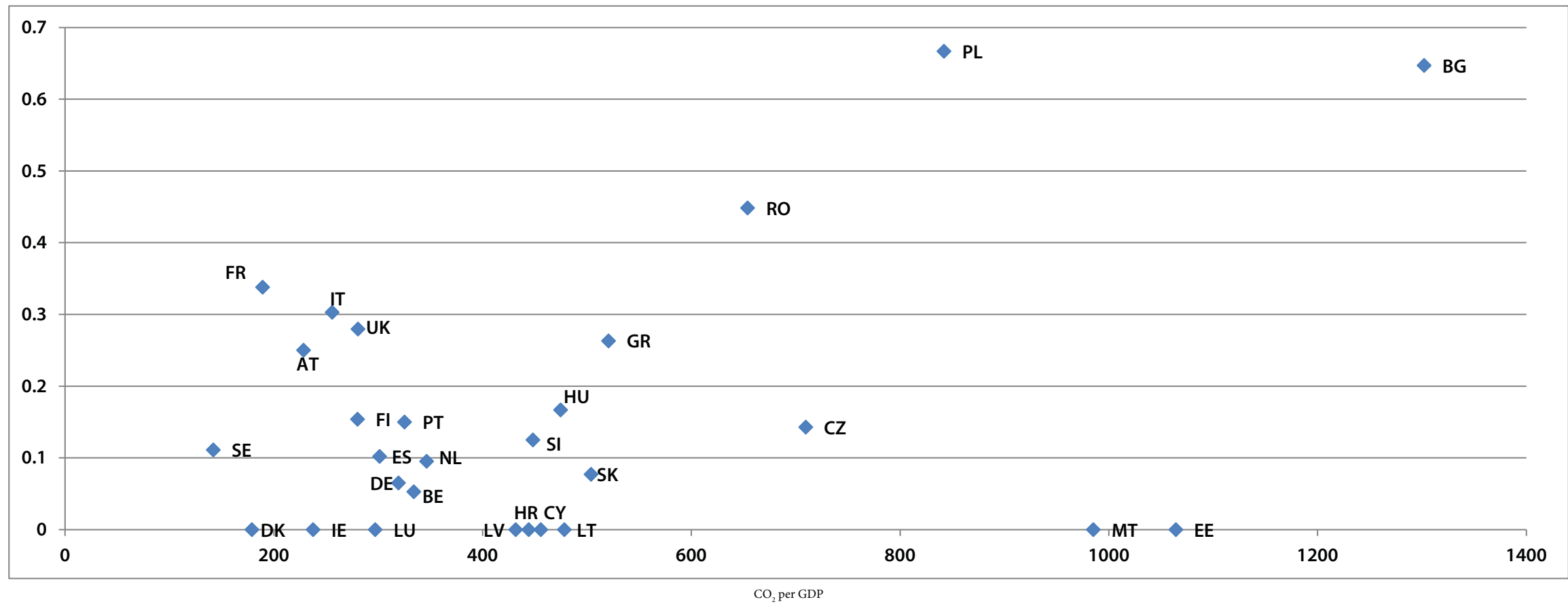
The second interesting observation is that there is a strong positive correlation between countries' per-GDP emissions and votes against the MSR. For example, most MEPs from Poland or Bulgaria (which are among the least carbon-efficient economies) voted against the MSR.

... the mechanism itself is inappropriate for ensuring an investible carbon price

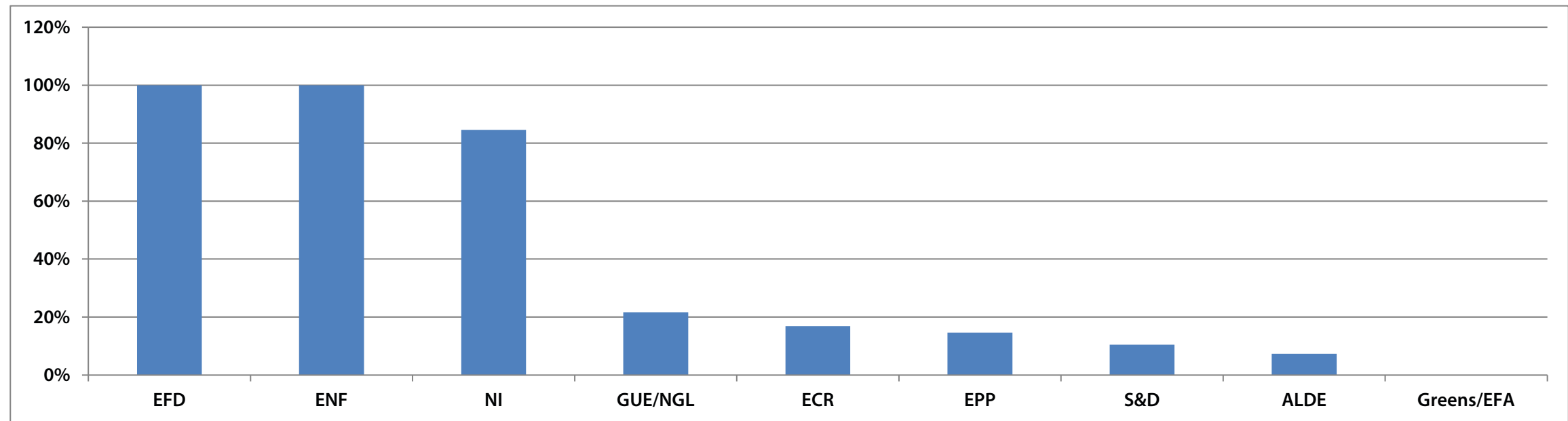
Emission allowance price



National votes against per-GDP emissions



Percentage of 'no' votes by party group



Appendix: European Parliament Political Groups

S&D: Group of the Progressive Alliance of Socialists and Democrats in the European Parliament

GUE/NGL: Confederal Group of the European United Left - Nordic Green Left

EPP: Group of the European People's Party (Christian Democrats)

ALDE: Group of the Alliance of Liberals and Democrats for Europe

Greens/EFA: Group of the Greens/European Free Alliance

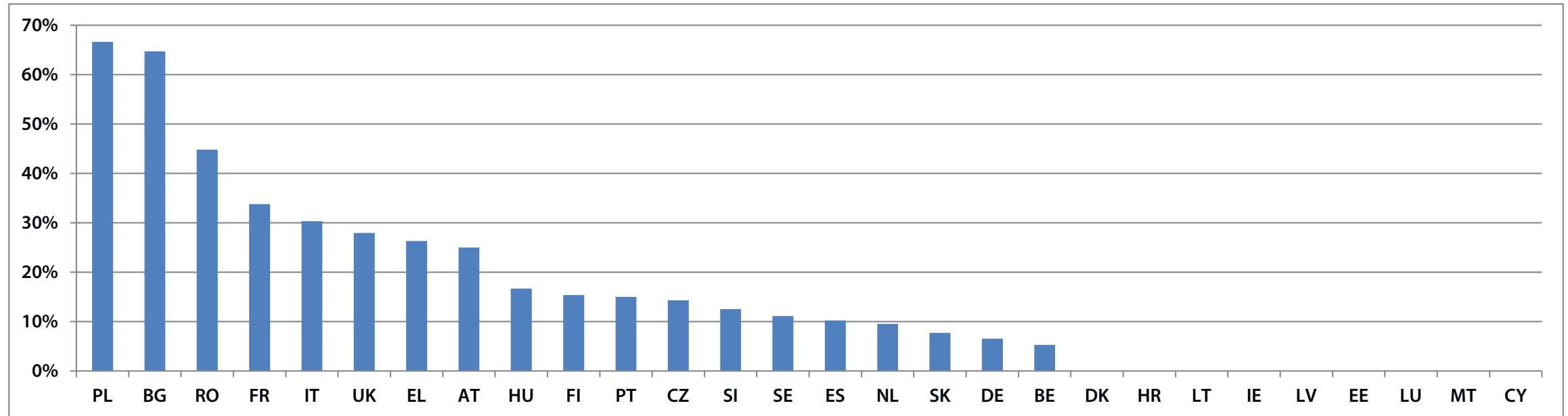
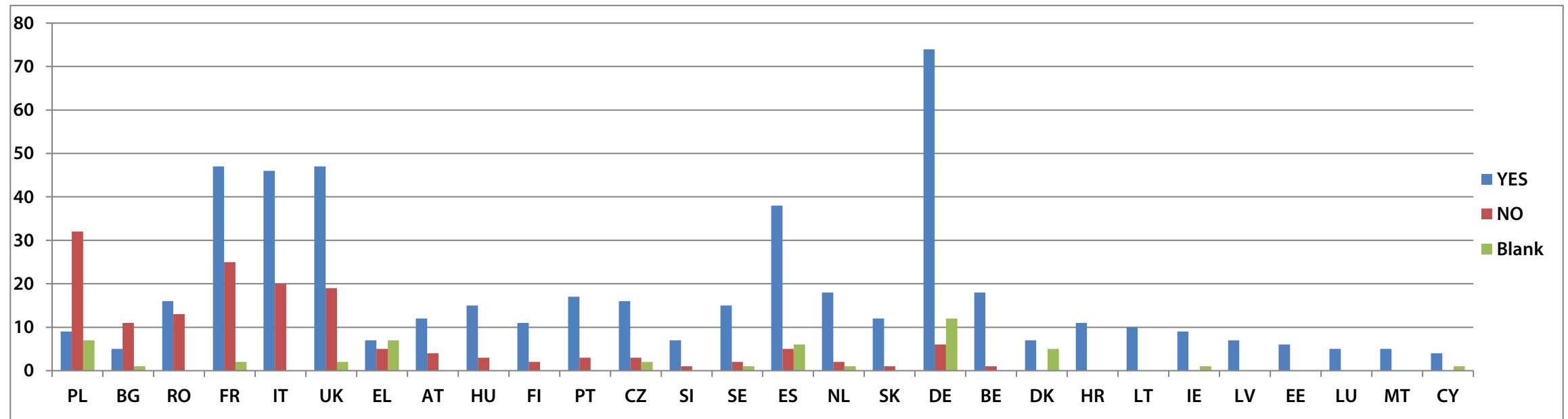
ECR: European Conservatives and Reformists Group

EFD: Europe of Freedom and Direct Democracy Group

ENF: Europe of Nations and Freedom

NI: Non-attached members

Appendix: results by country



A third observation is that some fairly carbon-efficient member states such as France, Italy and the United Kingdom produced about twice as many 'no' votes than one would expect from their carbon-intensity. In fact, a large share of the 'no' votes came from MEPs representing parties such as the Front National in France (21 of 25 noes), UKIP in the UK (all 19 noes) and Movimento 5 Stelle in Italy (15 of the 20 noes). This might be explained by these parties general opposition to any European-level instruments.

In conclusion, the MSR vote did indeed deliver a political signal in favour of emissions trading in Europe. However, despite the strong positive result, the fine details are less encouraging. ■

Georg Zachmann is a Research Fellow at Bruegel

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The climate scare's 'useful idiots'

Tom Harris writes that coal executives and conservatives are unwittingly promoting global warming concerns

In her 2002 book, *Language and War*, University of Florida linguist MJ Hardman tells us that, “*Language is inseparable from humanity and follows us in all our works. Language is the instrument with which we form thought and feeling, mood, aspiration, will and (action), the instrument by whose means we influence and are influenced.*”

It is not surprising then that language always has been a crucially important weapon of war. Delivered with convincing rhetorical flare, language has driven ordinary citizens to heroic acts of self-sacrifice in defence of their countries while pushing others to unspeakable acts of barbarism.

And now language tricks are being used to justify the unjustifiable in the global warming debate. Over and over we are told that, ‘Climate change is real,’ that, ‘We owe it to future generations to stop climate change,’ and that, ‘97 per cent of scientists agree.’

Even non-experts are starting to recognize that these assertions are meaningless or simply unproven. Climate change, at times far more severe than anything seen in humanity’s short history, has been ‘real’ for billions of years. No one knows whether human activity has become a major factor influencing it today or that we could have a measurable impact on future climates. And despite the popular notion that a meaningful consensus exists among experts about this question, such an agreement never has been convincingly demonstrated.

Although the impact of these particular language tricks is gradually diminishing among educated people, other equally misleading phraseology is coming to the fore. President Barack Obama’s so-called Clean Power Plan (CPP) is a case in point.

The August 3 Environmental Protection Agency (EPA) news release asserted that the CPP ‘will cut US carbon pollution.’ ‘Carbon pollution’ was referenced five times in the first four sentences of the release and the [EPA website](#) is rid-

dled with the term. EPA administrator Gina McCarthy told the [Resources for the Future \(RFF\) Policy Leadership Forum](#) on August 11 that *“climate change is driven in large part by carbon pollution.”*

What McCarthy and the EPA are actually referring to is carbon dioxide (CO₂). But CO₂ is a non-toxic, odourless, invisible gas essential to plant photosynthesis. Grade school students know that it is no more pollution than is water vapour, by far the principal greenhouse gas (GHG) in the atmosphere.

New Zealand-based renewable energy consultant Bryan Leyland [commented](#), *“It is shocking that McCarthy does not understand the difference between CO₂ — a harmless gas that benefits agriculture — and genuine pollutants like particulates, sulphur dioxide and the like emitted from old obsolete power stations. Modern coal-fired stations do not emit these pollutants.”*

Since the CPP only regulates CO₂, which is in no way unclean, using the word ‘clean’ in the CPP’s title is a rhetorical trick to fool the public into thinking the regulation is something it is not.

‘Carbon emissions’, ‘carbon footprint’, ‘low-carbon energy sources’, and so on make no sense either. Carbon is a solid, naturally occurring, non-toxic element found in all living things. Carbon forms thousands of compounds, much more than any other element. Everything from medicines to trees to oil to our own bodies and those of all other creatures are made of carbon compounds. Pure carbon occurs in nature mainly in only two forms: graphite and diamonds, neither of which is floating around in the atmosphere let alone being discharged from the smokestacks of electricity generating stations. There is one form of pure carbon important to control and that is soot, the emissions of which no longer constitute a problem in most developed countries.

Ignoring the oxygen atoms and calling CO₂ ‘carbon’ makes about as much sense as ignoring the oxygen in water vapour (H₂O) and calling it ‘hydrogen.’ This is not merely an academic point but is part of the way language has been

distorted to bolster concerns about human-caused climate change. Calling CO₂ 'carbon' encourages people to think of the gas as pollution or something dirty like graphite or soot. Calling CO₂ by its proper name would help people remember that, regardless of its influence on climate (a point of intense debate in the climate science community), it is actually the elixir of life. Some scientists say we should intentionally increase CO₂ emissions so as to enhance crop yield, a benefit that has already been observed across the world as CO₂ levels have gradually risen.

It is not surprising that those who support drastic action on climate change would see political and public relations benefits to continue the misleading rhetoric. But what is surprising is the way those who have the most to lose in a CO₂ constrained world unwittingly support their adversaries by using much of the same language employed by climate alarmists. While they may not be prepared to directly contest the hypothesis that we are causing dangerous climate change, there are ways they can honestly address the issue while not betraying their own interests.

A useful idiot is a person who supports one side of a philosophical debate while unaware of the overarching agenda driving the ideology they promote. Useful idiots are often held in contempt by the leaders of the movement they support

Here are examples from the European Union, the United States, Canada, and Australia of counterproductive messaging from those who are threatened by the climate scare, and suggestions for what they could say instead that would not shoot themselves in the foot.

European Union

The European Association for Coal and Lignite – EURACOAL

EURACOAL is the umbrella organisation of the European coal industry. EURACOAL has 34 members including national coal associations, importers associations, research institutes and individual companies from 20 countries: Belgium, Bosnia-Herzegovina, Bulgaria, the Czech Republic, Finland, France, Germany, Greece, Hungary, Italy, Poland, Romania, Serbia, Slovakia, Slovenia, Spain, Sweden, Turkey, Ukraine and the United Kingdom.

Here are some of EURACOAL's mistakes in their [key messages](#) listed on their website:

They say, "Carbon Capture and Storage (CCS) is important for international climate protection policies."

Besides the error of calling CO₂ 'carbon,' saying that CCS is important for 'climate protection' implies an endorsement of the hypothesis that CO₂ emissions are causing dangerous climate change. A less damaging (to the coal industry) way of saying the same thing would be:

"Carbon dioxide capture and storage is important for international CO₂ emission reduction policies."

Whether those policies would have any impact on climate is unknown and not something EURACOAL is qualified to take a position on.

Next EURACOAL assert:

“An appropriate climate protection policy must consider all greenhouse gas emissions from all fossil fuels...”

This sounds like an effort to spread the pain of emission limits to other sectors, hardly a strategy to be proud of. Regardless, given the uncertainty in the science, the only ‘appropriate climate protection policy’ would be one that helps vulnerable people adapt to climate change, however caused. Again, EURACOAL is not qualified, and it is certainly not to their members’ benefits, to endorse the emissions/climate change connection.

Finally, EURACOAL state:

“An efficient and affordable CO₂ transport network on European level is needed and the EU should pro-actively promote the creation of a CO₂ infrastructure together with EU member states...”

The creation of an EU-wide ‘CO₂ infrastructure’ would cost many billions of euros and so would greatly diminish the competitive advantage current enjoyed by coal over most other energy sources. It is the last thing EURACOAL should encourage. Instead they should simply have said:

“A CO₂ transport network and related infrastructure on the European level will assist in meeting CO₂ emission policies.”

This is simply a statement of fact and does not endorse the scheme or imply that it would have any impact on climate.

World Coal Association (WCA)

The London-based WCA identifies itself as 'a global industry association formed of major international coal producers and stakeholders.' They claim on their webpage:

"Carbon capture use and geological storage (CCUS) technology is the only currently available technology that allows very deep cuts to be made in CO₂ emissions to atmosphere from fossil fuels at the scale needed."

Besides the ubiquitous 'carbon' mistake, WCA should not be asserting that "very deep cuts...in CO₂ emissions to atmosphere" are needed. They should have simply said that it is potentially useful to meet CO₂ emission targets, though yet to be proven on a national scale.

Next, WCA state:

"Failure to widely deploy CCUS will seriously hamper international efforts to address climate change..."

Of course, they should have said:

"Failure to widely deploy CCUS will seriously hamper international efforts to reduce CO₂ emissions..."

In his August 10, 2015 article, [World Bank climate chief ignoring reality on coal](#), Benjamin Sporton, WCA Chief Executive wrote, concerning the *Guardian* newspaper [article](#) by the bank's climate chief Rachel Kyte: "Ms Kyte does raise legitimate concerns about CO₂ and other emissions from coal that raise climate and environmental challenges."

This is a serious strategic mistake. CO₂ and 'other emissions from coal' should be referenced very separately since, while the former does indeed raise potential climate concerns (not something the WCA should promote), it is only

the latter that is known to 'raise environmental challenges.'

Three days later, the [WCA issued a news release](#), *World Coal Association calls for governments worldwide to support all low emission technologies equally*, in which Sporton is quoted as saying: "...we should instead focus on meeting these [energy] needs as cleanly as possible. For countries reliant on coal, this means utilising high efficiency, low emission (HELE) coal technologies and, in the future, carbon capture and storage (CCS)..."

This is reminiscent of Obama's mistaken use of the word 'clean,' wherein CO₂ abatement is portrayed as resulting in cleaner power plants. It is only if real pollution is reduced that a power plant becomes cleaner.

In his June 16 article [The High Cost of Divestment](#), Sporton wrote, "As shown by the Intergovernmental Panel on Climate Change, this [CCUS technologies] is a vital development if global temperature increases are to be kept below 2°C."

No one at the WCA should be seen to promote the ridiculous notion that we can control so-called global temperature as if we had a planetary thermostat.

The WCA's December 1, [2014 release](#) committed many mistakes, among them the following misleading statements:

"It is vital that negotiators in Lima support all low emission technologies if we are to have an effective and sustainable climate response...Cleaner coal technologies are essential to affordable action on climate change..."

Sporton is not the first WCA chief executive to help their opponents with strategically unwise comments. In his May 7, 2014 presentation, *THE PUBLIC IMAGE OF COAL Inconvenient facts & political correctness*, to the COO Leaders Resources Summit in Australia, then WCA CEO Milton Catelin showed the following slide.

Figure 1: Slide presented by then WCA CEO Milton Catelin to the May 2014 COO Leaders Resources Summit in Australia

Comparative climate actions

Initiatives needed to cut 2 Gt of CO₂ emissions

- Run the EU ETS for 53 years
- Run the Kyoto Protocol 3 times
- Multiply the world's current solar power capacity by 195
- Increase the efficiency of all coal power plants from 34% to 40%



A later slide in Catelin's [presentation](#) included the statement:

"In the power sector roughly 25% of the answer to climate change lies in coal," and then listed CCS as one of the "Global investments necessary to effectively combat climate change."

While these statements are clearly unwise for a promoter of coal-fired electricity generation, the WCA committed an even worse communications blunder when they partnered with the Polish Ministry of Economy to issue the November 2013 [Warsaw Communiqué](#) which started:

"Recognising international consensus on the need to reduce global greenhouse gas emissions, in conformity with the objectives of the United Nations Framework Convention on Climate Change (UNFCCC)"

It was of course politically expedient to say this, with the UNFCCC COP19 negotiations then underway in Warsaw. But, ultimately, it makes no sense for the WCA to boost the UN body at a time when coal is under attack across the world, largely because of the UNFCCC's exaggerated pronouncements.

The United States

The US Chamber of Commerce

Representing more than 3 million American businesses, as well as state and local chambers and industry associations, the US Chamber of Commerce is the world's largest business federation. They *"oppose EPA efforts to regulate greenhouse gases under the existing Clean Air Act,"* and [state](#) that the *"EPA's rule is unlikely to reduce global carbon emissions..."*

Besides the 'carbon' mistake, one the Chamber commits often, they should not be talking about GHGs, which, in addition to the benign CO₂, include real pollutants. Most people remember that CO₂ is plant food, while greenhouse

gas sounds, and in some cases is, more ominous. The Chamber should take advantage of the fact that the rule being referenced, the Obama administration's CPP, *only* restricts CO₂ emissions. The Chamber should have said that they 'oppose EPA efforts to regulate CO₂,' which sounds like a waste of money to anyone who remembers what they learned in elementary school.

The Chamber's [position on the environment](#) includes the statement:

"We support efforts to reduce greenhouse gas emissions through a comprehensive legislative solution that does not harm the economy, recognizes that the problem is international in scope, and aggressively promotes new technologies and efficiency."

In the Chamber's description of the [problems with the CPP](#), they cite findings by climate experts Knappenberger and Michaels that the new EPA rule would result in *"an estimated 0.018 degrees centigrade reduction by the year 2100."* The Chamber goes on to correctly conclude, *"That's too small to even put into context - it's essentially undetectable, researchers say."*

So why would the Chamber advocate a 'solution,' let alone 'a comprehensive legislative solution,' to GHG emissions? Are they looking for an even more damaging plan? If the CPP will have no discernible impact on climate and yet, according to [Chamber President and CEO Thomas J Donohue](#), *"impose tens of billions in annual compliance costs, and reduce our nation's global competitiveness,"* a CO₂ reduction plan that might have significant impact would almost certainly destroy the US economy entirely. A 'solution that does not harm the economy' undoubtedly does not exist.

Finally, the assertion that the 'the problem is international in scope' is only true if climate change is being driven by humanity's GHG emissions. If it isn't, and the Chamber should do nothing to promote the idea that it is, then climate

change is obviously a regional problem, and each region should adapt to whatever is happening in their area, independent of global trends.

United Mine Workers of America (MWA)

The UMWA has about 35,000 members, of whom 20,000 are coal miners, mainly in underground mines in Kentucky and West Virginia. They have held massive protests against the CPP and have given their members petitions to sign and distribute as well as suggested talking points for mine workers to bring up in their own [letters to newspapers](#) and government representatives.

In the [petition](#) they have prepared for state and local governments, the UMWA wrote:

“Whereas, the US EPA has proposed a ‘Clean Power Plan’ (CPP) rule with the stated intention of reducing the amount of greenhouse gas emissions which contribute to climate change.”

Like the Chamber, the union errs by stating that the CPP is about GHG emissions instead of just CO₂. Similarly, they are not qualified to say, nor is it in their best interest to say, that emissions ‘contribute to climate change.’

The suggested petition nonsensically concluded:

“Climate change is a global problem and requires a global solution.”

In the suggested text for members’ letters to the editor, the UMWA wrote that the EPA plan is designed “to reduce carbon emissions” and that:

“No one can deny that greenhouse gas emissions represent a problem that needs to be addressed...The EPA needs to give serious thought to pursuing promising new technology to capture and store carbon emissions. The shuttering of the coal industry in the United States will not have an impact on this global problem”.

Besides the ‘greenhouse gas,’ ‘carbon,’ and ‘global problem’ mistakes, the reports of the Nongovernmental International Panel on Climate Change ([NIPCC](#)) demonstrate that thousands of climate experts dispute the idea that CO₂ emissions ‘represent a problem that needs to be addressed.’ UMWA executives are not qualified to imply that these scientists are wrong and it obviously sabotages union members to do so.

UMWA officials have clearly decided that it is not in the union’s interest to contest the official excuse for the CPP, the supposed threat of CO₂ emissions. But it is a serious strategic mistake for them to promote it.

Duke Energy

Duke Energy, the largest electric power company in the United States, supplies and delivers electricity to more than 7 million customers in the Southeast and Midwest.

In the climate change section of their [web site](#), Duke repeatedly labels CO₂ ‘carbon’ and say that they are “*committed to finding new ways to confront one of our industry’s biggest challenges – global climate change.*” While regulations to restrict CO₂ emissions present serious challenges to the industry, trends in so-called ‘global climate’ have no effect on the electricity sector.

Lynn J Good, Duke’s President and CEO, [wrote](#):

“We are advocating for climate change policies that reduce emissions while balancing the impact on customers’ rates, state economies and power reliability.”

In her response to the CPP, Good [promised](#) to work with state officials to keep moving toward 'a lower carbon future.'

While all companies must comply with applicable government regulations, they are under no obligation to encourage them. Considering that a significant fraction of the power Duke generates comes from natural gas and coal, both significant CO₂ sources, it does not make sense for them to encourage tighter rules on CO₂. While coal is the primary target of the EPA right now, gas will undoubtedly come under increasing attack if the new rules are successful.

Arch Coal

Arch Coal is one of the world's largest coal producers and marketers with mining complexes in Wyoming, Colorado, Illinois, West Virginia, Kentucky, Virginia and Maryland.

In their August 3 [news release](#) Arch's Senior Vice President of Strategy and Public Policy Deck Slone promoted 'investments in low-carbon fossil fuel technologies' and asserted:

"To truly address the threat of climate change, these [developing] countries will need low-cost, low-carbon mitigation tools for fossil fuels."

It makes no sense for a major coal producer to promote the underlying premise that threatens their industry.

Canada

Federal Government

Thanks to increasing development of Alberta's oil sands, Canada is now one of the largest oil producing nations. Because oil sands production is more CO₂ intensive than is conventional oil production, climate activists have made

shutting down the oil sands one of their key objectives. The last thing the Conservative government of Stephen Harper should do is encourage the climate scare. Yet they regularly do.

For example, following the Obama administration's June 2014 announcement about the CPP, Canada's Minister of the Environment is quoted in an Environment Canada (EC) [news release](#), *Minister Aglukkaq responds to proposed US carbon regulations for the electricity sector*, as saying:

"We congratulate the Obama administration on proposing steps to regulate greenhouse gas emissions from power plants."

Besides the 'carbon' and 'greenhouse gas' mistakes, the Canadian government should obviously not encourage tighter CO₂ controls in our major trading partner when our economy is so dependent on the success of the oil sands. The need for diplomacy dictates that Canada treat US actions with respect, but this does not mean we should encourage them to inflict unnecessary damage on their most important electricity source.

Contrary to the loud condemnation of environmental groups, the Harper government is one of the strongest supporters of the UN climate change negotiation process. In her December 9, 2014 delivery of [Canada's National Statement](#) at the UN climate conference in Lima, Peru, Aglukkaq reassured delegates:

"As we approach next year's meeting in Paris, Canada will continue to work with our international partners and be one of the strongest advocates for a final agreement that includes all major emitters."

Aglukkaq should know that the current negotiating text for the upcoming Paris agreement includes stipulation that 'the first and overriding priority' for developing countries is not climate change mitigation, but poverty alleviation and development. Since any significant mitigation effort will interfere with these priorities, developing countries

will undoubtedly not be held to any emission limits whatsoever. So, Canada unwisely supports a process that is generating documents that will violate what we say we are seeking.

After nine years in power the Harper government have still not corrected the error-riddled messaging about climate change on the EC web site. For example, in the Climate Change Science and Research [section](#) of the site, it is asserted:

“The international scientific community has determined that recent changes in many aspects of global climate have been primarily caused by the build-up of greenhouse gases in the atmosphere, and that human activities are a major source of these gases.”

This is both patently false and counterproductive to Canada’s goal of taking advantage of the oil sands to become an ‘energy superpower.’

In the Information on Climate Change [section](#) of the EC site we are even given the nonsensical claim that:

“How much climate change future generations are exposed to will be determined by the actions that we take over the coming decades to reduce human impacts on the climate system...The recent warming has been largely attributed to human activity, primarily the release of carbon dioxide and other greenhouse gases to the atmosphere”

It appears that, like the EPA in the US, EC has been hijacked by climate activists, precisely the opposite of what Harper promised would happen when he was first running for Prime Minister.

TransCanada Corporation

Calgary, Alberta-based TransCanada Corporation develops and operates 3,460 km of oil pipelines, plus 68,500 km

of wholly owned and 11,500 km of partially owned gas pipeline across North America. They have proposed the Keystone XL Pipeline Project, a multibillion dollar project to bring Albertan oil sands bitumen to refineries in Texas. Climate activists have dedicated enormous resources to convincing Obama to reject XL because they believe that it will encourage expansion of the oil sands.

While it may be understandable that TransCanada will not directly contest the climate scare, it is clearly counterproductive for the company to support it. Yet, like the Canadian government, that is precisely what they do.

For instance, in [Climate Change Strategy](#) on their web site, the company asserts:

“TransCanada believes every individual, industry and government must be involved in managing/reducing emissions that contribute to climate change and air quality issues... TransCanada will facilitate the use of natural gas as a fuel source because it is less carbon intensive than other fossil fuels.”

Like Duke Energy, TransCanada seem oblivious to the ultimate aim of climate campaigners—end all hydrocarbon fuel use.

Canadian Manufacturers and Exporters (CME)

CME identifies themselves as ‘Canada’s largest trade and industry association, and the voice of manufacturing and global business in Canada...CME represents more than 10,000 leading companies nationwide.’

You would expect that CME would be the last group in Canada to support the need for CO₂ controls. Yet, in the climate change [section](#) on their web site, they say:

“The ultimate goal is a federal-provincial agreement on GHG reduction targets and how to get there, as long as it takes competitiveness and early action by manufacturers into account.”

The CME even supported the flawed notion that Canadian provinces can help mitigate climate change when they stated in their April 13, 2015 [news release](#),

“The provinces of Quebec and Ontario have made significant progress addressing climate change. Ontario’s emissions have fallen by 20 percent since 2005 while emissions in Quebec are down by 9 percent.”

According to the CME, *“Cap and trade needs to encourage investment by industry in the technologies that will lead to lower GHG emissions.”*

So Canada’s largest trade and industry association appears to have fallen, hook, line and sinker for the climate scare. David Suzuki must be pleased.

Australia

Australia is the second largest coal exporter in the world. Their coal industry employs about 50,000 people directly and 150,000 indirectly and represents 4.2% of the nation’s Gross Domestic Product or almost \$60 billion. No one related to the coal industry should say anything that provides support to the powerful groups determined to shut the sector down.

Minerals Council of Australia

Yet, that is exactly what leaders like Brendan Pearson, Chief Executive of the Minerals Council of Australia have done. In the Council’s June 9, 2015 [media release](#), Pearson said,

"The G7 has delivered a timely reminder on the need for a global roadmap to a low carbon economy through on-going research and development in carbon capture, storage and re-use technologies...Importantly, the [IPCC] has forecast that a global solution to climate change without CCS will be 138% more costly than other options."

The G7 announcement is only 'a timely reminder' if establishing 'a low carbon [sic] economy' is worthwhile, an idea you would expect the Council president to never support. Yet, here he does.

In a similarly misguided announcement, the council asserts in their [Minerals Sector Statement of Principles on Climate Change Policy](#):

"The minerals industry acknowledges that sustained global action is required to reduce the scale of human induced climate change...a global agreement for greenhouse gas emission abatement that includes emissions reduction commitments from all major emitting nations."

Such a politically correct statement appears to betray the Council's mandate to 'represent Australia's exploration, mining and minerals processing industry.'

Other Australian industry

Ray Evans, former Executive Officer at Western Mining Corporation and founder of The Lavoisier Group, an Australian climate sceptic group, explained what is happening in his country when he told an Australian Broadcasting Corporation [audience in 2007](#),

"My experience in industry over 20 years was that many companies can't wait to lie down and get rolled over because they're frightened to contest the issues...the response of many coal companies has been both predictable and pathetic."

The approach of coal industry leader Dr Nikki Williams appears to illustrate Evans' point well. Appearing on the same television show as Evans, Williams, then New South Wales Minerals Council CEO and a director of the Australian Coal Association said,

"The industry for at least a decade in Australia has acknowledged the reality of global warming, the contribution of man-made CO₂ and other greenhouse gases. And, importantly, recognizes that the potential risks associated with climate change are such that action is required. We have to take action. We, as a producing industry, have a very important role there."

Similarly, in a 2009 ABC TV debate, Williams said:

"...if you are serious about solving climate change - and we are; we have to be. It's a major problem - then you have to be serious about how you use coal and how you burn coal in a way that reduces its greenhouse gas footprint."

As CEO of the Australian Coal Association, Williams continued to support the climate scare [asserting](#) in May 2013:

"Let's be clear. Greenhouse gases from burning coal are a problem...if we don't have a solution for coal use – particularly in China and India - we don't have a solution to climate change. This incontrovertible fact is recognised by every major entity including the World Bank, the IEA and the IPCC."

Even now, as former coal industry executive CEO, Williams continues to publically support the climate scare. At the November 2014 Wheeler Center [debate](#) on the future of coal, [Williams said](#),

“The coal industry has long accepted the science of climate change, long accepted that carbon emissions from burning coal are a problem and that they must be reduced.”

With a PhD in International Relations in the field of terrorism Williams is not qualified to decide which scientists are right and which are wrong in the climate debate. Yet, like most of the other industry leaders who have decided to support the UN’s stance on climate change, she unwittingly helps those threatening the industry she holds dear.

Useful idiots feeding the climate scare

A useful idiot is a person who supports one side of a philosophical debate while unaware of the overarching agenda driving the ideology they promote. Useful idiots are often held in contempt by the leaders of the movement they support.

The term was often used during the Cold War to describe communist sympathizers in the West. The accusation was that, while they thought of themselves as standing for benign socialism and allies of the Soviet Union, they were actually scorned by the Soviets who used them as tools to help weaken democratic nations.

Many environmentalists undoubtedly regard conservative governments such as that of Stephen Harper as useful idiots on the climate file. No matter how many billions of dollars the Canadian government pours into supporting the climate scare, no matter what they say about the importance of ‘stopping climate change,’ climate activists still despise them and fight them at every turn.

Similarly, environmental campaigners will never be friends with groups like the coal industry, no matter what the latter do to support the global warming cause. Like naïve governments who attempt to appease aggressive environmentalists, coal companies cannot satisfy those whose ultimate agenda includes killing the industry entirely.

Its time conservatives and industry stopped feeding the fire that is threatening to burn down their homes. ■

Tom Harris is the executive director of the Ottawa, Canada-based International Climate Science Coalition

Fuel subsidies in Nigeria

A high-angle photograph of a congested multi-lane road in Nigeria. The traffic is dense, featuring a large number of yellow minibuses, various private cars, and a prominent white truck with a red cargo box on the right side. The scene is set in an urban environment with buildings and trees visible in the background under a slightly overcast sky.

Peter Wooders says there are better ways to help the poor (and the economy and the environment)

The downturn in oil prices over the past year has hit Nigeria's public budget hard. When money is tight, it seems obvious that governments should first phase out programmes that are expensive and have low benefit to their intended beneficiaries. Subsidising gasoline fits the bill perfectly, and *The Economist* has been among a number of commentators urging the recently elected President Muhammad Buhari to reform these subsidies. But Buhari has rejected reform this quarter while promising to review the literature and information—what gives?

There are three main factors: efficiency; other pressing issues, such as corruption; and social welfare alternatives.

How efficient are fuel subsidies?

Like many other countries, Nigeria began controlling the price of gasoline and other fossil fuels decades ago, largely to provide stable and secure prices to families and small businesses. Also in common with other countries, these price controls became more expensive as demand—some of it driven by cheap, subsidised prices—grew exponentially, and as world oil prices increased, notably in the past decade. What started out as a relatively small programme ballooned, with Nigeria's gasoline import subsidy alone costing over **US\$13 billion** (Naira 2.19 trillion) in 2011.

The gasoline subsidy is also highly inefficient: the 85 per cent of Nigerians living on less than US\$2/day gain little directly, given they do not consume much gasoline. And spending on health, education and development are sacrificed to pay for the costly fuel subsidy. Perhaps counter-intuitively, subsidies also lead to scarcity, with long queues at service stations earlier this year providing yet more evidence of how inefficient these policies are at helping people.

In short, the fuel subsidy doesn't work very well at achieving its intended objectives. There are strong arguments in favour of re-directing the subsidy towards public expenditure that would more effectively lift millions of Nigerians out of poverty. But that is challenging.

The question of corruption

To get a sense of why reform is so difficult, let's consider some recent history. Nigeria's previous administration attempted to double gasoline prices overnight at the beginning of January 2012. The resultant public protests included a two week national strike and had a simple message: deal with corruption first. This argument—led by a broad grouping, including trade unions—was that there was no need for people to pay for holes in the national budget when this could be made up by reducing corruption, including for example when significant parts of Nigeria's crude oil production disappears before it gets near the public purse.

President Buhari is attuned to that message. His election platform and subsequent statements have focused squarely on corruption more generally. In his words, *"such an illegal yet powerful force soon comes to undermine democracy because its conspirators have amassed so much money that they believe they can buy government. We shall end this threat."*

Yet corruption and subsidies are tightly intertwined. Official and unofficial analyses of the 2011 gasoline import bill identified at least US\$5 billion of subsidies to imports which never existed, from ships which never landed their cargo to over-reporting and leakages through the whole supply chain. Justifiably, gasoline consumers do not see why they should pay more if such robbery persists. But trying to choose one problem to fix first—corruption or subsidies—will almost certainly be harder than tackling them both individually and immediately.

Transitioning from subsidies to a targeted, efficient welfare system is a significant undertaking with major stakes involved

President Buhari noted that much had been written and advised on subsidy reform, but that it 'lacked depth.' In effect, this reflects two concerns: that there may be significant impacts from subsidy reform on the poor and vulnerable; and, relatedly, that reforming subsidies may cause serious shocks to the economy through inflation, lower GDP and other economic indicators. These are serious concerns, but an examination of the scale of these impacts in Nigeria and across the world shows that when impacts are quantified they are often far lower than perception. In most cases, the rate of change (the size of any individual price increase) is more significant than the scale of the change (the total price adjustment that needs to be achieved over the long term). As such, a steady but gradual phase-out of subsidies is normally best.

What are the alternatives?

All of this leaves one pressing question: if subsidies are so costly and inefficient, what are the alternatives that can take their place, and can these alternatives be delivered? Protestors against reform admit that very little of the benefit goes to the poor and vulnerable they are representing. But tellingly they also hold to the view that at least the poor are getting something, and alternatives would not even deliver that.

So what should President Buhari do next? The key is to recognise subsidies for what they are—a highly inefficient form of social assistance—and to work on developing better alternatives. Identifying and building on existing social spending programmes that are working well is a good first step, as is increased investment to enhance capacity for the development and implementation of new social programmes. Many countries have been down this path, even when corruption levels have been uncomfortably high. Subsidy reform in Indonesia, Thailand and Viet Nam has all proceeded in parallel with the development and implementation of better welfare systems, such as increasingly well-targeted cash transfer programmes.

Transitioning from subsidies to a targeted, efficient welfare system is a significant undertaking with major stakes involved. Investing in the expansion of existing programs, the creation of new programs and systems to identify the

needy and deliver benefits will touch on themes as diverse as energy access, [gender](#), urban-rural wealth divides and the differences in needs between states. Complex questions also exist about what share of resources should be invested in social assistance, to protect the poor, and what share into boosting and diversifying the economy, thereby lifting households out of poverty through economic growth. If he feels it is lacking, President Buhari is right to demand deep and rigorous analysis on these matters.

There is much that can be learned from international experience. It is now up to Nigerian and international policy-making communities to listen and to help deepen the information and options available.

Peter Wooders is director of IISD's Energy Program and IISD's [Global Subsidies Initiative](#)

The background of the slide features a series of high-voltage power line towers silhouetted against a vibrant orange and red sunset sky. The towers are arranged in a receding line, creating a sense of depth. The overall mood is industrial and dramatic.

Managing risk through futures contracts

Paul Cusenza addresses how entities can manage their
price risk through futures contracts

Risk exists in business. How effectively risks are managed greatly impacts the performance of the business. In businesses dependent on commodities (eg, cocoa, corn, wheat, gold, oil, electric power), price risk is a critical factor. If an entity produces or purchases a commodity, the future price of that commodity is a significant risk. For example, an entity that wants to invest in developing windmills to produce electricity will incur significant fixed costs and has uncertain knowledge about the future price they will obtain for that electricity. In short, the windmill developer has price risk.

This article will address how entities can manage their price risk through futures contracts and how futures contracts also address the credit risk and liquidity risk involved in buying or selling a contract that settles in the future at a specific price.

Nodal Exchange is an electric power futures exchange in the United States which allows participants in the North American power markets to trade power to hedge future price risk. Nodal Exchange contracts are settled financially, meaning the contracts are settled without having to provide the physical power. The wind developer noted above could sell futures contracts for a specified volume of electric power at a specific location in the electric grid (US power prices are priced at 'nodal' locations on the electric grid) to lock in a price.

Suppose the wind developer sold a futures contract for \$50 per megawatt hour for the month of September 2018. If three years later in September 2018 they actually sell the power for \$45 in the physical market, they will earn that \$45 plus another \$5 from the futures contract they sold at a fixed price of \$50 settling at the actual market price of \$45.

Similarly, if the actual physical market price in September 2018 is \$55, then they will earn that \$55 from their physical power sales but lose \$5 on the futures contract ($\$55 - \50). No matter what the actual price of power is in September 2018, the wind developer has sold the power for \$50. By hedging their price risk through a futures contract,

the wind developer creates a certainty of price that allows the wind generator to sleep well knowing they will earn sufficient revenue to cover, for example, the financing cost of developing the windmill. Futures contracts enable entities to manage their price risk.

However, there is also credit risk - will the counterparty who agreed to the trade today be there to complete the final settlement three years from now in September 2018? In order to manage this risk, futures contracts are 'cleared'. When contracts are cleared on a market such as Nodal Exchange, the clearing house becomes the central counterparty, acting as the buyer to every seller and the seller to every buyer.

For example, if the windmill developer trades the September 2018 futures contract with a financial entity, the clearing process inserts the clearing house into the trade, creating one trade between the windmill developer and the clearing house and a second trade between the financial entity and the clearing house. This process is called novation. The clearing house ends up in the middle, but takes no market risk as it has an equal and opposite position for every trade. To protect against the risk of default, the clearing house uses three risk mitigation mechanisms: collection of variation margin, collection of initial margin, and insertion of additional layers of protection.

The first mechanism for addressing credit risk is to mark the futures contracts to market price at least once per day (at Nodal Exchange, contracts are marked twice per day) and then to collect variation margin from participants

... managing risk is critical to effective business management in commodity dependent businesses

every time the price moves. Regularly collecting variation margin based on market prices prevents losses from accumulating. For example, if the contract's price diverges from the original trade price over time prior to final settlement (September 2018 in our example), the clearing house is always collecting the value of the price difference so that the exposure in the case of a party's default is never more than a half business day's price movement in the contract.

The second mechanism for addressing credit risk is to collect initial margin. Initial margin is an amount collected from each counterparty to the transaction sufficient to handle a certain number of days of price movement to a defined probability level. For example, for the Nodal Exchange market, the clearing house calculates initial margin to cover a two day price movement with 99.7% probability. With initial margin in hand, if an entity does default, the clearing house is fairly certain it has the resources, provided by the defaulting party, to cover at least two days price movement as it closes out the defaulting party's positions to remove any further market risk. Initial margin is a way of ensuring that the defaulting party essentially pays for their own default.

The third mechanism for addressing credit risk is having additional layers of protection. One of the additional layers of protection is inserting clearing members, typically large banks, between the clearing house and trading participants to guarantee the trades of their participants. With this structure, the large banks handle participant defaults and the clearing house is only at risk if the clearing member defaults. In addition, the clearing members also contribute to a guaranty fund which provides additional funding in the event that the defaulter's initial margin is not sufficient to cover the cost of closing its positions. The guaranty fund is part of a 'default waterfall' which outlines the sequence of various funds that can be used in the case of a default and typically includes a significant capital contribution from the clearing house as well.

With these three main mechanisms for providing credit risk protection, parties can trade safely without having to worry about the credit quality of the entities they may be trading with. The clearing house process has been very

successful and counterparties in the United States have never suffered a credit loss when they traded cleared futures contracts.

The final area of risk management that futures contracts provide is liquidity risk management. Liquidity risk is the risk of not being able to find a counterparty to a trade at a fair market price. The advantage of futures contracts is that the contracts are all standardized. By having standard contracts it is easier to find multiple interested counterparties. Similarly, by trading futures contracts instead of doing a direct bilateral swap transaction with a specific counterparty, the entities do not have to worry about the credit quality of the counterparty.

This opens up a wider number of possible entities to trade with, thus improving liquidity and the ability to trade at the best price. Also, by having a central counterparty, trades that offset each other can be netted and extinguished making the futures market more attractive and therefore more liquid. Trade prices and volumes, but not trading entities, on futures contracts are also transparent to the marketplace. This aids liquidity as it increases participant confidence that trading is at fair prices. Finally, the trading screen or voice broker assisted trades that support futures markets make it easy to trade with any participant in the market. Futures markets help with managing liquidity risk.

As discussed, managing risk is critical to effective business management in commodity dependent businesses. Futures markets, such as Nodal Exchange, provide participants an environment to be able to manage their price, credit and liquidity risk so that they can more effectively manage their business and achieve superior performance. ■

Paul Cusenza is Chairman & CEO of Nodal Exchange and Nodal Clear

More than a name,
a reference

Q&A

In a Q&A with Olivier Bizon future developments in
wealth management are discussed



1875 FINANCE is recognized as a leader in the world of independent wealth management that has developed around three business lines: Private Clients, Multi-Family Office and Institutional Clients.

We spoke with Olivier Bizon,
Managing Partner of
1875 FINANCE

In today's complex investment climate clear goals and strategies are required by individuals, families and companies. The readership of *World Commerce Review* are sophisticated investors and have requested the inclusion of a specialist editorial piece covering these areas. Could you describe the history of the firm?

1875 FINANCE is one of Switzerland's well-established independent financial institutions. It provides a full array of wealth-management services, ranging from asset management, legal and tax advisory services, to corporate finance and private equity. 1875 FINANCE is an organisation founded in 2006 by myself, Paul Kohler, Aksel Azrac and the Ormond family which started up its first asset management company in 1875.

1875 FINANCE is the result of our common objective to better serve our clients. The firm specialises in private wealth management, multi-family office services and institutional clients. 1875 FINANCE is already one of Switzerland's major independent financial institutions. Our primary assets are: an irreproachable team spirit, demanding ethical standards and the drive for excellence.

The innovative model developed by 1875 FINANCE efficiently meet the needs of our private and institutional clients. As a keeper of tradition, 1875 FINANCE provides clients with the utmost skill and the best tools to achieve performance.

Today, 1875 FINANCE is recognized as a leader in the world of independent wealth management that has developed around three business lines: private clients, multi-family office and institutional clients.

How do you help residential customers?

What is unique about 1875 FINANCE's multi-family office is the technical expertise we have developed that has won us the trust of prominent families and allows 1875 FINANCE to assist them with multi-dimensional projects as well as estate transmission.

The management of family assets requires just as much care as that of a company. Every effort is made to increase its assets in order to pass it on to future generations; our expertise revolves around three main areas: wealth management, the management of day-to-day operations and asset structuring.

1875 FINANCE offers a global approach to securities management and real estate investments. In order to meet clients' expectations in terms of asset protection, growth and monitoring, 1875 FINANCE analyses and takes into account their family's values and visions.

The innovative model developed by 1875 FINANCE efficiently meets the needs of our private and institutional clients. As a keeper of tradition, 1875 FINANCE provides clients with the utmost skills and the best tools to achieve performance

1875 FINANCE offers multiple advantages: we are proud of our professionalism and of our experience in risk management. 1875 FINANCE is an independent entity bringing in independent specialists when necessary. Furthermore, efficient reporting and competitive rates are made possible thanks to shared infrastructure.

What services do you provide to the institutional clients?

We provide institutional clients with a different approach to their asset management to improve their performance and governance requirements. Convinced that tactical allocation plays a major role in portfolio returns, we developed 1875 MAP.

WCR was curious to find out more about the MAP philosophy which the group employs for the clients benefit. 1875 MAP (market allocation process) acts as an asset allocation optimizer. The whole process is key to reducing risk and ensuring that capital growth and returns have the best possible chance to reach desired targets. Could you explain how MAP developed?

1875 Map is a result of over 20 years experience, it uses a unique, robust and replicable process, based on a multi-factor model, it is designed to derive an optimal investment grid for each portfolio, determined according to a strategic allocation. Relying on the systematic analysis of the evolution of 2'500 economic and financial variables, this method prevents subjective factors and provides sustainable excess returns above the defined benchmark.

As PRI signatories (UN Principles for Responsible Investment), we are convinced that a relevant integration for environment (E), social (S), governance (G) criteria improves portfolio efficiency.

The founding partners of 1875 FINANCE have defined a pioneering long-term model on which its difference and strength are based; neither bankers nor solely wealth managers. At the same time, a fully integrated bank-style company but also an independent structure, the model is perfectly suited to the evolving wealth management trade for private and institutional clients.

How does your approach differ from your industry colleagues?

1875 FINANCE provides an open architecture, free from conflicts of interest. A fully integrated bank-style company with an independent structure, the model is perfectly suited to the evolving wealth management trade for private and institutional clients.

Currently the group manages \$6 billion dollars on behalf of clients operating through Geneva, Hong Kong and Luxembourg. The expansion into London is currently underway.

Interestingly the group is in effect a one stop investment boutique with experts and personnel covering a wide range of portfolios from corporate and personal wealth management to family trust planning and advice. In addition, solid relationships exist with the world's leading private and commercial financial institutions. The key strength of the group is the combination of experience and innovation and this is reflected in the range of products and solutions provided to clients.

The pensions sector is an area that 1875 FINANCE has allocated substantial expertise in. Could you explain your strategy?

A comprehensive investment strategy has been developed with the aim of providing secure and consistent returns over time with asset management in line with governance requirements.

It seems to the writer that having access to a pool of experts with considerable experience in their field via a single point of contact is a significant advantage.

There are many organisations with expertise in this sector but 1875 FINANCE seems to have recognised that significant client benefits can be gained by marrying this expertise with long term experience and thus take the longer more balanced view. This it would seem is the choice that clients need to make and balance short term gain over long term consistency.

Currently the group manages \$6 billion dollars on behalf of clients operating through Geneva, Hong Kong and Luxembourg. The expansion into London is currently underway. ■

The editorial team at World Commerce Review would like to thank Mr Bizon for taking the time to explore this important and dynamic financial sector.

The third act of the Greek tragedy

Bartosz Radzikowski writes that if the third act of the Greek tragedy does not run on a suitable and sustainable course, membership of the eurozone will be, for the first time, reversible



On July 15th 229 out of 300 members of Greek parliament voted 'yes' to reforms necessary to get a new aid package: €86 billion bailout over the next three years (2015-2018). Nevertheless, the risk of Grexit - a Greek exit from the euro - has not gone away. Thirty-two Syriza MPs voted 'no' and six abstained. It meant a serious shock for the ruling coalition. Ultra-leftist rebels from Syriza, led by both former ministers, Panagiotios Lfazanis, the minister of energy, and Yanis Varoufakis, the minister of finance, formed a new party to fulfil anti-austerity promises. As a result, Syriza's coalition, formed in January 2015, lost the majority in the parliament, which forced Alexis Tsipras to announce his resignation on August 20th. Greece is now awaiting new elections that will probably take place on September 20th.

The history of Greek bailouts

Greece's predicament began in 2009 when its true economic situation had been uncovered. Its budget deficit was estimated at more than 15% of GDP, approximately 10 percentage points higher than that reported by officials. With a more accurate picture of the Greek economy and its twin deficits—a deep fiscal deficit and a chronic current account deficit—credit rating agencies downgraded Greece's ability to service its debts and the risk premiums on long-term Greek government soared. The country needed a financial assistance, and a recovery program was negotiated by the Greek government and the Troika¹.

The first Greek bailout package was signed in 2010 with a financial support package of €107.3 billion, which was linked to the reform package aimed at restoring Greece's competitiveness and stabilizing its economy. The program was addressed to restore market confidence and lay the foundations for sound medium-term growth, and was meant to urgently limit fiscal deficit. It involved a wage freeze in the public sector, a 12% cut in public bonuses, and a VAT rise. In addition, the government planned to reduce the number of public companies from 6,000 to 2,000. Another key reform was the reorganization of the pension system: equalization of state pension age and a reduction of the amount of 13th and 14th pension instalments. In other words, the main points covered strong and sustained

fiscal consolidation, deep structural reforms, while safeguarding financial sector stability and reducing the risk of further international systemic spillovers.

Having not revived the Greek economy and the government debt crisis in particular, in 2012 the Papademos government was forced to request a second bailout program. This time, financial assistance amounted to €100 billion, and was based on three conditions. Firstly, the Troika insisted on confirmation that all private holders of Greece debt would accept a 50% write-off with yields reduced to 3.5%. Secondly, Greece had to consider implementing further demanding austerity measures in order to bring its budget deficit into sustainable level. The plan included continuation of spending cuts: a 22% decrease in minimum wage, a suspension of holiday wage bonuses, reduction of 150,000 jobs in the public sector, and cuts in the health and defence sectors. Moreover, the government declared a restriction on professions opening, an increased flexibility of the labour market, as well as further privatisation. In addition to that, the Troika required that a majority of Greek politicians would declare support to the new austerity package, regardless of the results of elections in April 2012. The second bailout package was agreed in February 2012.

... if the third act of the Greek tragedy does not run on a suitable and sustainable course, membership in the eurozone will be, for the first time, reversible

Nevertheless, implementation of these two programs has not reduced public debt sufficiently; structural reforms practically stalled mainly due to resistance of various interest groups. Improvement in tax administration proved to be more complex and time-consuming than expected, which resulted in slower progress in collecting evaded taxes. Competitiveness-promotion also did not meet all expectations. Unit labour costs have declined since 2010, but did not entail price-drop substantially. Moreover, despite the reform, some of restricted professions remained closed (pharmacists, lawyers, energy and transport specialists).

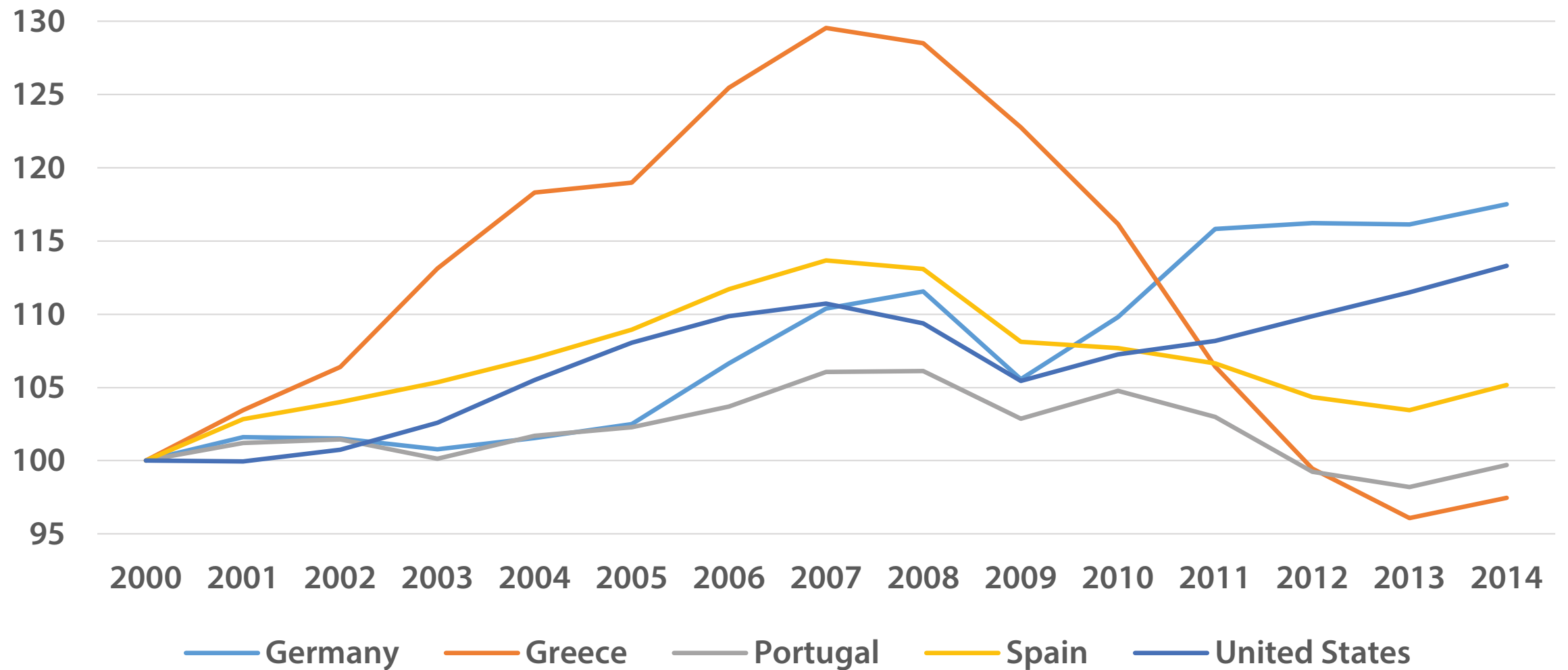
As a result, the unemployment rate increased to 25%, with one out of two youths in the labour market unable to find work. Real wages fell to the levels of 2000, and, ultimately, real GDP per capita collapsed, backsliding to pre-2000 levels (Figure 1)

Will the third bailout help?

Conditions for the third programme are mostly continuation of the previous two. The bailout imposes further fiscal consolidation to strengthen surplus in Greece fiscal balance. The aim is to run a primary budget surplus of 3.5% of GDP by 2018. During the last 20 years, the two leading parties, the New Democracy and PASOK, conducted in spendthrift fiscal policies (the most spectacular of which occurred during the New Democracy's government in 1992-1993 and 2008-2009).

The main problem was that even during recovery, public expenditures exceeded revenues. This was partly due to the rigid and oversized social security system, which served as the main incentive for securing Greek votes. Retirement pensions, dominated by the state pillar system, formed the backbone of the Greek social security system, in some cases, more generous than the German one. The third bailout assumes further 'sustainability' measures, which include reduction in the overblown benefits (13th and 14th month pension instalments) and the raising of the retirement age to 67 by 2022.

Figure 1: Real GDP, 2005 = 100



Source: IMF WEO, April 2015

Furthermore, the program imposes streamlining of VAT and a broadening of the tax base. The Greek taxation system is still extremely leaky with a great shadow economy. According to CASE's *Study to quantify and analyse the VAT Gap in the EU* for the European Commission, the VAT gap² in Greece was 33% in 2012. Although it had been reduced from 39% in 2010, Greece remained one of the countries with the highest VAT gap in the EU. Therefore Greece had to declare a reduction of a range of exemptions and amnesties as well as termination of fuel tax benefits for farmers. Eurogroup creditors also requested a guarantee that official statistics offices would stay independent of internal and external political pressure.

Two previous deals were negotiated by the Troika in tandem. This time, the IMF is cautious and not willing to contribute unless the EU relieves Greek liabilities. According to the Fund, Greek debt, accumulated for years, is not just 'highly vulnerable', but becomes unsustainable, and probably not repayable without a write-off.

The Fund's reluctance comes from its findings from ex post evaluation of previous arrangements with Greece. The IMF's findings illustrate the critical importance of ownership of a reform program. Structural-adjustment reforms are the most effective when the debtor country's government is an active partner that initiates policy changes, while with Greece the government is being forced to adopt a program imposed from the outside. During the recent bailout negotiations the Greek Prime Minister admitted that he did not believe in the economic reform agreement made during the July 2015 summit in Brussels.

The political will for reforms is still rather sceptical. Left-oriented politicians often accuse international lenders of being influenced by neoliberal market fundamentalists who put the market mechanism, as well as interests of their own countries, above the country in need. This has been a recurring theme in Syriza's rhetoric for the last six months. According to latest opinion polls, Tsipras's Syriza is the favourite to win upcoming elections. If Greeks' support for the reforms remains low, they will be quickly diluted.

Moreover, a fiasco of the two previous packages was an effect of too optimistic assumptions. According to the IMF ex post evaluation, the austerity measures helped the economy to limit its primary deficit, but as a side-effect it contributed to a more than expected deterioration of the Greek recession. A sharp reduction of labour costs in 2010 has not stimulated exports, as in the case of Spain or Portugal. This reveals yet another Greek deficit—an institutional deficit. According to the World Bank Group's *Doing Business* reports, Greece's biggest gaps in institutional framework are observed in registering property and enforcing contracts.

Furthermore, an outcome of privatization of Greek state-owned assets was far from the level that had been projected. Greece has only gained approximately €5 billion in privatization revenues for the last 4 years. It looks frugal, comparing to the planned €50 billion the country expected to receive in 2011.

Who really fears Grexit?

The third bailout is meant to strengthen reform process and further cut spending. For Greece, it might mean a further decrease in GDP, an increase of unemployment, and further fiscal tightening. A decline in GDP may cause tax revenues to plummet and upset public finances. Furthermore, if the unemployment level increases to 30% or 40%, Greece may find itself in the middle of a damaging social unrest. Therefore, the Grexit scenario seems still possible.

From the EU perspective, Grexit will most likely mean the write-off of the Greek debt. But the eurozone can certainly function without it – comprising 2.2% of the EU population and 1.3% of EU GDP, Greece is not perceived as a mainstay of the eurozone. Nevertheless, leaving the eurozone would be a political defeat. First, it would be an unprecedented event and the first serious impediment to the so-called United States of Europe. Greece's exit from the eurozone would blaze the trail for other member states to exit, potentially causing a domino effect. If Greece's debts are written off, then why not Italy's, Ireland's, or Portugal's?

Furthermore, it would add fuel to the fire of anti-establishment, euro-sceptical parties from other countries, such as France's National Front and Italy's Cinque Stelle, to name a few. Europe's reputation would suffer, potentially undermining the 'West' in the eyes of imperialistic Russia. Hence, America insists on keeping Greece in the eurozone to maintain the integrity of the EU. Furthermore, investors may even limit funds for Europe, as it would be perceived as the area that is not able to solve problems with a small member state.

On the other hand, Grexit could actually help Greece to recover. Regaining the drachma means independence in monetary policy. Paradoxically, this may even help Greece to repay its debts. Greece's Central Bank would have an instrument to implement the controversial debt monetization. The Central Bank can print money to cover government bonds denominated in the new drachma at the cost of higher inflation. If the Central Bank controls the process and does not cause hyperinflation, it may help the government to repay obligations, similar to the actions of the US Federal Reserve. What is more, a nominal devaluation would contribute to a restoration of Greek competitiveness, although, since Greece is a small quasi-closed economy, the impact on current account might be moderate.

On the other hand, if the government sets a fixed euro-drachma rate to exchange all savings, it will likely undermine the real value of savings in the new currency, which may be the trigger point for a temporary run on banks for the remaining euros.

Conclusions

For now Greece remains in the eurozone. However, if the third act of the Greek tragedy does not run on a suitable and sustainable course, membership in the eurozone will be, for the first time, reversible, as noted by German Finance Minister, Wolfgang Schäuble. Something that seems politically impossible may be economically inevitable.

The third agreement seems only a prolongation of the agony rather than a solution to Greeks' problems. It seems confusingly similar to the previous two and may become completely insufficient in six or twelve months.

It is worth stressing that Greece suffers from lack of pro-reform leaders, who could guide the society through present turbulences. According to the US economist, Tyler Cowen, the country needs a 'Thatcheropoulous': a strong, credible, pro-debt renegotiation, pro-capitalism, anti-corruption, pro-tax fairness, and pro-foreign investment politician. Will there be such name on the voting card in September 2015? ■

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Endnotes

- 1. the European Commission (EC), the European Central Bank (ECB), and the International Monetary Fund (IMF), collectively known as 'the Troika'*
- 2. The VAT gap is the difference, in any given year, between the VAT collections (as recorded by Eurostat) and the amount theoretically due, ie. VTTL (VAT Total Tax Liability).*



International financial institutions facing a credibility crisis!

Deepanshu Mohan says that institutions such as the IMF are not prepared to meet the great macroeconomic challenges that lie ahead

The last few months in Europe have put economic historians, economists and political economists back in business, especially those fascinated in studying financial crises. The focus now seems to be on gauging the politico-economic crisis unfolding post an intense round of periodic negotiations between a debt-ridden Greece and its creditors (including Germany). The deal finally made may even lead to the worsening of the Greek economic situation in the future. The entire process of how Greece has been made to accept some tough reform proposals and conditions for a bailout fund has been a painful watch, especially because of the role played by Germany in managing these with other members of European Union and institutions like the IMF, European Central Bank (ECB).

Amidst all the hue and cry on what is/was so inherently wrong with the Greek economy, it is important to raise a simple yet perplexing question: to what extent is the *Troika* (consisting of the European Union, European Central Bank and the IMF) responsible for this? Or, perhaps more importantly, what has the IMF done in preventing this from happening?

I focus here on the second part to the question, particularly the role of the Fund. The Fund now seems to be facing a huge credibility crisis because of its failure in mitigating crisis like the 2008 eurozone crisis. It is beyond me how an international financial institution such as the IMF, mandated and set up to surveil, mitigate and end financial crises of such a nature, has yet again been unsuccessful in doing these effectively. There is enough evidence from the recent past of this, including crises such as the 1997-98 East Asian crisis, 2002 dot-com bubble burst and the 2007 US sub-prime crisis, which the IMF also failed to mitigate.

When evaluated in its role as a central institution of global monetary cooperation, the IMF seems to hardly be prepared to meet the great macroeconomic challenges that lie ahead. For example, in the case of the current eurozone crisis, we still do not know if there is a clear recovery plan proposed by the IMF to deal with the impact of a Greek

default or debt relief on the euro members and what happens if other debt ridden countries (Italy, Spain, and Portugal) face a similar economic catastrophe.

Let me attempt to briefly highlight two central issues stanching the IMF's performance with regard to its mandated goals of surveillance and crisis lending, which are at the heart of its inability to identify rudimentary causes of today's financial crises.

Surveillance

Morris Goldstein, in a paper written a decade ago, addressed the structural problems related to a central, but often neglected issue of the IMF's role in surveillance, in particular over member's exchange rate policies. The Bretton Woods Conference created a post-World War II international monetary system based on fixed exchange rates that sought to avoid 'beggar thy neighbour policies' that had undermined the global economy. However, time and time again, the Fund has fallen down on the job as the umpire of the exchange rate system. As an example, Goldstein cites the classic case of China's manipulation of their exchange rates to prevent global balance of payments adjustment.

... any effective reform of the IMF must clearly highlight the priorities in the Fund's activities

A fallacy needs to be debunked with respect to exchange rate manipulation. If a country's rate is fixed against another country's currency, the country cannot be manipulating that rate. Passive intervention in defence of a fixed rate is not manipulation even if it is heavy – a country may be justified in maintaining an undervalued rate for domestic economic reasons. It is the real exchange rate that matters and in due course inflation will take care of any nominal undervaluation.

To restore the IMF to its proper role in this area some valuable reform proposals have previously been offered but ignored. These proposals first suggested by Goldstein include one in which the Fund should use a system of providing semi-annual or quarterly estimates of reference rates and, second, in issuing its own semi-annual report on exchange rate policies for its member nations. If we analyse these two proposals on their merit, the Fund indeed will benefit by implementing these and identifying practices of potential currency manipulation involving central banks of member nations. The reference rates too can become a basis for IMF surveillance over exchange rate policies of members and revise them periodically.

Another problem that has imperilled trust in the IMF is its inability to effectively deal with regional monetary arrangements which includes the dealing with the European Monetary Union (EMU). In an earlier article, I mentioned that it was a grave mistake to allow for a monetary union to be established in Europe without effectively bringing the members into a fiscal union. The absence of a fiscal union among the EU members has landed the entire region in a fiscal mess today. This is the type of situation where the IMF should have played a key role before giving its consent for the Euro to be used as a single currency in the region.

Crisis lending and conditionality

The IMF's crisis lending mechanism too, in my opinion, is least effectively designed to fulfil the role of providing effective liquidity assistance or act as a lender of last resort in contingency. Liquidity crises need immediate response, leaving no time for crisis countries and the Fund to be involved in protracted negotiations. As Charles W Calomiris

mentions *“The current IMF formula of taking weeks or months to negotiate terms and conditions for liquidity assistance, and then offering that assistance in stages over a long period of time simply is a non-starter if the goal is to mitigate or prevent liquidity crises.”*

The Fund has in the recent past also managed to transfer resources to debtor countries during severe economic crises, along with other development bank lending (which entails substantial subsidies to borrowing countries); however, most of the transfers do not seem to improve financial markets or increase growth levels.

Joseph Stiglitz, in one of his recent articles, has critiqued the series of austerity measures unleashed on the Greek economy to no avail and significant result. He says: *“the economics behind the program that the ‘troika’ (the European Commission, the European Central Bank, and the International Monetary Fund) foisted on Greece five years ago has been abysmal, resulting in a 25% decline in the country’s GDP. I can think of no depression, ever, that has been so deliberate and had such catastrophic consequences: Greece’s rate of youth unemployment, for example, now exceeds 60%.”*

I have previously argued that because of such reasons, confidence in the older Bretton Woods framework of economic governance – such as the IMF is modeled on – seems to be rapidly waning, especially when looked from the lens of developing countries that are in need of more surveillance and capital. This waning confidence is giving rise to new regionally designed multilateral institutional frameworks such as Asian Infrastructure Investment Bank (AIIB) by China and New Development Bank (NDB) set up by Brazil, Russia, India, China, and South Africa (BRICS).

While deciding the process of financial lending, it is prudent to identify goals and take into account factors such as local ownership, private investment, innovation, multi-stakeholder partnerships, accompanied with the process of institutional development through mutual accountability and transparency. No single change by itself can restore the IMF or institutions like itself as a highly respected international monetary institution (Truman). Similarly, any

effective reform of the IMF must clearly highlight the priorities in the Fund's activities, as in where it should become less as well as more involved.

Effective and expedient surveillance mechanisms (members' exchange rate management, monetary and fiscal policies) and more prompt and reasonable policies in crisis sending (and the conditionality attached) for me must be the two most important and probably the only institutional functions that the Fund should involve itself in if it is to uphold its existence as a transnational pecuniary organization. ■

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Regulations badly needed – the case of Islamic financial institutions

The need to create uniform, universally acknowledged and followed standards is arguably the most pressing challenge for Islamic financial institutions, Katarzyna Sidło writes

Islamic banking and finance (IBF) has long ceased to be merely a curiosity on the global financial scene. With IBF industry's assets estimated at USD 1.87 trillion at the beginning of 2014 (IFSB, 2015) and growing annually at 17%, it is one of the fastest growing segments of the market. Moreover, it is projected to keep on growing faster than conventional banking for the upcoming years, not only due to its low levels of penetration and low base, but also growing demand for sharia-compliant products in the predominantly Muslim countries, as well as increasing interest in the ethical banking in the so-called Western world (largely as an aftermath of the recent financial crisis).

That said, the Islamic financial industry – being still relatively young (first Islamic financial institutions started appearing in late 1960s) – faces a lot of challenges. The need to create uniform, universally acknowledged and followed standards is arguably the most pressing one.

Generally speaking, Islamic financial institutions are regulated on three different levels: international, country, and institutional.

Country-level regulations

Regulations on the country level are arguably the most straightforward ones – any financial institution, depending on its domicile, has to follow certain rules and regulations.

Some countries, like the United Kingdom, Saudi Arabia, or United Arab Emirates do not distinguish between Islamic and conventional banks in terms of regulations and apply a single integrated regulatory framework. In others, like Jordan, Qatar, or Turkey, additional provisions applying to IBF institutions are added to the general regulatory framework. In yet others, like Bahrain, Iraq, and Kuwait, separate regulatory frameworks exist. In Malaysia and Indonesia, one of the most vibrant Islamic financial markets, a mixed approach is being applied, with some rules being issued specifically for Islamic institutions, and others being mandatory for both conventional and Islamic ones.

International regulations

Those jurisdictions that do have separate rules for IBF institutions usually apply one of the existing international standards issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB), or International Islamic Financial Market (IIFM).

The first one (AAOIFI), established in 1993 and based in Bahrain, has 200 institutional members from 40 countries; its standards are mandatory or highly recommended in: Bahrain, Dubai International Financial Centre, Jordan, Sudan, Syria and Qatar. Some other countries, like Indonesia, Malaysia, Lebanon, Saudi Arabia or United Arab Emirates, have incorporated only some of AAOIFI to their own guidelines.

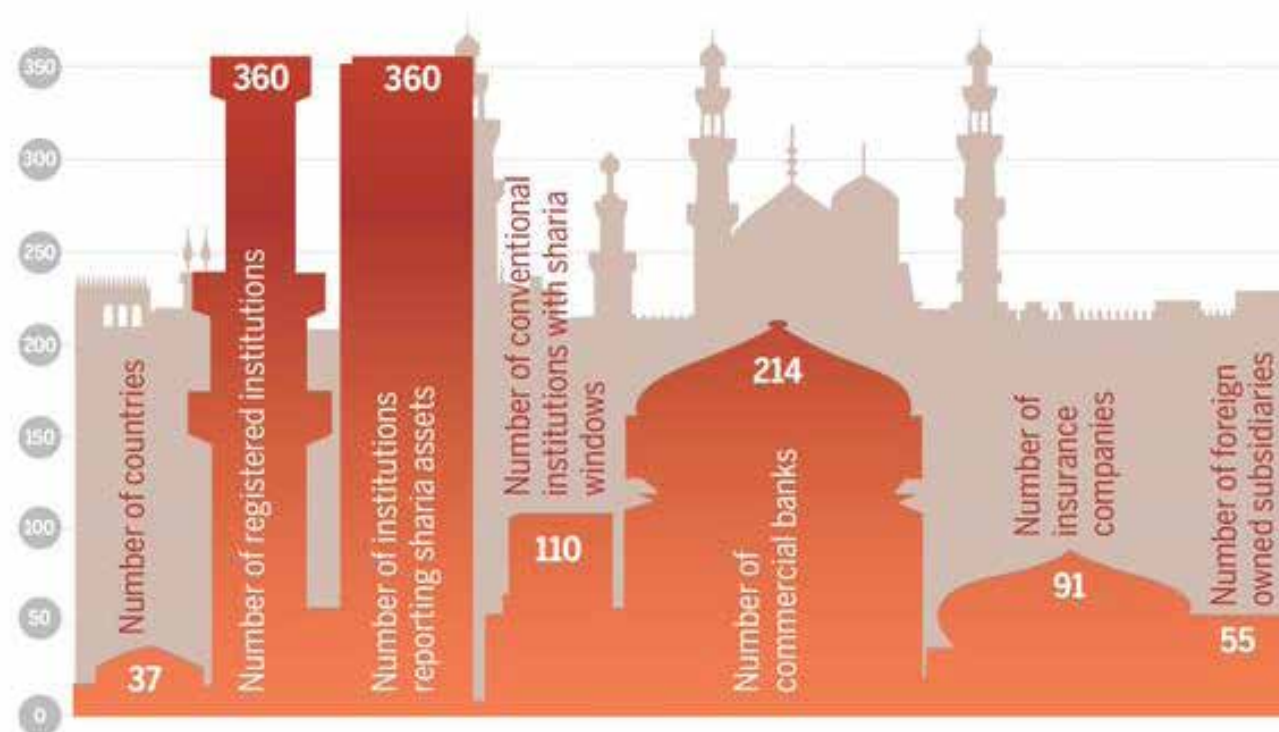
IFSB is much younger (started operations in 2003) and is based in Kuala Lumpur, Malaysia. According to its authorities, its work complements that of the Basel Committee on Banking Supervision, International Organisation of Securities Commissions and the International Association of Insurance Supervisors. According to their [website](#), they have

What is needed are universal, internationally agreed-upon rules without which the industry will be growing less fast than it could

'188 members of the IFSB compris[ing of] 61 regulatory and supervisory authorities, eight international inter-governmental organisations, and 119 market players (financial institutions, professional firms and industry associations) operating in 45 jurisdictions.'

What it means is that in one country, for example Saudi Arabia, some Islamic institutions will follow AAOIFI guidelines, while others will choose to accommodate those published by IFSB. Yet others might chose to use a mixture of both, or none at all. On the top of it, there are standards issued by the Manama-based International Islamic Financial Market, whose members include, among others, Islamic Development Bank, Central Bank of Bahrain, Central Bank of Sudan, Bank Indonesia, Autoriti Monetari Brunei Darussalam, State Bank of Pakistan, Dubai International Financial Centre Authority, and Indonesia Financial Services Authority.

Highlights of the top Islamic Financial Institutions ranking in 2014



Source: The Banker. Top Islamic Financial Institutions, November 2014

Institutional-level regulations

Now, to make things even more complicated, the vast majority of Islamic financial institutions will have its own sharia board or committee (in some countries, eg. in Afghanistan, Malaysia, or Pakistan it is also obligatory for the central bank to set up one), responsible for ensuring the sharia-compliance of the institution's activities. Members of each board should be qualified scholars in Islamic law, specializing in *fiqh al-muamalat* (Islamic commercial jurisprudence). Ideally, they should also possess certain degree of knowledge of

conventional banking and finance. In most cases, it is the sharia board who holds the ultimate responsibility for the institution's sharia compliance, although in some countries – like Malaysia or Sudan – the sharia board of the central bank has the final authority over sharia compliance issues, and thus has a final say should any dispute or controversy arise.

As it can be seen, then, sharia boards are of crucial importance for the functioning not only of each of the institutions for which they work (I wrote 'work' on purpose, because members of the board are being paid salaries, which – needless to say – is a matter of substantial controversy), but of the entire industry. Who is appointed to sit on the boards should be very carefully decided upon. Unfortunately, the industry suffers from the lack of adequately qualified scholars, and so many of those eligible will sit on a number of sharia boards at the same time. It is an open secret that three most popular sharia scholars are members of 27 regulation bodies and over 240 Islamic financial institutions (*Financial Times*, 2014).

The scale of the problem

Let's imagine that you want to set up an Islamic bank in the United Kingdom. First of all, you have to abide by all the rules set up for conventional banks (including, for example, the provisions of Basel III, which might be difficult eg. in case of profit-sharing investment accounts (PSIAS) popular in Islamic banks). Luckily, the UK – aiming to position itself as an Islamic financial hub in Europe – has already introduced some amenities, including the removal of the double Stamp Duty Land Tax, and is largely accommodating for IBF institutions. Once you have managed to fill in all the necessary paperwork, you need to find typically between 3 and 6 scholars, who will sit on your sharia board. Due to the already mentioned shortage of qualified individuals, you will probably have to hire someone who is already a member of a sharia board of one of your competitors. This is where a number of issues arise; conflict of interest being probably the most serious of them. You should also probably think beforehand what kind of instruments you wish to offer to your customers. If you believe they should have access to, let's say, *tawurraq* (or commod-

ity *murabaha*) – a much disputed instrument, which allows the client to obtain cash in line with sharia rules (at least according to some scholars) - you should probably consider appointing Malaysian scholars, for although *tawurraq* is indisputably convenient for the customer, it is not recognized as sharia-compliant almost anywhere but Malaysia.

Those differences arise from the fact that in Islam, unlike for example in Catholicism, there is no one universally followed school of thought. In fact, only in mainstream Sunni Islam, there are four popular schools (or *madhahib*): *maliki*, *hanbali*, *hafi'i* and *hanafi*. Depending on the school followed by a particular scholar, their rulings will vary, and so the same instrument might be simultaneously deemed both sharia-compliant and *haram* (forbidden) by different scholars.

What next?

Those working in the Islamic financial industry are well aware of the problems the lack of uniform regulations causes. This is especially visible in case of *sukuk* – certificates commonly known as sharia-compliant bonds. As Islamic instruments they need to be asset-based, which means they will have some other sharia-compliant instrument underling them. For example, *sukuk al-musharaka*¹ used to be one of the most popular structures in use. However, since AAOIFI criticized its use in 2008 it became less popular in many countries, to the extent that although it is still deemed sharia-compliant by certain scholars, it might be difficult to find buyers for it.

Most efforts in the field of regulations are applied on a country level – for example some countries like Oman, Malaysia, and Indonesia have already implemented certain rules on who can sit in sharia boards. What is, however, needed, are universal, internationally agreed-upon rules without which the industry will be growing less fast than it could, especially when taking into consideration the resulting difficulties with global trading. Islamic financial institutions need legal, corporate and regulatory frameworks just as much as conventional ones do. All the previously mentioned institutions – AAOIFI, IFSB and IIFM – are doing a good job preparing various guidelines and rules, until

their regulations are coherent and consistent, and – even more importantly – universally followed, their efforts will not be as fruitful as they could be.

Meetings like the recent 12th IFSB Summit, themed *Core Principles for Islamic Finance Regulation: Integrating with the Global Regulatory Framework*, which was held on 20 and 21 May 2015 in Kazakhstan, should therefore be more inclusive (perhaps changing the name to IFSB/AAOIFI Summit?). Political differences, especially those between Sunni and Shi'a countries, should also be put aside. After all, the main principle behind Islamic economics was to serve for the common good of the society. One may only hope this idea will not be completely lost somewhere between cheque books, multi-million investments and political fights inside of the Muslim *ummah*. ■

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Endnote

1. A form of sukuk based on the musharaka joint venture or partnership structure, one of the profit-and-loss sharing (PLS) schemes popular in Islamic finance.

When you dreams
become reality

Q & A

World Commerce Review spoke with Ron Shaw about
building your tropical paradise

Since 1998 RA Shaw Designs has mastered the art of building dreams and bringing imaginations to life. *World Commerce Review* spoke with Ron Shaw about building your tropical paradise



Please tell us about your background and the history of RA Shaw designs

RA Shaw Designs Ltd commenced business in the Turks & Caicos Islands in 1998. Our niche, (and my passion) in the market is single family homes. I have been designing homes in the TCI ever since. I am a product of the Ontario College system, graduated from Niagara in 1980. I am a certified Quantity Surveyor, and although I studied architecture, I have no architectural accreditation, and yet my entire career has been design. I came to the islands from the commercial/industrial design and construction market in southern Ontario Canada in 1996. We emigrated to the islands to accept a position in project management and design on a residential condominium project on Providenciales.

Since completion of that project I have been designing (and building) single family homes in the Turks and Caicos Islands and other tropical locations including the Mauritius, British Virgin Islands, The Bahamas, and west coast of Africa. The majority of our projects are off-island Owners building their dream vacation home in paradise. Over the past 10 years, 54% of our clients are from North America, 29% UK and Europe and balance are local. We take pride in thinking outside the box and creating homes that truly leave visitors with a tropical living experience that you will not find in northern climates. Our average home is in the 3,000 to 6,000 sf range. Our largest is the Emerald Cay project at 30,000sf.

Early in our days here in TCI, I discovered that maintaining a reasonable level of quality construction is very difficult on a small island so I created Design Build Associates Ltd, a general contracting firm that builds the majority of the projects we design here in the Turks & Caicos. We have a staff of 15 managers that are very active not only the design but continue thru to construction. Aside from the benefits of continuity, this instils a tremendous amount of pride and dedication to the project. I am passionate about single family residential design and consider myself very fortunate to have been able to establish a successful design practise located in the tropics. We have designed and built some pretty incredible residences. It is more about client relationships and building their dream than it is

about making money. I find this to be a stark contrast to the commercial industrial design work that filled the earlier days of my career.

What particular challenges and opportunities exist in the Caribbean?

Our focus is single family residential and the majority of our clients look for a return on their investment thru short term vacation rentals. Based on this, our designs focus on creating architecture that leave a lifelong impression on their vacation purely due to the unusual and unique tropical living experience that our homes deliver. Also, need to keep in mind the client's interest at protecting personal belongings that they store in the house. All our homes are different and unique, each designed around the panorama, wind directions, topography, ease of access, and making indoor and outdoor living spaces seamlessly connected. Our climate is perfect, rarely goes below 70 degrees F or over 90. A residence properly designed to take advantage of cooling breezes does not require air conditioning. One of my biggest challenges is convincing North Americans of this fact. Utilities are very expensive here, power can be 3 to 4 times greater than in North America. We do not have any fresh water resources in the TCI. Our water is either collected from rainwater, or desalinated ocean water. Costs of potable drinking water here are roughly 25

The majority of our projects are off-island owners building their dream vacation home in paradise



times higher than average rates in North America. Proper design can/should reduce consumption and focus on recycling. All our homes are equipped with sewage treatment plants that use the effluent for direct discharge to plant irrigation on the property.

How does the process work with a client?

We are design/builders. All work is negotiated thru five well defined phases of the process which includes:

- Concept Development
- Budget Pricing of the Concept
- Preparation of Construction drawings and schedules
- Repricing of the project based on final details
- Construction

Our service includes full design including:

- Structural design
- Electrical, plumbing, and air-conditioning
- Interior design and decorating
- Landscaping
- Permit applications

We offer turnkey packages to our clients starting with conceptual development and often continue right thru to full provisioning of furniture, artwork, small appliance, dishes and cutlery, and even linens. Being on an island, it is not easy to source household items at reasonable cost. We therefore often provide this 'icing-on-the-cake' provisioning

in addition to our design and construction services based on expansive roster of North American suppliers and our refined procedures including delivery in North America, consolidation of goods, ocean freight, clearing of product thru Customs once it arrives here, and finally, on-island delivery and set up on site.

Please describe a typical project

A typical project is a single family home, usually ocean front or located on a canal. End use of the home is used for owner's vacations and short term vacation rental. Most residence have their own website and marketing plan for rental. Average home is 3,000 to 5,000 square feet with 4 to 6 bedrooms. As mentioned earlier, our design delivers very unusual layouts that bring lasting memories to vacationers, particularly when it comes to connecting indoor spaces to the preferred outdoor space.

Please tell us about your team and their expertise

The majority of my staff are AutoCAD literate and delve into a broad spectrum of responsibility ranging from detailing of construction documents right thru to field management of the actual construction. Aside from business management, I personally focus on conceptual development and am the only Quantity Surveyor on staff, so I do the vast majority of material take-off and pricing. My Construction Manager Ian van Wallegghem is responsible for all construction activity. Ian possesses an uncanny ability to identify the critical path of the project. Very virtuous ability particularly when involved in the procurement of construction materials in a remote market. Equipped with communication skills that equal (or surpass) his management skills, Ian quickly wins total respect from our Suppliers and Clients. As a result, our reputation of unique designs followed with quality construction and an ability to deliver quickly, has generated an enviable reputation in the islands.

Case in point... our latest project is 4,900 square foot, 5 bedroom, \$2.2 million house went from concept to completion in just 10 months. We (and our clients) are fortunate to have Ian on our team.

How do you see the market developing?

The Turks and Caicos Islands, particularly Providenciales, was voted the #1 Tourism Island in the World, April 2015 by *Trip Advisor*. I think the Grace Bay Beach is unequalled in the world. The Caicos Bank emanates the most beautiful turquoise water for as far as the eye can see. Fish and marine life are enjoyed by divers in our crystal clear waters. Lowest crime rate in the Caribbean, British Dependent Territory, English speaking, US currency, absence of income or property taxes, all have contributed to our popularity as a destination island. But more than a destination, once you have visited the TCI, one cannot wait for the return. As a result we are seeing private investment in the single family villa development with handsome returns thru short term rental. This attraction is of even higher benefit as we see the trend being lower density development in comparison to other islands, keeping our population and related ecology in check as a result.

What advice would you give to a client searching for an architect with luxury experience?

The most important element in developing new is to involve local knowledge early in the process. Prior to land purchase is not too early. Local designers know and understand the local annual weather patterns, topography, neighbourhood, and can point out differences and advantages of alternate sites based on experience and knowledge. Highly recommend local designers. I insist you need to live in the environment to fully understand it and take advantage and capitalize on everything our location and climate has to offer. Traditional northern designers often miss the target by a long shot. ■



The EU-China's Comprehensive Agreement on Investment

A successful CAI could give a welcome boost to EU-China economic and trade relations and should be warmly welcomed by business, Fraser Cameron writes

Introduction

The EU and China launched negotiation for a comprehensive agreement on investment (CAI) in November 2013. There have been six rounds of negotiations (as of August 2015) and officials hope there will be an agreement in 2016. The CAI will be the EU's most important investment agreement since foreign direct investment (FDI) became its exclusive competence under the Lisbon Treaty in 2009. Once it enters into force, the new agreement will replace the existing bilateral investment treaties between China and EU member states. The CAI negotiations are embedded in the wider framework of EU-China relations which includes the annual summits, high level dialogues on foreign and security policy, economic and trade policy and people to people contacts.

At the 17th EU-China summit in Brussels on 29 June both sides agreed on an impressive list of priorities for the coming year with connectivity, infrastructure financing and innovation at the top of the list. Both sides agreed to discuss links between the Juncker Plan and China's 'One Belt One Road' initiative. EU and Chinese leaders emphasised at the summit that they wanted to conclude an ambitious and comprehensive CAI that would include investment protection, market access, and other elements further facilitating trade and investment. They agreed that a joint text should be ready by the end of 2015. Cooperation on the protection of intellectual property was also further strengthened by the signing of a MoU on reinforcing the bilateral IP dialogue mechanism.

Why now?

Why did the two sides agree to negotiate a CAI? Despite the one billion euros in daily trade between the EU and China (as much as in the whole year of 1975 when diplomatic relations were established) the respective FDI totals are low. China accounts for less than 5% of global European FDI while Chinese FDI in Europe is less than 3% of the total. Both partners have suffered reduced growth and hope that a comprehensive CAI will give a boost to two-way FDI and help their respective economies.

Apart from the expected economic benefits, the CAI is considered a stepping-stone for a future free trade agreement between the EU and China. The CAI will then fit into the mosaic of FTAs and investment agreements that are being negotiated between the world's major players eg. TPP, TTIP, and the US-China investment agreement.

A CAI should alleviate and hopefully resolve most trade problems between the EU and China. The EU Chamber of Commerce in Beijing has noted that barriers to European investors in China exist at all levels and in different forms. Problems such as obligations to set up joint ventures with local partners, mandatory transfer of technology and local content requirements negatively accentuate the lack of a predictable and secure economic environment affecting existing and prospective investors. Similarly, China hopes that the CAI will reduce what they view as increasing protectionist sentiment against Chinese investment in Europe.

Contents of the CAI

The CAI is expected to improve the legal certainty for investors by expanding the existing standards of investment protection and reducing barriers for investors. The overall result should be to increase the flow of FDI between them. Some key principles have already been outlined by both sides.

Non-discrimination

The CAI should enforce the principle of non-discrimination principle which means that foreign investors will receive similar treatment to that accorded to national investors in like circumstances. Under the MFN clause, both parties

The CAI will not be a magic bullet but should provide an improved legal framework for economic operators in the EU and China

will extend to those investors and investments covered by the CAI, treatment which is no less favourable than that which they could accord to foreign investors of any third country. From the investors' perspective, the conditions to entry will be more transparent and predictable, as the regime will be regulated by the agreement itself and not subject to changes by both parties. It is expected that there will be an obligation to accord fair and equitable treatment and provide full protection and security of investments unless there are specific exclusions.

Other provisions

Given that direct expropriation is today very rare, the CAI will mainly focus on the regulation of the notion of indirect expropriation. Other relevant provisions for the protection of investors likely to be in the CAI include the transfer of funds into or out of the country, without delay, at a market rate of exchange; the abolition of performance requirements; the elimination of restrictions on the appointment of senior management of the board of directors.

Dispute settlement

The CAI will contain some type of international dispute-settlement mechanism to enforce its rules and resolve disputes brought by either the affected country or private parties. This is a controversial element and the final agreement may well reflect the outcomes of other similar international negotiations.

Right to regulate

The CAI will have a clause to make sure that the investment protection provisions fully preserve the right of governments to regulate and implement public policy objectives and avoid any abuse of these rules, either with the negotiation of a general exception clause or by the insertion of exceptions in each clause.

Market access

A key part of the CAI will be the provisions on market access. The EU is pushing for a 'negative list' approach which means that both sides would be legally bound to open all market sectors unless specifically declared 'sensitive.'

Conclusion

A successful CAI could give a welcome boost to EU-China economic and trade relations. The potential for increased FDI in both directions is vast. Chinese FDI in Europe, for example, is less than 5% of US FDI in Europe. The CAI will not be a magic bullet but should provide an improved legal framework for economic operators in the EU and China. As such it should be warmly welcomed by business. ■

Fraser Cameron is Director of the EU-Asia Centre in Brussels

Brussels's lobbying bonanza

Pia Eberhardt, Lora Verheecke and Kenneth Haar write that EU politics is heavily skewed in favour of capital and transnational corporations and that TTIP would expand their power even further



An estimated 20,000 to 30,000 professional lobbyists roam the corridors of the EU capital Brussels, 70% representing big business. Brussels is home to more than 500 transnational corporation offices, over 1,000 industry associations and hundreds of consultancies. Many of their staff used to work in EU institutions, know who and how to lobby, and have **enormous resources** at their disposal.

The **financial industry**, for example, spent more than €120 million per year on lobbying around the EU's efforts to regulate the financial sector in the wake of the 2008 crisis – outspending other interest groups by a factor of more than 30. At that time, there were **1,700 financial sector lobbyists** working in Brussels, four for every one financial civil servant. Moreover, the most powerful sections of the EU institutions seem eager to put themselves at the disposal of corporations, not least the civil servants of the European Commission that negotiate EU trade agreements.

The talks on the proposed EU-US TTIP (Transatlantic Trade and Investment Partnership) agreement have shown this very clearly and could offer business lobbyists even more tools and leverage to tangle up, delay, sue for compensation for, and even cancel, regulations that hamper profits.

Excessive rights for foreign investors – a key element in the proposed TTIP – will significantly expand **big business power**. The idea is to grant EU investors in the US, and US investors in the EU, far-reaching rights to attack decisions made by parliaments, governments and even courts. To claim these rights, investors would have access to a parallel legal system which is exclusively available to them: via so called investor-state dispute settlement (ISDS), they can bypass local courts and sue states directly in private international tribunals.

Around the world, companies are already using similar rights in trade and investment agreements to claim compensation for perfectly legitimate government policies to protect health, the environment and other public interests – because they claim these policies have the indirect effect of undermining corporate profits. For example, tobacco giant Philip Morris is demanding US\$2 billion from Uruguay over health warnings on cigarette packets; Swedish

polluter Vattenfall is seeking €4.7 billion from Germany following a democratic decision to phase out nuclear energy; and Canadian company Lone Pine is suing Canada via a US-subsiary for CAN\$250 million after the Canadian province of Quebec imposed a moratorium on shale gas extraction (fracking) over environmental concerns.

Countries have indeed been asked to pay huge sums of money to companies under investor-state disputes. One of the highest known compensations to date, US\$2.3 billion, was awarded to US oil company Occidental Petroleum against Ecuador, for the termination of an oil production site in the Amazon.

There is also evidence that proposed and adopted laws on public health and environmental protection have been abandoned or watered down because of corporate claims for multi-million dollar damages – or the threat of an expensive claim. Five years after the investor-state provisions of the North American Free Trade Agreement (NAFTA) came into force, a [former Canadian government official](#) told a journalist: *“I’ve seen the letters from the New York and DC law firms coming up to the Canadian government on virtually every new environmental regulation... Virtually all of the new initiatives were targeted and most of them never saw the light of day.”* A clear example of this regulatory chill

EU politics is already heavily skewed in favour of capital and transnational corporations. TTIP would expand their power even further to threaten any future regulation that limits big business profits – and the very essence of democracy

effect is the announcement by New Zealand's Health Minister to delay the enactment of tobacco plain packaging legislation until after Philip Morris' claim against Australia's tobacco rules has been resolved.

Critical scholars such as [David Schneiderman](#) from the University of Toronto have therefore aptly described the anti-democratic character of international investment treaties as: *"an emerging form of supraconstitution... designed to insulate economic policy from majoritarian politics"*. US-based journalist William Greider has argued that the excessive investor rights in international trade pacts are part of *"a long term strategy, carefully thought out by business"* to re-define *"public regulation as a government 'taking' of private property that requires compensation"*. The implications, according to Greider, are far-reaching – and that was exactly the intention: *"Because any new regulation is bound to have some economic impact on private assets, this doctrine is a formula to shrink the reach of modern government and cripple the regulatory state – undermining long-established protections for social welfare and economic justice, environmental values and individual rights. Right-wing advocates frankly state that objective – restoring the primacy of property against society's broader claims."*

Enshrining the excessive investor rights in agreements between capital-exporting countries such as the EU and the US would multiply litigation risks (one reason investment treaties between capital-exporting states are very rare). TTIP would cover more than half of all foreign direct investment in the whole of the EU, including in industries which have proven prone to investor-state claims in the past, such as extractives or water and energy utilities. According to research by the US-based consumer organisation Public Citizen, a total of 75,000 cross-registered companies with subsidiaries in both the EU and the US could launch investor-state attacks under the [proposed deal](#). This danger is even more real given that EU and US businesses are well aware of how to work the system: according to UNCTAD, they account for 75% of all [investor-state disputes](#) known globally. Under the proposed corporate rights in the EU-US trade deal, companies could basically sue the living daylight out of governments on both sides of the Atlantic.

When preparing the mandate for the negotiations on TTIP, and in the first important months of the talks themselves (January 2012 to February 2014), the European Commission's trade department (DG Trade) had 597 behind-closed-door meetings with lobbyists to discuss the negotiations, according to internal Commission files obtained via access to information requests. 528 of those meetings (88%) were with business lobbyists while only 53 (9%) were with public interest groups. So, for every meeting with a trade union or consumer group, there were 10 with [companies and industry federations](#).

There is evidence that DG Trade actively encouraged the involvement of corporate lobbyists. For example, in autumn 2012, DG Trade chased pesticide lobby group ECPA to participate in the then-ongoing public consultation on TTIP. As *"the European crop protection/pesticides industry is one of the key sectors we would be looking at in terms of improving the framework for business,"* an official emailed ECPA, their contribution *"would be most welcome"*. ECPA responded together with its US counterpart CropLife America, demanding *"significant harmonisation"* for pesticide residues in food.

Another example of the formidable alliance between EU negotiators and the corporate sector is the enthusiasm in the financial lobby community for the EU's approach on financial regulation in TTIP. When the EU's position on the issue was leaked in early 2014, Richard Normington, Senior Manager of the Policy and Public Affairs team at TheCityUK – a key British financial lobby group - [applauded the Commission's proposals](#), because it *"reflected so closely the approach of TheCityUK that a bystander would have thought it came straight out of our brochure on TTIP"*.

On investment protection, the Commission seems to side with the corporate lobby. When the Commission organised a public consultation on the issue, over 97% of the nearly 150,000 participants rejected investor-state dispute settlement in TTIP, including many businesses, governments and all the non-corporate members in the Commission's advisory group on TTIP. Still, the [Commission seems to follow the big business lobby groups](#) calling for ISDS in TTIP.

The EU negotiation position for regulatory cooperation in TTIP has also been [heavily influenced](#) by BUSINESSEUROPE and the US Chamber of Commerce, two of the most powerful pro-TTIP lobby groups. They see regulatory cooperation as a 'potential game changer', a 'gift that keeps on giving', which would allow business lobbyists to 'co-write legislation', as they put it. They understand it as an ironing out divergence in existing and future laws in the long term – be it in food standards, chemicals approval, or rules on production methods, to name but a few. These [proposals](#) have been discussed in several meetings in a friendly atmosphere where the Commission stressed its desire to work closely with the two business lobbies to refine the proposal.

The 'regulatory cooperation' chapter is another part of TTIP that could dramatically increase corporate influence over [EU and US policy](#). Since 2013, several EU negotiation proposals on regulatory cooperation have been leaked which show that the European Commission is ready to provide business groups with a series of tools that will enable them to influence the outcome of new and existing laws, in Brussels and Washington as well as in EU capitals and United States. This is a powerful toolbox for corporations to apply pressure on decision makers to scare them away from adopting new rules that would hurt the interests of business, often to the detriment of other groups in society.

The proposed investor rights and regulatory cooperation under TTIP deserve all the attention they can get from NGOs, social movements, citizens, trade unions and not least, from legislators across Europe. In this TTIP project, everything seems set up so that the leeway of elected politicians is minimized when it comes to legislating in any area that may limit the profits of investors and the free exchange of capital and goods. Indeed, if a legislative initiative in the public interest could pass through the cracks of regulatory cooperation, multinational corporations could still use the investor-state arbitration courts to win 'compensation'. The mere prospect of such outcomes would be enough to discourage more than one policy-maker.

EU politics is already heavily skewed in favour of capital and transnational corporations. TTIP would expand their power even further to threaten any future regulation that limits big business profits – and the very essence of democracy. ■

Pia Eberhardt, Lora Verheecke and Kenneth Haar are political activists and campaigners for Corporate Europe Observatory, a non-profit research and campaign group based in Brussels

A wooden gavel with a dark handle and a light-colored head, resting on a stack of US ten-dollar bills. The bills are slightly out of focus, showing details like the serial number 'B 37535872 A' and the Treasury Department seal. The background is a dark, textured surface.

One court to rule them all? The EU's proposal for a world investment court

Hussein Haeri writes about European Commission calls for the creation of a world investment court to resolve investor-State disputes

The most salient feature of the current international investment law framework is the use of international arbitration to resolve disputes between investors and States. Although arbitration has a longstanding pedigree in resolving international disputes at both the State-State and investor-State levels, it was not until the 1960s that investor-State arbitration provisions (ISDS) started to be included in bilateral investment treaties. Just over 50 years later, the vast majority of the 3,000 plus bilateral investment treaties contain standing offers by signatory States to resolve investment disputes with foreign investors through binding arbitration.

Arbitration is the quintessential feature of the modern investment law framework. Many of the substantive standards of investor protection in investment treaties have precursors and complementary standards in customary international law. However, it is the right given to investors in investment treaties to have investment disputes resolved before arbitral tribunals that are constituted on a case-by-case basis (as opposed to before national courts) that gives investment treaties real practical utility for investors.

A key feature of this framework is party autonomy – the right of the parties to investment treaty disputes and (namely the investors and the States) to select the arbitral tribunal that will adjudicate the dispute. In the majority of cases, this is done by each party appointing an arbitrator and the third tribunal member being agreed upon jointly by the parties or the party-appointed arbitrators, or selected by an appointing authority (often an arbitral institution).

EU member states have been particularly prominent in the establishment of this investment treaty framework and in placing investor-State arbitration at the core of it. Indeed, EU member states are parties to almost half of the total number of investment treaties in force worldwide. It is therefore notable that the EU trade commissioner, Cecilia Malmström, recently called for the creation of a world investment court to resolve investor-State disputes. Given the major role that the EU plays as a host and maker of foreign investment, this proposal is potentially far-reaching and significant notwithstanding the considerable legal and practical difficulties of establishing a world investment court.

The European Commission proposal

The background to the EU Commission's proposal of a world investment court is the ongoing negotiations between the EU and the United States for a trade and investment deal, known as the Transatlantic Trade and Investment Partnership or TTIP. In the context of the EU's public consultation on the TTIP and ISDS in the TTIP, the EU is exploring proposed reforms to ISDS, including the possibility of appeals from ISDS decisions. The establishment of an investment court would be the most far-reaching of all of these proposals.

Specifically in a concept paper that the EU Commission [published](#) in May 2015, the EU Commission proposed that:

"...the EU should work towards the establishment of an international investment court and appellate mechanism with tenured judges with the vocation to replace the bilateral mechanism which would be established [in the TTIP]. This would be a more operational solution in the sense of applying to multiple agreements with multiple partners but it will require a level of international consensus that will need to be built. It is suggested to pursue this in parallel with establishing bilateral appeal mechanisms. These changes are intended to be the stepping stones towards a permanent multilateral system for investment disputes."

...the establishment of a world investment court would add a new possibility for the resolution of ISDS disputes to the current alternatives of arbitration and submission to the jurisdiction of local courts

Following on from the EU Commission's proposal, on 8 July 2015 the European Parliament approved a [resolution](#) proposing the replacement of investor-State arbitration provisions in the TTIP with a dispute resolution system before "*independent professional judges in public hearings*".

The variables of a world investment court

Given the instrumental role that EU member states have played in the creation of the global investment treaty and arbitration architecture, the explanation given by the EU Commission for its proposal of a world investment court is instructive.

The EU Commission has described its proposal as being driven, inter alia, by concerns about potential conflicts of interest from arbitrators who also serve as counsel on ISDS disputes, public perceptions regarding the ad hoc nature of the appointment of arbitrators and a desire to 'break the link' between the parties to the dispute and the arbitrators.

However, consideration of these variables does not necessarily lead to the conclusion of the inevitable establishment of a world investment court. As regards conflicts of interest, parties often agree to the application of the International Bar Association (IBA) *Guidelines on Conflicts of Interest in International Arbitration of 2014*, which address conflicts issues. Such guidelines are often periodically updated and could be adapted further to address conflicts and perceived conflicts issues.

Furthermore, the perception that the ad hoc nature of arbitration is itself problematic may be open to doubt. As arbitrators do not enjoy security of tenure in the way that a judge does, their professional reputation is the best guarantor of a successful career. This could indeed be considered a positive feature of arbitration. The security of tenure enjoyed by judges in some jurisdictions does not always result in the highest quality of decision making.

Finally, it may be questioned whether it is necessarily positive to 'break the link' between parties to the dispute and the arbitrators in the sense of preventing parties from being involved in the constitution of arbitral tribunals. This feature of party autonomy in the choice of arbitral tribunals is a core aspect of international arbitration, the loss of which would apply both to investors and States.

Moreover, the coordination and costs requirements for establishing a world investment court would be significant. With over 3,000 bilateral investment treaties in force, the vast majority of which provide for ad hoc arbitration of disputes between investors and States, it would likely take considerable time and careful calibration in order for a world investment court to gain serious global traction. For example, according to the United Nations Conference on Trade and Development (UNCTAD) over [40 investment treaty arbitrations](#) were commenced in 2014 and a new investment treaty was signed every other week that year.

Furthermore, a key decision in the creation of a world investment court would be whether it was to be established within the framework of a multilateral organisation, such as ICSID - the World Bank investment arbitration centre – or created as a self-standing body. The EU Commission paper states that *“work has already begun on how to start this process, in particular on aspects such as architecture, organisation, costs and participation of other partners.”*

If established, an investment court would be unlikely in its early years to have jurisdiction over a majority of ISDS disputes, still less over all of them. International arbitration of ISDS disputes is therefore unlikely to disappear from the investment arbitration landscape any time soon. However, the establishment of a world investment court would add a new possibility for the resolution of ISDS disputes to the current alternatives of arbitration and submission to the jurisdiction of local courts. The legal and practical challenges to establishing a world investment court should not be underestimated and the likelihood of it materialising in the next few years may yet remain fairly low.

Nevertheless, with its announced desire to create a world investment court, the EU Commission has taken a significant and potentially far-reaching step towards the establishment of a multilateral body to resolve ISDS disputes in the future. ■

The views expressed in this article do not necessarily reflect the views of Withers LLP or its clients.

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The geopolitics of the TPP: reconfiguring regional architecture in East Asia

Stephen Nagy argues that the TPP reconfigures regional architecture from a China-centred economic framework to one that will attenuate Chinese economic domination

Currently there are three significant competing trade agreements undergoing negotiation in East Asia: the Regional Comprehensive Economic Partnership (RCEP); the Transpacific Partnership (TPP); and the Trilateral Free Trade agreement between China, South Korea and Japan. Each agreement would bolster trade in the corresponding mega regions. They are qualitatively different and would result in different short, mid and long term geopolitical changes.

This essay will touch upon the geopolitics of the competing trade agreements with a special focus on the TPP and a lesser focus on the RCEP. Based on the TPP's next generation trade rules and characteristics of participating countries, I conclude by arguing that the TPP reconfigures regional architecture in East Asia away from a China-centred economic framework to one that is not only transpacific but one that will attenuate Chinese economic domination by the bifurcation ASEAN into TPP members and non-members. Founding and fledgling members from ASEAN will enjoy large flows of FDI to boost their socio-economic development while securing access to arguably the most important and some of the largest consumer markets in the world.

RCEP: China-centred regional architecture

RCEP and TPP are structured to exclude particular states, although perhaps not in perpetuity. RCEP excludes the US, creating a China-centred regional trade framework while the TPP excludes China, creating a very significant regional economic framework with rules and guidelines cemented by its founding and arguably most influential members^{1 2}.

This exclusion strategy is purposeful. In the case of RCEP, the exclusion of the US enables China to play the central role in economic integration within the region. Acting as the core of the regional framework, the size of the Chinese economy would serve the region well by opening its 1.3 billion consumers to the region. Trade figures from the ASEAN Secretariat show that China already represents ASEAN's largest trade partner (See Table 20). Further integration through the realization of RCEP would deepen that trade flow significantly. In addition to the trade and investment, commodities from Australia that help fuel the growth of the Chinese economy would also benefit from RCEP.

Table 1: Top ten ASEAN trade partner countries/regions¹

Trade partner country/re- gion ²	Value US\$			Share (percent) to total ASEAN trade		
	Exports	Imports	Total trade	Exports	Imports	Total trade
ASEAN	329,700.42	278,617.63	608,318.05	25.5	22.5	24.1
China	150,425.25	216,116.37	366,541.62	11.6	17.5	14.5
EU-28	132,484.05	115,847.68	248,331.73	10.2	9.4	9.8
Japan	120,248.92	108,827.27	229,076.19	9.3	8.8	9.1
USA	122,377.23	90,040.99	212,418.22	9.5	7.3	8.4
Korea, Republic of	51,659.07	79,814.77	131,473.84	4.0	6.5	5.2
Taiwan	39,543.73	68,841.91	108,385.64	3.1	5.6	4.3
Hong Kong	85,274.71	14,096.88	99,371.59	6.6	1.1	3.9
Australia	45,345.73	25,027.19	70,372.92	3.5	2.0	2.8
India	43,346.53	24,381.93	67,728.46	3.4	2.0	2.7
Total top ten trade partner countries	1,120,405.64	1,021,612.62	2,142,018.26	86.7	82.6	84.7
Others ³	172,228.00	214,671.20	386,899.20	13.3	17.4	15.3
Total	1,292,633.64	1,236,283.82	2,528,917.46	100.0	100.0	100.0

Source: Association of South East Asian Nations Homepage

<http://www.asean.org/resources/2012-02-10-08-47-55/asean-statistics/item/external-trade-statistics-3> (Accessed August 24th, 2015)

1. Preliminary data

2. Identified/ranked based on share of total trade

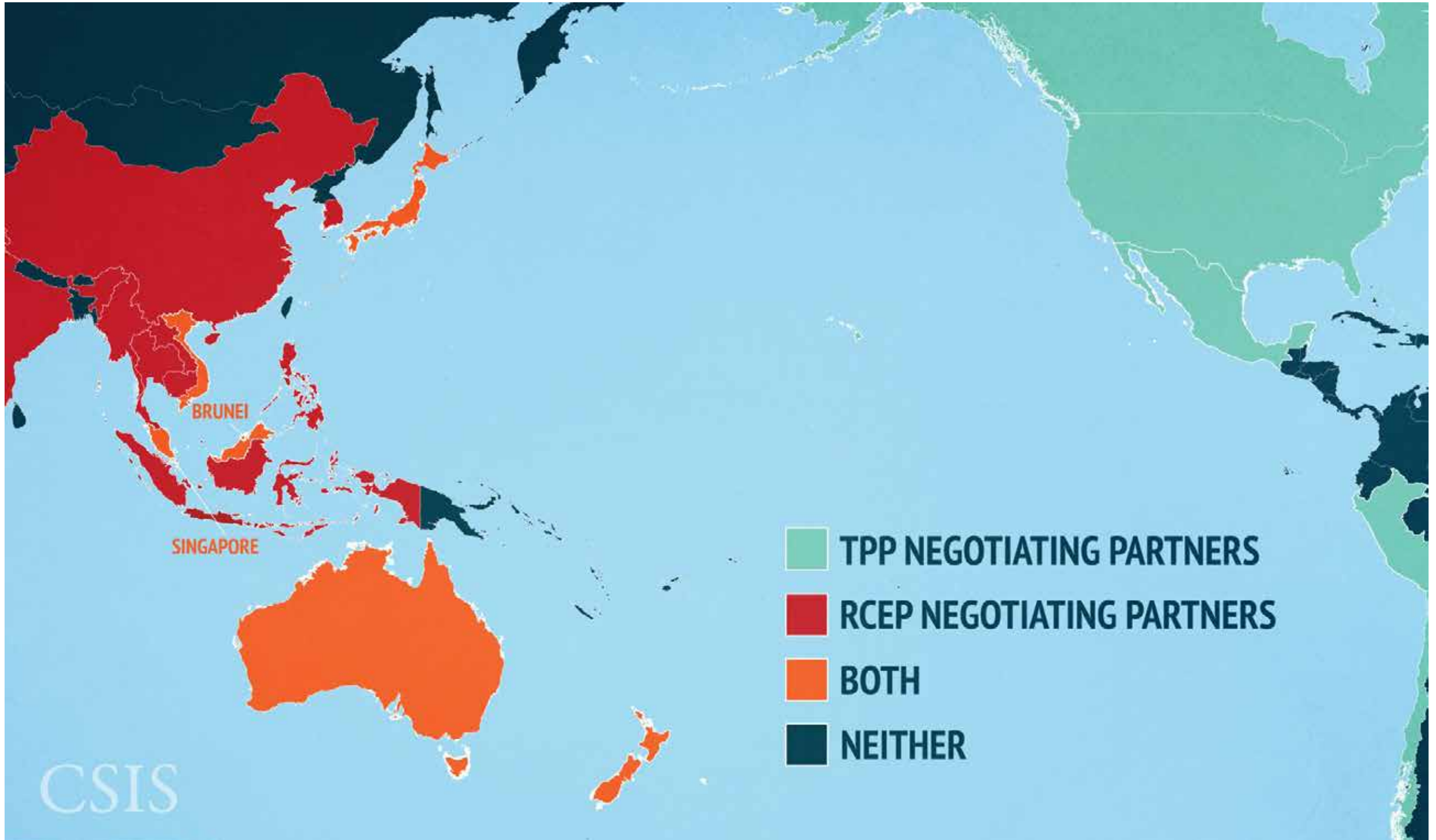
3. Includes trade of all other countries and those that could not be attributed to specific countries

It should be noted that China and ASEAN countries are competing for leadership in RCEP however the size of the Chinese economy will dictate where the leadership will eventually fall.

Another central feature of this agreement is that the hand-in-hand with the advantages of further coupling to the Chinese market, deepening economic interdependence would also decrease American economic and political influence in the region while increasing China's political leverage on partner states.

Beijing's track record of using market access to influence relations and behaviour has been demonstrated numerous including pushing the boundaries/legalities of the WTO when it does so. Most recently, rare earth metal access by Japanese in 2012, punitive economic tactics related to political disagreements include China stopping the import of

... the TPP reconfigures regional architecture in East Asia away from a China-centred economic framework to one that is not only transpacific but one that will attenuate Chinese economic domination by the bifurcation ASEAN into TPP members and non-members



Philippines' bananas, disruption of travel by Chinese tourists to the Philippines, France, and Norway; and stopping the import of Norwegian Salmon and removing Norway from the list of countries allowed visa-free visits to Beijing after the Nobel Peace Prize was awarded to Liu Xiaobo³.

States with deep trade ties with China as well as disputes with China in the South and East China Sea see themselves as highly susceptible to coercive tactics and thus have been actively devising strategies to hedge their economic bets while still maintaining economic engagement with China. TPP is one such tactic that I will expand on later in this piece.

It's important to note that the TPP and RCEP are qualitatively different. First, RCEP will have 16 participating states which include more than 3 billion people, a combined GDP of more than 17 trillion dollars that would represent 40% of global trade⁴. Second, the RCEP is a more China-centred framework focusing on free trade of lower value products to account for developmental differences amongst participants. Third and as we will read below, unlike the TPP which is a high quality agreement that focuses on services and intellectual property rights (IPR), RCEP is not really writing any new rules of the trade game nor including stringent IPR rules as some of its negotiating partners would like (South Korea). Fourth, RCEP aims to harmonize all pre-existing FTAs in the region to simplify trade and eliminate trade barriers.

The take home message here is that RCEP makes China the centre of the trade network. RCEP is good for China and preferred by China as it opens markets to goods made in China, especially those cheap, low value goods. As China continues to have a trade profile that is best characterized as low quality products and the manufacturing of either other countries products or low value products RCEP better meets the needs of the Chinese level of development.

TPP: transpacific-centred regional architecture

The TPP regional trade framework consists of 12 countries spanning the Asia-Pacific region and represent at least

40% of global trade. The TPP protects IPR including services and thus is a positive for innovative countries that are producing patents, high tech items, and high value items. Japan, the US, Canada, Australia, and Singapore all fit this profile in terms of IPR and services. They can write the rules to protect these products far into the future. China can't meet these standards at this time and IPR laws are at best weak⁵. This intentional or loose end to law enforcement allows China to leap frog its development. It won't agree to the TPP either as it would handicap their development. That being said, China has voiced 'interest' in the TPP and the US sees the possibility of open membership as a way to 'socialize or tame new applicants'⁶.

The other trade agreements under consideration are more trade promoting than rule making. An ASEAN plus-3 free trade agreement has been in discussion for a long time but many ASEAN countries, especially over the past five years have changed their tune about economic interdependence with China. China's assertiveness has concerned ASEAN members even though they enjoy a trade balance with China. There is a realization that trade needs to be better balanced to avoid Beijing applying economic or security leverage to achieve political objectives.

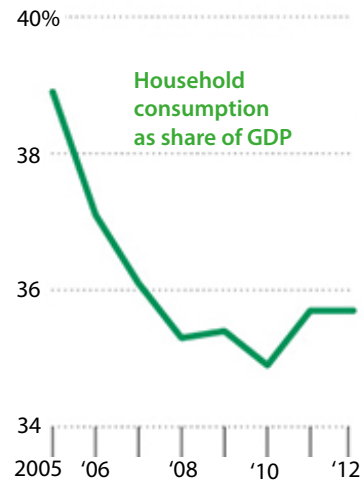
TPP is important for the US's Asian rebalance (but also many countries in the region) as it creates an alternative to China's economic size with rules and a renewed focus on protecting services and IPR. It also weakens Beijing's economic influence and tools in the region.

Above and beyond the economic impact that the TPP will have, the TPP serves as a powerful geopolitical tool. First, the TPP sets the next generation of trade rules for the most vibrant part of the global economy, the Asia Pacific. By establishing transparent rules that protect the key innovative sectors of participating countries, the TPP establishes a trade regime that preferences rule followers and not rule breakers.

Second, the inclusion of states such as Vietnam is not immediately self-evident. That being said, their inclusion is crucial to incentivizing participating in the TPP. As a low cost manufacturing centre, Vietnam will grow as a produc-

Rising wages - costs and benefits

Higher wages should help boost consumption....



... but they hit manufacturing competitiveness....



... denting export and profit growth

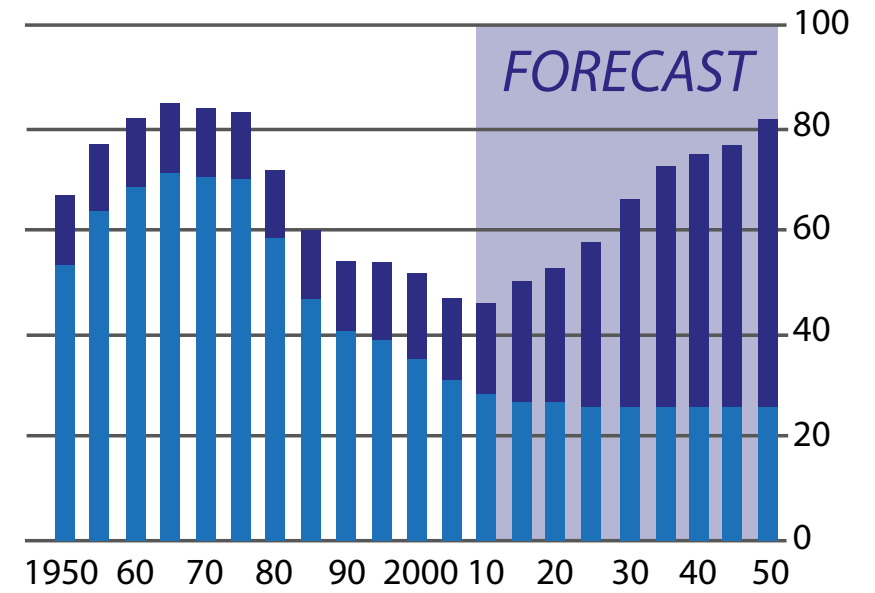


Sources: CEIC, Economist Intelligence Unit, NBS

All uphill from here

China's dependency ratio as % of population aged 15-64

■ Elderly
■ Children



Source: "World Population Prospects", United Nations 2009

tion hub for manufacturing that will have direct access to the first and third largest economies in the world, Japan and the US. This means that although Vietnam will indeed need to work very hard to abide by IPR and other rules that its developing economy may not be prepared for, it will at the same time become a very attractive centre for FDI which will further boost its economic growth. Policy makers in Vietnam have already done the math that the sacrifices in the short term will more than pay off as dividends in the long term.

Increasing flows of FDI into Vietnam will most certainly be attractive lures for other countries within the region such as the Philippines, Indonesia, Thailand, Myanmar, Laos and Cambodia and as a result, the first three will make the necessary commitments to join the TPP. The landlocked latter two unfortunately will not be able to make the commitments necessary to join the TPP because of level of development, lack of strong institutions and political relations with China.

Thailand's future participation in the TPP is dependent on domestic politics and political stability in the period of a new King's ascension to the throne. Political divisions and political instability will make it difficult for Thailand to make the appropriate commitments necessary to join the TPP and thus it will lose out to ASEAN countries with more stable domestic political situations and commitments to TPP demands.

Myanmar, like Thailand suffers from an uncertain domestic political situation. Weak institutions, still uncertain division between the previous military government and the current elected one, Myanmar will most likely not be able to find the political consensus to commit to the TPP.

Vietnam and other potential members to the TPP from ASEAN will enjoy a large inflow of FDI and this will create a virtuous circle in terms of socio-economic development. At the same time, other members of ASEAN will find themselves falling further and further behind in terms of socio-economic development as they will be seen as less attractive investment destinations.

Further escalating these trends will be demographic pressures associated with a greying population, the consequences of the one-child policy and increased labour costs in China (See figures). The end result will be more and more businesses seeking to lower their costs of doing business. The vibrant ASEAN economies with their young populations are the logical choice for FDI, especially if these countries are founding or potential TPP member states with access to the North American and Japanese economies.

The bifurcation into the high growth, TPP member states and the low growth, non-TPP member states will weaken the importance of ASEAN as an economic, political and culture regional framework⁷. Geopolitically, this division will weaken China's influence on the region and enhance the US's and core TPP member states influence on the region. It strengthens the rationale for further economic, political and security ties within the region.

The potential division of ASEAN countries into high and low performers has important consequences for regional integration in East Asia based on economic interdependence. The so-called ASEAN way will become increasingly difficult to maintain as socio-economic development differences become more apparent.

ASEAN is often seen as the model for East Asian integration with its respect for sovereignty and consensus making decision process. It is also seen as the driver behind East Asian integration allowing the 'big' economies in the region, namely China, Japan and South Korea to act as the 'engine' of integration thus diffusing potential conflict in terms of leadership of the integration process. This role will be severely weakened as economic divisions manifest. Consensus-based decision making will produce minimum results leading to member states questioning the *raison d'être* of a regional institution that cannot meet their needs.

China's economic slowdown, yuan devaluation and the TPP

China's economic slowdown and yuan devaluation will increase the incentive for negotiating states to complete the TPP agreement. ASEAN members will benefit from the agreement by having trade barriers removed and access to

the largest consumer markets opened. Japan, South Korea and other countries whom have a large and growing FDI foot print in ASEAN countries will further their investments to create strong manufacturing platforms in ASEAN in countries, especially those that will have access to the North American market.

At the same time, TPP membership allows participating states to decrease their reliance on the Chinese market and the influence of further yuan devaluation or economic coercion over political differences. North American, South America, Australia and New Zealand will also benefit from the removal of trade barriers to previously highly protective markets but also by the enactment of trade rules that protect many of their niche industries through strong IPR and services related rules.

Decreasing reliance on the Chinese market does not mean deleveraging or leaving the Chinese market. Instead, the TPP if realized provides participating nations a window of opportunity to have two production networks that have different end consumers. The China based production will gradually shift its weight towards the production of goods for a domestic Chinese consumer while the evolving production network in Southeast Asia will engage in the production of goods for TPP member states and a global consumer base. This bifurcation of production networks isolates TPP members from the inevitable ups and downs associated with economic, political and security relations with China. With this in mind, the successful realization of the TPP will reconfigure regional architecture through access to large consumer markets, transparent rules and leveraging the economic development differences of participating member states. ■

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Mega regional trade agreements and the Indian economy

Bipul Chatterjee and Kyle Cote assess the potential impact of the three mega RTAs on the Indian economy, with particular focus on the TPP and TTIP

Due to a multitude of factors, not least the stagnation in multilateral trade negotiations under the aegis of the World Trade Organisation (WTO), mega regional trade agreements (RTAs) are gaining momentum. The three main mega RTAs concerning India are the Trans-Pacific Partnership (TPP), Transatlantic Trade and Investment Partnership (TTIP), and the free trade agreement (FTA) between the European Union (EU) and the Association of Southeast Asian Nations (ASEAN).

The TTIP accounts for about 60 per cent of global trade where about 30 per cent is global trade in goods and 40 per cent is global trade in services. TPP will encompass 40 per cent of global gross domestic product (GDP) with a population of 800 million. Both agreements intend to emphasise greater trade openness, high '21st century standards', and regulatory harmonisation that provides a competitive trade and investment environment for deeper economic and trade linkages.

These mega RTAs create opportunities and challenges for excluded countries like India. As noted in both the Economic Survey¹ and new Foreign Trade Policy², India must recognise the emerging challenges from mega RTAs. Potential effects that India may sustain stem from loss in market access due to exclusion from preferential treatment and unattainable higher trade standards.

India can take these challenges and transform them into opportunities for serious economic growth and development. India will have the opportunity to update and upgrade its domestic regulations on tariffs and non-tariff issues, reach out to new markets and perhaps benefit from an increase in global economic growth. For India to gain the greatest benefit from these opportunities, it will require a balanced approach between market liberalisation and support for domestic industries.

There is abundant space for new and alternative markets in Latin America, Central Asia and Eastern Europe, and Africa. Domestic reforms can address gaps in specific trade regulations where there is potential for streamlining and

stimulating trade competitiveness. Its encouraged role as a rule-setter in the Regional Comprehensive Economic Partnership (RCEP) of Asia and the Pacific would provide India a stepping stone to strategically craft trade rules in preparation for possible pressure from mega RTA members and even higher standards placed at the multilateral level.

Indian industry can be encouraged to integrate deeper into value chains both in mega RTA regions, particularly in ASEAN, and elsewhere by producing high-value products that, with the assistance of domestic reforms and more comprehensive trade agreements, will satisfy the increasingly high standards based on mega RTAs. Importantly, India needs to assess the advantages that accrue from participation at the technology-intensive, highly profiting top end of the value chain as well as the labour-intensive, small and medium enterprise (SME) mobilising, job-generating bottom end of the value chain.

... for the first time, the Foreign Trade Policy 2015-20 views trade as a significant part of achieving security and strategic objectives in the long-term, and integrates trade into India's national development policies

Accordingly, it needs to optimise its tariffs and arrive at a balanced policy while engaging in future bilateral and regional trade agreements. Similarly, domestic policy tools, such as the 'Make in India' programme³, can assist India in broadening its portfolio at both ends of the value chain.

This article concisely assesses the potential impact of the three mega RTAs on the Indian economy, with particular focus on the TPP and TTIP. In detailing the forecasted implications, it provides a series of recommendations as to how India should adapt its trade policy and strategy, efficiently embrace the opportunities arising from this new international trade regime and minimise the potential negative impacts. These recommendations include unilateral measures that India could carry out by changing its own domestic regulations and other bilateral, regional and multilateral measures that will include RTA members but also non-traditional markets which are excluded from these mega RTAs.

Trade diversion and macroeconomic variables

Based on scenarios created using the Global Trade Analysis Project (GTAP) model combined with the poverty analysis tool (POVCAL)⁴, the net-effect of trade diversion expected from mega RTAs on India's exports and imports were found to vary across commodities and scenarios both in terms of the magnitude and direction of change.

In general, the impact on exports was largest when all three mega RTAs were in force. Table 1 summarises the expected export losses and gains in certain commodities from all three mega RTAs as a change from the current status quo scenario (BASE).

The extent of the impact for both export and import is significantly larger and more favourable under the scenario where there is full global free trade as per multilateral trade liberalisation under the WTO compared to all other scenarios. In particular, under this scenario, aggregate welfare improves by 1.7 per cent of total GDP, inequality falls by over half a percentage point and poverty head count decreases by 12.3 per cent.

Table 1. India's Expected Export Losses and Gains (% change from BASE)

Export Loses		Export Gains	
Commodity	All 3 RTAs in force	Commodity	All 3 RTAs in force
Grains and crops	-0.2 per cent	Extraction	0.3 per cent
Processed food	-1.6 per cent	Utility and construction	0.4 per cent
Textiles and wearing apparel	-1.7 per cent	Transport and communication	0.7 per cent
Light manufacturing	-0.2 per cent	Other services	0.9 per cent
Heavy manufacturing	-0.2 per cent		

Source: Author's calculations

Table 2. Welfare impacts for India (% change from BASE)

	TPP	TTIP	EU-ASEAN	ALL 3 PTAs	MLTL
Aggregate welfare (US\$ millions)	-322	-408	-336	-757	21,216
Welfare as % of GDP	-0.03	-0.03	-0.03	-0.06	1.68
GINI index	0.0036	0.0041	0.0029	0.0082	-0.0666
Poverty head count	0.3	0.5	0.2	0.8	-12.3
Poverty gap	0.5	0.5	0.5	1.2	-16.0
Poverty FGT index	0.8	0.8	0.8	1.6	-17.9

Source: Author's calculations

Note: Aggregate welfare is reported in US\$ million and as a % of GDP in the scenario. The inequality poverty measures are percentage change from BASE levels.

Furthermore, the welfare gains arising from multilateral liberalisation appear to be more favourable than the scenario where India takes unilateral tariff liberalisation. According to the model analysis, India stands to make welfare gains of about US\$7.5 billion, compared with US\$ 21bn under the multilateral scenario. Much of these gains would come from extraction (US\$3 billion) and processed food sector (US\$2.2 billion). India is also expected to see welfare losses in meat and livestock, textiles and wearing apparel, and light and heavy manufacturing.

The changes in India's exports under different scenarios may affect demand for domestically made products with associated consequences on outputs, product prices, factor prices, factor returns, and income generation, which in turn can trigger second round impacts on domestic demand, outputs, and prices.

Similarly, changes in imports affect domestic availability, domestic prices and hence demand for various goods. The model took these effects into account. However and importantly, the dynamic effects of any trade policy change,

Policy recommendations

- The results of the modelling simulations suggest that India should continue advocating for global trade rules to be negotiated and agreed in a multilateral platform, ie. the WTO.
- In parallel to the multilateral level, especially considering the slow rate of progress in the Doha Round of multilateral trade negotiations, India should aggressively pursue new and comprehensive trade agreements, in addition to current arrangements, with members of the three mega RTAs, such as the on-going RCEP negotiations.
- These agreements should go beyond tariffs and trade in goods, and should cover trade in services, investment, competition, intellectual property rights (IPR), among other areas.

whether in India or external to the country, and the impact of standards and non-tariff measures were beyond the scope of this GTAP analysis.

Stakeholder views

In conversations and interviews with about 60 stakeholders⁵ in Mumbai, Chennai, and Kolkata, where about 70 per cent of India's trade takes place, the study gained valuable insight from those with high exposure to the TPP and TTIP regions. The sectors included textiles, automobile, and agricultural products.

Although small traders demonstrated minimal knowledge about the mega RTAs; policy-makers, government officials, researchers, and trade bodies proved to have a good understanding of the agreements. Large traders even have dedicated research divisions for global trade developments. However, utilisation of trade agreements was still found to be low, where traders used traditional markets and well-established contacts instead. Many stakeholders pointed out that due to India's bilateral trade relations with many TPP member countries, India may not be as drastically impacted.

Both policy-makers and government officials raised the concern of outflow of capital and relocation of production from India into TPP members. Given the size of the market, both the TPP and TTIP will have influence on the sentiments of the global investing community. Foreign direct investment (FDI) flow could be redirected to these regions that may have a more conducive trade and investment environment stemming from mega RTAs.

Government officials, trade bodies, and policymakers also stated that there are a large number of non-tariff barriers which Indian products are facing from TPP and TTIP countries. Higher regulatory standards negotiated under these mega RTAs will act as further barrier to India's exports. Moreover, the influence of mega RTAs may result in the creation of a dual regulatory regime in developing countries, one for mega RTA members and another for the rest of the world.

Under these circumstances, large exporters will likely have the resources to adopt the complex regulatory standards in these markets while small exporters will face much more difficulties in adhering to these standards. This may be detrimental to a large number of small and medium enterprises (SMEs) in India that play a pivotal role in the Indian economy.

Policy recommendations

- There is the need to ensure greater participation of various stakeholders and improvement of their knowledge base about bilateral/regional preferential trade agreements through outreach, capacity building activities, and participatory initiatives with the government.
- The imperative is to build inclusive coalitions at the multilateral and even regional level, with members and non-members of mega RTAs that share similar concerns as India, to promote a more balanced international trade regime that works towards opening markets and supporting domestic industries that require time to prepare for greater foreign competition.
- By creating an enabling environment in the domestic market, India can improve the competitiveness of the Indian industry and hence, greater participation in regional and global value chains (GVCs) by moving beyond commodities and intermediate goods and producing high-value products.
- Much work is needed at the multilateral level through the recently concluded Trade Facilitation Agreement and at the national and local level to improve trade-related infrastructure, including ports, roads and railway networks. In doing so, India can reduce transaction costs incurred by Indian traders while responding efficiently to international market demands.
- India's approach to open new and expanded trade ties with countries needs to realign with the objectives of India's trade policy and other macroeconomic policies.

New trade rules and India's domestic reform opportunities

The mega RTAs portend an overhaul of the language of market access by redefining the extant rules of trade. They propose to be comprehensive in their coverage by disciplining areas which are not presently dealt by the WTO. It is now becoming abundantly clear that, for the excluded countries, the shocks caused by further tariff liberalisation will be far less palpable than those transmitted by these 'WTO-plus' and 'WTO-extra' rules. The pressure of adhering to these new rules can be used by India as an opportunity to upgrade and harmonise certain domestic rules and standards which will facilitate and increase trade.

Mega RTA rules on sanitary and phyto-sanitary (SPS) measures and technical barriers to trade (TBT) will assimilate the burgeoning class of voluntary standards which have already started guiding procurement decisions in value chains and consumer preferences in advanced countries. Emphasis will be placed on regulatory coherence which would entail systemic changes to the bureaucratic structure. There are proposals to completely prohibit export subsidies and trim subsidies that have negative externalities on the environment. There might be stricter rules to determine countervailability and/or anti-dumping action.

The Rules of Origin (RoO) at the TPP will be determined in a manner that will ensure fuller integration of the United States (US) in regional production networks of Asia and the Pacific. The value addition threshold, pre-empting the possibility of trans-shipment through China or India, will be restrictively defined. With regard to market access in farm products, it is unlikely that the US or EU would change their farm policies considering that they see mega RTAs as a sort of backdoor rule-making with minimum compromises in areas where they have defensive interests.

Mega RTA rules pertaining to export restrictions seek to undercut the General Agreement on Tariffs and Trade (GATT) exceptions to the ban on quantitative export restrictions. This could severely limit the policy space to impose checks for price stabilisation or domestic supply shortages. The rules will also try to break new ground in the

area of social standards. Other than delineating the ambiguous relationship between trade sanctions contained in Multilateral Environment Agreements (MEAs) and WTO laws and ensuring enforcement of core labour standards contained in International Labour Organisation (ILO) conventions, social standards could well be the key determinants of accessing the markets of mega RTA countries.

The TPP chapter on trade facilitation would seek to improve the efficiency of border procedures with the use of cutting-edge technology and by dismantling unnecessary bottlenecks. Broadly, the mega RTA rules will bring an increased emphasis on risk management techniques, advance rulings, and uniformity in appeal procedures.

Intellectual Property (IP) provisions in TPP will most likely upset the balance that was achieved by the WTO TRIPS Agreement and the Doha Declaration on TRIPS and Public Health. It is expected that the TPP will go beyond the extant multilateral legal framework in areas like data exclusivity, patent linkage, trademarks, and trade secrets. The proposal made by the US and Japan with regard to the 'subject matter of patentability' specifically targets India's domestic law (Section 3(d) of Patents Act, 1970) that prevents the practice of patent ever-greening and reduces the patentability threshold of an invention. Similarly, IP-related border measures envisage seizure of 'confusingly similar goods' that are in transit. Such measures could impede the legitimate trade in generic drugs. On the other hand, the TTIP is unlikely to have a comprehensive chapter on IP provisions. Instead of attempting to harmonise their IP regimes, the EU and US may focus on enforcing their IP rights in third countries.

The TPP and TTIP negotiations are aiming to administer regulatory disciplines in service sectors that were hitherto left untouched such as air traffic rights, maritime transport, and some professional services. It will delve into cross-cutting issues which have ramifications across sectors and treat the different modes of delivery separately. The investment chapter will direct capital flows to countries which are party to mega RTAs with strict investment regimes, which can afford better protection to investors and have liberalised capital account regimes.

While dealing with the impact of mega RTAs, there are several critical issues that India has to consider. India should remain cautious of the direct effect on trade diversion caused by these new rules but also of the efforts by advanced countries to capitalise on these early agreements by making them a template for future discussions and negotiations at the multilateral level. The extent to which TPP and TTIP rules would influence negotiations at RCEP, to which several members of TPP are also party, is yet another important matter to ponder over.

India has to look at the potential challenges emanating from mega RTAs as a window of opportunity to undertake sweeping institutional and organisational reforms at the domestic level to ensure unobstructed and improved market access. It has to leverage the mega RTAs to initiate these reforms to attract investment, promote the transfer of technology, upgrade its standards regime, integrate into value chains, and set the stage for an export- and FDI-oriented growth. In short, there is an opportunity to transform India's trade and trade-related FDI regime from being export-import neutral.

External trade engagements

A multi-pronged approach at the bilateral, regional and multilateral level to update its trade standards on its own terms, rather than pressured from mega RTAs, could give India the diplomatic flexibility to negotiate standards that are proportional to what can realistically be achieved based on pertinent economic and development needs. These markets can also be tapped as suppliers of intermediate goods and inputs that could complement India's manufacturing and trade policy⁶. Strategic external trade engagements can also give the Indian economy and affected stakeholders' adequate timeframes to implement necessary reforms.

Bilateral and regional engagements with mega RTA partners

India has 15 active trade agreements; another 14 are being negotiated. In the context of the looming challenges from mega RTAs, India has the opportunity to remain engaged through its existing FTAs as well as deepen relations with mega RTA members, including integration into ASEAN production networks that address market access on

Policy recommendations

- A strategic roadmap for standards that is harmonised with 'Make in India'.
- The government should prioritise sector-specific regulations to ensure mandatory compliance with SPS and TBT requirements.
- The aspirations of industries, exporters and other relevant stakeholders should be assimilated while setting standards. India should also focus on gathering economic intelligence on standards that the industries or governments of advanced countries are developing.
- A uniform approach while formulating RoO in India's trade negotiations could considerably improve the utilisation rate of FTAs and strengthen India's pursuit to become integrated into global production networks.
- By gradually phasing out export subsidies and rationalising export promotion schemes, India could transform its irregular subsidies into environmentally-sound subsidies and better targeting of the beneficiaries.
- A stable agricultural trade policy that is predictable and not reacting to the vagaries of global markets can give further impetus to India's food processing sector. Being a crucial player in certain farm products, India will have to exercise caution in its use of export prohibition and quotas.
- New dimensions in anti-dumping jurisprudence could find reflection in India's trade policy and trade agreements. A distinction could be drawn between discriminatory price policies that are driven by predatory, monopolistic tendencies and those that could be beneficial to consumers in the long run by enhancing productivity and efficiency.
- Electronic filing of bills of entry (BOE) and declarations should be made the norm and the customs gateway (ICE-GATE) could work toward seamless and undisturbed connectivity to traders for uploading their documents.
- Reforms to road and rail infrastructure targeting bottlenecks that impede freight transportation through the route of public-private partnership can be actively pursued to step up infrastructure development.
- Keeping in mind India's development objectives and its role as the 'pharmacy of the developing world', India should refrain from aligning its IP provisions with the mega RTA standards.
- India's FDI policy and the Reserve Bank's monetary policy should be accordingly attuned to address the capital requirements in infrastructure.

trade in goods and advance its partnerships in trade in services and investment. India's future RTAs with TPP countries like Australia, Canada, and New Zealand provide an opportunity to align its trade standards and modalities as well as propose mitigating measures while maintaining realistic expectations for India's industry. Importantly, though, will be the effective implementation and follow-through for all agreements and their individual modalities.

India's active participation in the G20 provides an opportunity to engage with many members of mega RTAs. This and other plurilateral forums, such as the Asia Pacific Economic Cooperation (APEC) and Pacific Alliance, can provide the space for dialogues on India's stance concerning the impact of mega RTAs on non-member countries. Opportunities exist to integrate further with the Pacific Alliance group through a Comprehensive Economic Cooperation Agreement (CECA) once preconditions are met⁷.

Alternative market opportunities

There is significant opportunity for new and expanded markets and for entering regional and global value chains in many regions, including Latin America, Central Asia, Eastern Europe, and Africa. This can be done while remaining engaged in India's established trade relations with partners involved in mega RTAs.

Currently, India's trade agreements in Latin America are with Chile and the Southern Common Market (MERCOSUR). Preferential trade agreements have been proposed or under consultation with Colombia, Peru, Uruguay and Venezuela. Countries such as Colombia, Mexico, and Trinidad and Tobago are key energy exporters, with India being Colombia's second largest oil export destination.

The Eurasian Economic Union (EAEU) and Central Asian countries offer India another opportunity for greater economic integration in new markets. India is about to enter into negotiations with the EAEU for a Comprehensive Economic Cooperation Agreement. India should fully exploit its access to the International North-South Trade Corridor to enhance its trade and investment relations with the EAEU and Central Asian countries including through long-

term, product-specific agreements to access strategic commodities such as oil and natural gas, uranium and potash.

Finally, there is a wealth of opportunity in trade with many African nations and regional economic communities in Africa, including the East African Community (EAC), the Economic Community of West African States (ECOWAS), the Common Market for Eastern and Southern Africa (COMESA), and the Southern African Development Community (SADC). Specific products and services originating in India can gain better access to numerous markets in Africa and potentially contribute to development agendas in African countries and regions. Thus deepening political and cultural relations for a sustainable future partnership. The recently negotiated Tripartite FTA among the EAC, COMESA and SADC is an opportunity that India should explore.

Opportunities at the multilateral level

The WTO is the most optimal forum for India to put forward its concerns, preferably collectively in issue-specific coalitions, and work with trade partners to find balanced, multilaterally agreed deals on various trade and development-related issues. The WTO platform provides India with an equal voice to raise its concerns and propose solutions to trade and development-related issues. With the comprehensive structure of the Doha Development Round, India has a stage at the multilateral level to ensure its economic interest and development needs are heard.

Mega RTA rules might eventually be imported into the multilateral platform of the WTO. This will reduce the space for negotiations by countries excluded from mega RTAs as they have to negotiate a text already agreed by many influential WTO members at another level.

Regional Comprehensive Economic Partnership of Asia and the Pacific

Currently, India is playing a major role in the crafting of the Regional Comprehensive Economic Partnership (RCEP) agreement among 16 countries of Asia and the Pacific⁹. In the context of the looming impact of mega RTAs, and considering that not all issues of trade-related development interests are being addressed in those negotiations,

Policy recommendations

- Comprehensive feasibility studies of potential FTAs will be required to assess the likely benefits for India's economy and development needs in deepening trade relations with mega RTA members.
- Potential markets and opportunities in Latin America include accessing energy products (e.g. Costa Rica, Mexico, Nicaragua, and Panama)⁸, agro-industry machinery as well as tapping into certain countries' knowledge of conditional cash transfer programmes for low-income families (e.g. Brazil's 'Bolsa Familia' programme).
- Trade in services, especially information technology (IT), is also an area where India can deepen its trade relations with Latin America.
- India should actively pursue its CECA negotiations with the Eurasian Economic Union and should fully exploit its access to the International North-South Trade Corridor.
- India should aggressively pursue linking its services industries, where it has strong comparative advantages, with manufacturing and commodity processing in the Central and Eastern European regions.
- Many African countries are rich in natural resources, which can help India in sourcing strategic commodities on a sustainable basis, including oil, natural gas, coal, coking coal and uranium, as well as provide its high-skilled services to facilitate trade in those commodities.
- India's trade policy should focus on balancing its participation in GVCs between high-value, high-skilled sectors and low-value, low-cost sectors of the value chain, thus broadening its trade portfolio at both ends of the value chain.
- Through active engagement and even leadership in the G-20 and G-33 group of developing countries at the WTO and building coalitions toward finalising negotiations based on the Bali Ministerial decisions and other issues of the Doha Development Round, India should pursue a balanced, multilaterally-agreed trade regime in the context of the potentially threatening new standards and rules being developed in mega RTAs.
- India's diplomatic strategy at the WTO should take into account the possibilities of upgraded, and even exclusionary, mega RTA-influenced standards becoming engrained in the multilateral system.

the RCEP is another crucial opportunity for India to incrementally meet the higher standards promoted in mega RTAs while ensuring support for its domestic constituencies and development dimensions of trade. India is encouraged to play an active role in setting the trade rules to place itself in a strategic position for upgrading its own standards as well as start to prepare for the eventuality of higher mega RTA-influenced standards brought to the WTO.

India has indicated its interest in increasing trade in services, removing non-tariff barriers as well as specific interest in trade in goods, such as pharmaceuticals and textiles, and attracting investment inflow and outflows¹⁰.

As negotiations currently stand India is prepared to reduce tariff rates to 70 per cent of tariff lines for ASEAN members, while the rest of the RCEP members would receive 40 per cent tariff lines cut¹¹. To assist domestic industry in adapting to new tariff cuts, categories of tariff lines could be reduced in an agreed timeframe over multiple intervals, similar to that of the India-Korea FTA. Furthermore, India's comparative and competitive advantage in many service sectors has not been met with adequate coverage in its existing FTAs and that is to be ensured in RCEP.

Preparing for the eventual stringent regulations on IPRs, India can begin to upgrade its own domestic IP policy, for example by beginning to relax copyright rules on certain products such as music or film while ensuring continued support for its generic medicines through reasonable patent lifetimes. India can act as a rule-setter on this specific area.

Moreover, agreeing to more open RoO criteria than its previous FTAs¹² and including product-specific rules for targeted items could give India the balanced approach to liberalise its markets while continuing to support certain domestic industries.

Policy recommendations

- India can include extended phase-in periods in the agreement of tariff reduction as a way to encourage competition and domestically address various types of anti-competitive market distortions while supporting domestic industries by giving them time to adapt.
- India can negotiate for greater openness in trade in services in all four Modes, particularly finding expanded avenues of trade (in addition to traditional IT and IT-enabled services) in tourism and hospitality services as well as business and cultural relations, including free movement of professionals and educational exchanges.
- In working with its RCEP partners on rule of origin, India can agree on criteria used by the majority of the RCEP membership, specifically allowing an option of either value-added content or change in tariff classification rather than the dual criteria requirement.
- India can offer product-specific Rules of Origin on a case-by-case basis that will prudently leverage support to India's manufacturing policy, such as 'Make in India'. Such specific rules may also aim to funnel other quality material from its RCEP partners that support its domestic producers and eventually tie with India's export of intermediate and finished products.
- India can begin to upgrade its own domestic IP policy through relaxation of targeted copyright rules and ensure continued support for its generic medicines by addressing patent lifetimes and other measures.

Conclusions

Due to the comprehensive and expansive mandate undertaken by the TPP, TTIP, and EU-ASEAN FTA, mega RTAs have the potential to impact India through trade diversion and erosion as well as placing pressure on India to liberalise markets for trade in goods and services, and raise standards where it may not be prepared to do so.

Considering that TPP and TTIP members account for more than 40 per cent of both India's imports and exports, tariff preferences created by these mega RTA are likely to divert trade from non-members to trade among mega RTA countries resulting in loss of market share for India. This scenario is supported by the economic modelling in the study. It reveals that the impact is generally less severe than expected, although particular products in which India relies on mega RTA countries substantially for trade have the potential to experience greater market loss, such as grains and other crops, processed food, textiles and wearing apparel, and light and heavy manufacturing. Furthermore, given India's links to GVCs through service exports, even in the case of mega RTA-led value chains, there is a high level of potential implications particularly related to market access of services.

Since many of the mega RTA countries already enjoy low tariff rates with their trade partners, significant impact is expected to come from the new and upgraded trade standards and regulations promoted in these agreements. Mega RTAs may re-orient standards of trade that advantage their members by paving the way to easing of compliance, streamlined customs administration, and improvements in infrastructure as well as higher labour and environmental standards that would likely to divert Indian exports that cannot comply with such standards of mega RTA members.

Finally, given that almost 60 per cent of India's GDP is tied to the services industry, a large portion being in IT and IT-enabled services, the regulatory harmonisation expected to be enacted in mega RTAs could greatly harm India's competitive edge in these sectors. Competitors in Southeast Asia such as Indonesia, Malaysia, and the Philippines will have the opportunity to develop stronger IT sectors under such favourable conditions that trade in services from India could be diverted.

In this context of impending challenges from mega RTAs, including the potential for higher standards incorporated at the multilateral level, there is enormous opportunity for India to go beyond general economic growth and move towards deeper integration into regional and global value chains to produce high-value products, create new trade

relations, craft structural reforms, and enhance domestic standards while maintaining support for India's industry, its workers, and other vital development objectives such as poverty reduction.

Indeed, for the first time, the Foreign Trade Policy 2015-20 views trade as a significant part of achieving security and strategic objectives in the long-term, and integrates trade into India's national development policies¹³.

As India embarks on diplomatic and policy recourse towards the potential impact of mega RTAs other developing countries could find lessons from India's case and create their own opportunities for economic and development growth. Similar to India, other low-income, resource-poor developing countries (including least developed countries) will need to strategise liberalising their markets while continuing to support domestic industries.

Further study will be needed to identify which sectors of each economy are prepared for greater competition and which require time for development. In sub-Saharan Africa, Latin America and Central Asia, economic communities and customs unions can be advantages for greater integration to help mitigate potential trade diversion. Through domestic policy reforms and with the assistance of programmes such as Aid for Trade and direct aid initiatives from mega RTA members, developing countries can identify where they need to upgrade their trade standards and improve infrastructure to cut cost.

In this respect, India can offer 'knowledge' and, therefore, other than trade and investment, 'knowledge-sharing' should become an important component in India's future comprehensive economic cooperation agreements with many of those other developing countries.

To conclude, a balance will be required in both domestic reforms and India's engagements at the bilateral, plurilateral, and multilateral levels to ensure that India is well-placed to partake, and indeed prosper, in the international trading system while maintaining strong support for its domestic industries and development objectives.

India can achieve this through its active participation as a rule-setter in the RCEP through targeted domestic policy reforms, improved trade infrastructure, continued with alternative bilateral and regional trade engagements, and building an inclusive coalition of developing and least-developed member countries at the WTO to address the evolving international trading system that encompasses mega RTAs, including RCEP. ■

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† Contribution to this article was made by Surendar Singh, Policy Analyst; Neeraj R S, Research Assistant; and Sara Núñez Évora, Assistant Policy Analyst, at CUTS International.

Endnotes

- 1. Chapter 1: Economic Outlook, Prospects, and Policy Challenges, Economic Survey 2015-2015, pp. 34-37.*
- 2. Foreign Trade Policy Statement, Government of India, pp. 18-19.*
- 3. The Government of India unveiled the Make in India programme on September 25, 2014 to attract investments from businesses around the world, and in the process, strengthen India's manufacturing sector.*
- 4. The simulations focused explicitly on effects from tariff and export subsidy elimination in merchandise trade. Analysis of non-tariff measures and investment flows were beyond the scope of the modelling tools.*
- 5. Traders, government officials, policy-makers, academician/researchers, and representatives of trade bodies.*
- 6. Foreign Trade Policy Statement, Government of India, para. 12 and 67.*
- 7. India must have at least three free trade agreements with Pacific Alliance members before attempting a CECA with the full group. India currently has an FTA with Chile. Other members are Colombia, Mexico and Peru. Chile and Peru are part of the TPP.*

8. *Dolezal, et al., 'The Way Forward for Renewable Energy in Central America', World Watch Institute, June, 2013.*
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Economic partnership as diplomacy in East Asia



Economic liberalisation and integration initiatives are the most important foreign policy strategies in East Asia, Steven CM Wong states

Given the territorial disputes and tensions in the South and East China Seas, the instability in the Korean peninsula, and the region's unsettled borders and non-traditional security issues such as natural disasters and pandemics, this may seem like a grand claim to make. Yet in almost all cases economic partnership arrangements (EPAs) constitute the most visible and tangible manifestation of regional diplomacy.

With divergences in worldviews, in national interests, and disparate levels of power making political and security issues hard to handle in East Asia, EPAs have emerged as a way to avoid direct confrontation, work around problems, and engage in constructive inter-state activities. They are significantly less problematic and provocative than regional security pacts and present a means to bide time while building and boosting confidence and trust.

In response to this growing role, the nature of EPAs has evolved: they now tend to be more comprehensive and involve more obligations than they did before. Their finalisation, therefore, is never a foregone conclusion and there are significant strategic consequences for countries' inclusion or exclusion from various blocs. Symptomatic of this was the rivalry between the China-backed East Asia Free Trade Area (EAFTA) and the Japan-backed Comprehensive Economic Partnership for East Asia (CEPEA) prior to 2008.

The USA's vaunted 'Pivot to Asia' provided an important impetus to resolving this impasse. Six ASEAN members were not participants in Washington's Trans-Pacific Partnership (TPP), and, faced with the difficulty of choosing between EAFTA and CEPEA, ASEAN came up with its own proposal: the Regional Comprehensive Economic Partnership (RCEP). Despite the reservations of some participants such as India and Indonesia, ASEAN spokespeople described RCEP as a 'comprehensive' and 'high-quality' agreement and opened negotiations that were more ambitious than it had ever attempted before. It seems likely that TPP, with its wider and deeper 'gold standard' provisions, influenced the agenda for RCEP.

There remain holdouts that prevent the onward march of interdependence. China is adding more complexity to the situation, seeking a stronger bilateral EPA with ASEAN (what it calls the China-ASEAN FTA Upgrade), while simultaneously pursuing its own Free Trade Area for Asia Pacific to try and lock down its trans-Pacific interests. It is also strongly backing RCEP, but there are fears that it may be prepared to limit its commitment in favour of concluding the FTA Upgrade. At the same time Beijing is pursuing a much broader, bilateral Asian agenda, characterised by initiatives such as the Maritime Silk Road and the Asian Infrastructure Investment Bank.

What are the long-term implications for peace and prosperity in the region? It is often assumed that economic power is uniformly distributed and that outcomes will be balanced. Countries will, in pursuit of their national interests, exercise self-restraint so as not to disrupt economic relationships that will hurt them. But on issues of sovereignty and security, economic interdependence alone is unlikely to be a sufficient constraining force. East Asia's states vary widely in size, capacity and power and so it would seem that unbalanced economic interdependence - or indeed dependence - may be a more typical outcome.

Unlike the members of the European Union, East Asian states can and do have the ability to diversify their relationships and thus also their institutional EPA arrangements. In this scenario, one of the most logical solutions to avoiding one entity's domination is to seek what may be termed hedged economic interdependence. The pursuit of this

... hedged economic interdependence is the driving force leading to the competing and rival proposals on the table in the region

hedged economic interdependence is the driving force leading to the competing and rival proposals on the table in the region.

East Asian states are too global and their national and security interests too dissimilar to adopt a one-size-fits-all solution. Hedged interdependence, therefore, offers East Asia's states the partial security of mutually assured economic damage to discourage conflict, while providing alternative pathways for the smaller states to avoid domination by any regional hegemon. ■

Steven CM Wong is Deputy Chief Executive of the Institute of Strategic and International Studies (ISIS) Malaysia

A close-up photograph of two hands shaking in a firm grip. The hands are positioned in the center of the frame. The person on the left has a darker skin tone, while the person on the right has a lighter skin tone. Both are wearing dark pinstriped business suits with white shirts and light blue cuffs. The background is a vibrant red field with a large yellow star in the upper left and several smaller yellow stars to its right, characteristic of the Chinese national flag. The overall image conveys a sense of international agreement and partnership.

China in Africa

Deepanshu Mohan and P Samuel Goweh analyse
the regional trade patterns of ECOWAS and EAC with
the Asian dragon

While studying China's active engagement with Africa as trade partner for more than a decade, trade and development experts have expressed mixed views regarding the economic relationship. Most see China as the driver of Africa's structural transformation towards prosperity and higher economic growth, while some see the emerging global economic powerhouse denting Africa's efforts in industrializing itself and exploiting the continent's dependency on its naturally endowed resources (African Development Bank Group, 2011).

For instance, the trade unions in Zambia have repeatedly banned cheap Chinese goods imported in the country that were undermining its growth in the clothing and electrical sectors (Ancharaz, 2013). China's share of Africa's fuel and mineral exports at the same time has increased from 11.8 per cent in 2000 to 19 per cent in 2012 and is pointed as a factor helping to deepen Africa's concentration in natural resource extraction. The share of fuel and mineral in Africa's export basket went up from 54 per cent in 2000 to 64 per cent in 2012.

In addition, the Chinese in concessional financing have put around US\$5.4 billion and US\$8 billion in the Angolan oil sector since 2005, US\$3.5 billion in total investment in Gabon iron ore deposit since 2006, US\$800 million-1 billion investment in the Zambian copper industry since 2007 and US\$2.6 billion investment in the Liberian Bong mind iron ore deposit since 2008 (AfDB, 2011); all these presenting classic examples of the Asian dragon's envelopment with Africa's natural resource endowments.

The Nigerian Central Bank Governor, in his address at the Bridges Africa Summit 2013, described the Chinese presence in Africa as a form of neo-colonialism, thus urging African countries to see the Asian power as a competitor. To further buttress the governor's statement, existing literature and empirical analysis from this article does show that the economic ties of regionally formed Economic Community of West African States (ECOWAS) and the East African Community (EAC) with China have negatively affected the intra-trade levels within the region's own member countries.

Our article in two parts focuses on the trade patterns between ECOWAS-China (in part 1) as well as East African Community (EAC)-China (in part two) attempting to investigate how China's engagement with these regions has influenced the intra-bloc trade within both of these regions. In analyzing the data on trade patterns (extracted from sources like UNCTAD, World Bank), we observe a limited positive impact of China's economic relationship with both of these regions has on levels in intra-bloc trade (member-member). In this article we discuss the case of ECOWAS-China relationship.

ECOWAS trade with China

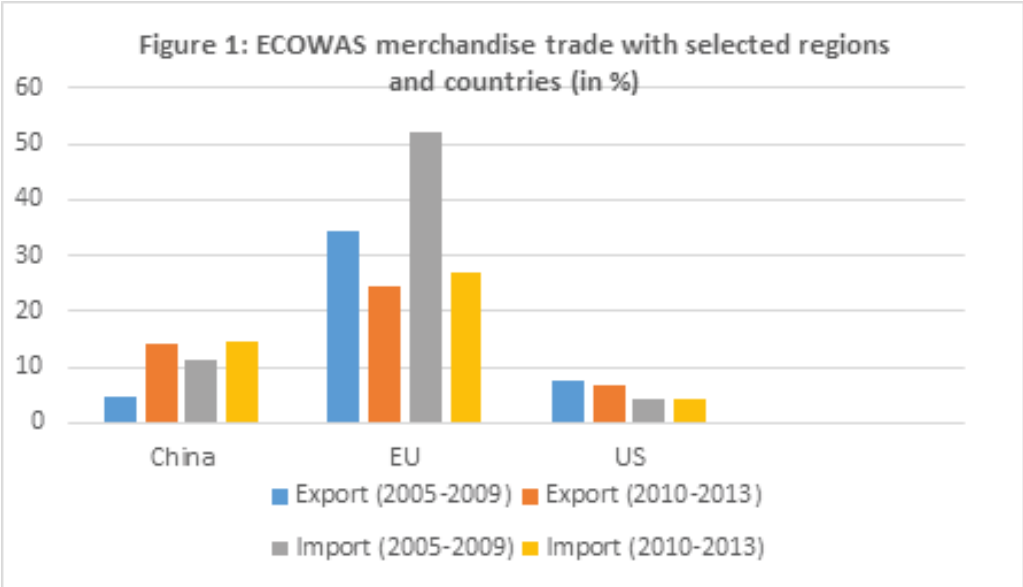
Export

China's trade with ECOWAS surged since 2005 as compared to any other region and countries in Africa. ECOWAS diverted 4.69 per cent of its export in goods to China between 2005 and 2009. Between 2010 and 2013, the figure rose to 14.26 per cent (see table 1). The natural resources within ECOWAS member countries remained the main motivation for China to trade with countries in the region. In Liberia for example, where exports to China increased from 0.39 per cent between 2005 and 2009 to 12.65 per cent between 2010 and 2013, China's major investment in

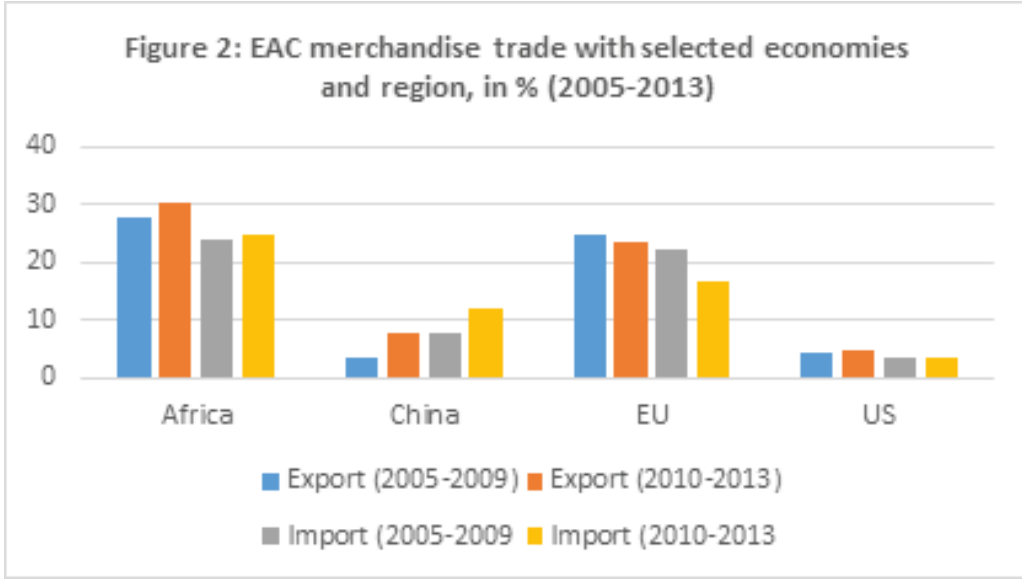
... one observes that the rising Chinese trade with ECOWAS and EAC hardly seems to be making any positive contribution to the level of intra-trade volumes within these regional trade blocs

that country is still in the iron ore sector. US\$2.6 billion was invested in the Liberian Bong iron ore deposit by China Union, a Chinese company in 2008 (African Development Bank Group, 2011).

Interestingly, while China’s imports from ECOWAS was on the rise, imports from two of the main trading partners, the US and the EU saw a downward trend. US imports from ECOWAS declined from 7.44 per cent between 2005 and 2009 to 6.59 per cent between 2010 and 2013. Similarly, the EU imports fell from 34.38 per cent to 24.52 per cent. Within the same period, ECOWAS’ merchandise export growth rate also increased by 3.92 per cent, but its export levels to other countries in Africa declined (see figure 1), which clearly suggests that the region’s merchandise export growth rate was driven and influenced by Chinese trade.



Source: Author’s calculation based on UNCTAD data



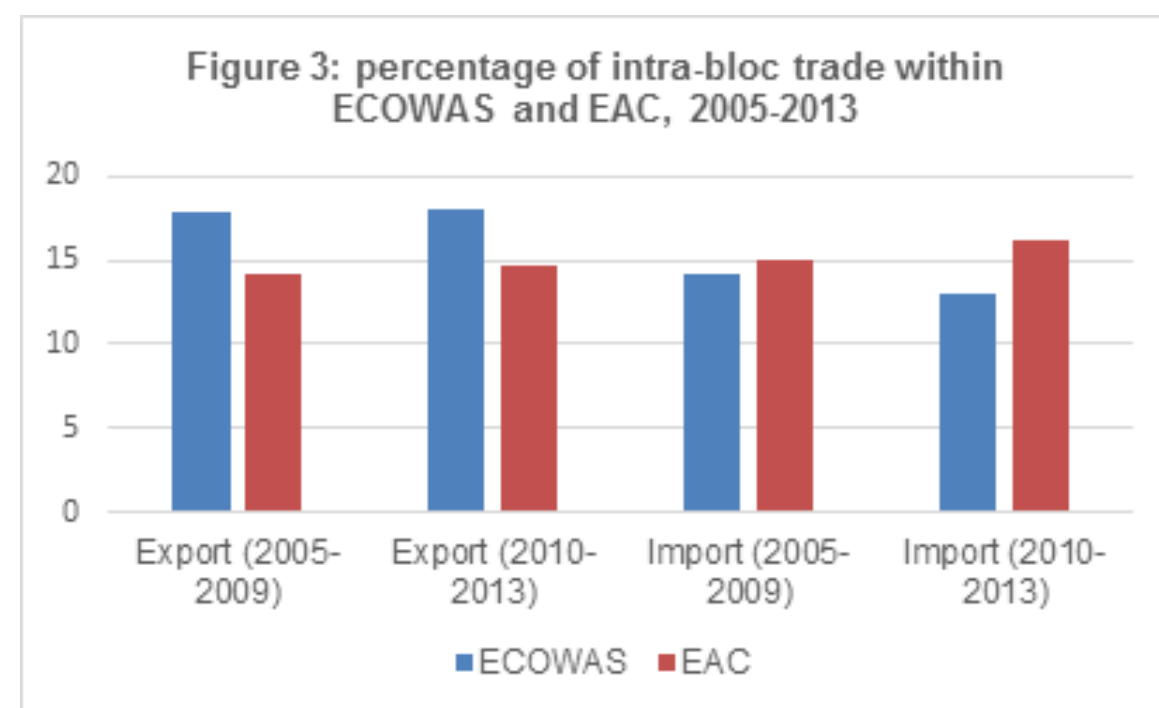
Source: Author’s calculation based on UNCTAD data

From the analysis put forth, all ECOWAS member states exports to China follow an increasing pattern except Benin and Togo. Both countries export levels to China dropped from 22.29 and 2.19 per cent between 2005 and 2009 to 20.86 and 2.12 per cent between 2010 and 2013. On the other hand, Sierra Leone, Liberia, and Burkina Faso, which had the highest percentages of merchandise export growth rate between 2010 and 2013 saw an export level rise to China from 1.82, 0.39 and 5.24 per cent between 2005 and 2009 to 55.93; 12.65 and 22.76 per cent between 2010 and 2013 respectively. Sierra Leone's own exports to China during the period increased by the highest percentage follow by Gambia, Burkina Faso and Liberia (table 1).

Imports

ECOWAS imports from China also rose since 2005. Benin had the highest percentage of the imports followed by Gambia, Ghana, Togo, Nigeria and Liberia (See Table 1). From these countries, Benin, Nigeria and Liberia were

among the countries with the highest percentages of merchandise import growth during the time periods.



Source: Author's calculation based on IMF data

Unlike the case of export, ECOWAS total merchandise import growth rate declined by 0.74 per cent between 2010 and 2013 but its import from China increased by 3.36 while its imports from Africa, EU, and the US fell by 0.13, 4.96, and 0.051 per cent between the same periods. Although Benin maintained the highest percentage of China's export in goods to ECOWAS, Benin and Burkina Faso import from China declined by 2.2 and 2.92 per cent between 2010 and 2013 while the rest of ECOWAS member countries imports from China increased over the period (see table 1).

Table 1: Percentage of ECOWAS exports and imports to selected economies and regions (2005-2013)

Country	2005-2009				2010-2013			
	Africa	China	EU	US	Africa	China	EU	US
EXPORTS								
Benin	18.62	21.29	14.99	1.64	8.98	20.86	5.56	0.21
Burkina Faso	24.77	5.24	25.07	0.94	17.04	22.76	11.30	0.46
Cabo Verde	7.59	0.00	86.30	2.03	1.12	0.03	84.54	3.08
Cote D'ivoire	30.67	0.75	47.76	9.31	34.41	1.16	36.48	9.19
Gambia	8.04	8.31	28.23	1.07	4.71	46.28	16.86	1.20
Ghana	10.66	2.19	41.55	5.35	10.92	5.76	47.13	5.36
Guinea	2.75	1.54	32.98	6.47	2.87	1.80	27.37	5.19
Guinea Bissau	20.76	0.35	1.75	0.09	26.60	3.04	2.21	0.42
Liberia	8.05	0.39	58.10	7.78	13.53	12.65	36.25	16.22
Mali	7.94	24.81	22.87	2.21	6.68	36.28	8.46	0.93
Niger	31.47	0.07	45.22	16.73	51.09	3.22	4.08	23.38
Nigeria	9.11	0.81	22.36	43.34	9.85	1.28	31.12	22.82
Senegal	46.80	0.69	22.36	0.55	46.28	0.76	14.99	0.31
Sierra Leone	6.95	1.82	60.57	15.23	2.93	55.93	27.08	3.30
Togo	70.32	2.19	5.61	0.57	64.17	2.12	14.44	0.52
IMPORTS								
Benin	9.19	37.48	20.18	8.07	7.55	34.78	23.95	7.47
Burkina Faso	35.27	6.24	31.06	4.69	40.52	3.32	35.74	2.43
Cabo Verde	2.60	1.71	75.71	1.74	1.64	6.27	79.22	1.28
Cote D'ivoire	31.79	5.75	34.27	2.62	31.55	7.55	25.74	2.49
Gambia	21.81	23.45	3.10	3.85	15.05	27.74	3.71	3.19
Ghana	24.83	14.61	26.95	5.60	21.57	21.80	22.85	7.07
Guinea	8.17	9.06	26.47	3.48	7.05	13.78	21.15	2.95
Guinea Bissau	22.95	4.11	41.74	1.59	22.25	4.27	40.01	3.79
Liberia	1.63	10.58	11.73	1.10	1.50	24.94	3.97	1.32
Mali	49.92	4.91	25.70	1.43	43.92	7.97	25.55	1.47
Niger	25.26	10.38	33.60	6.85	27.10	12.75	29.82	2.98
Nigeria	5.11	12.23	32.80	8.38	4.74	18.13	24.48	9.91
Senegal	18.59	6.20	43.94	2.88	18.77	7.55	39.74	3.36
Sierra Leone	18.75	8.31	30.50	7.45	18.63	14.06	26.98	6.76
Togo	16.60	14.43	42.85	2.08	13.66	14.97	3.33	4.56

Source: Author's calculation based on UNCTAD data

With support from the Chinese government in setting up special economic zones in Ethiopia, Mauritius, Nigeria, Zambia and Algeria, China's efforts in helping countries in Africa develop their manufacturing sector is quite evident. On the other hand, the influx of cheap Chinese exports to Africa is also likely to cause a serious disadvantage to most of these countries working with an 'infant' industrial set up.

EAC trade with China Export

EAC exports to China had also been increasing since 2005. Between 2005 and 2009, EAC directed just 3.59 per cent of its exports to China, 27.90 per cent to Africa, 24.82 per cent to the EU and 4.38 per cent to the US. From 2010 to 2013, EAC percentage of merchandise export to China increased to 7.88 per cent, while EAC export to Africa, and the US also increase by 3.47 per cent and 0.38 per cent, and its export to the EU fell by 1.4 per cent. Although the trade bloc's merchandise

export to China increased, its merchandise export growth rate slightly fell by 0.04 per cent (figure 2).

At the individual economies level, Tanzania and Rwanda, which were among the EAC member countries with the highest merchandise export growth rate also had the highest percentage of EAC's merchandise export to China. Uganda, despite its high merchandise export growth rate, its export to China increased at a marginal rate (table 2).

Import

EAC export to China grew slightly steeper relative to China's export to the region. Between 2010 and 2013, EAC export to China increased by 4.9 per cent while China export to the region increased by 3.96 per cent. During the same period, EAC merchandise import declined by 8.57 percent. Its import from the EU also declined by 5.67 per cent while its import from Africa managed to slightly rise by 0.77 per cent (figure 2).

With respect to individual country, Tanzania had the highest percentage of EAC's merchandise import from China between 2005 and 2009, followed by Kenya and Uganda. Of these countries, Tanzania and Uganda were among EAC member countries with the highest merchandise export growth rate during the period (table 2).

Africa remains the prime source for China's fuel and raw materials (Foster, 2009), which justified the argument that it is also deepening Africa's dependency on natural resources and subsequent failure to diversify. In addition, China is also tracing the path of Africa's former colonial masters who used the continent as a basis for raw materials, thus leaving its infrastructure sector underdeveloped.

Diminishing intra-trade levels

From the data extracted and presented, one observes that the rising Chinese trade with ECOWAS and EAC hardly seems to be making any positive contribution to the level of intra-trade volumes within these regional trade blocs. In the case of ECOWAS, where China trade with the region followed an increasing pattern during the period under

Table 2: Percentage of EAC exports and imports to selected economies and regions (2005-2013)

Country	2005-2009				2010-2013			
	Africa	China	EU	US	Africa	China	EU	US
EXPORTS								
Burundi	10.98	1.12	21.16	0.50	16.71	4.59	34.11	1.09
Kenya	41.03	0.60	27.18	13.51	42.16	0.83	22.42	10.91
Rwanda	26.38	6.53	22.32	3.97	32.00	18.59	12.52	7.08
Tanzania	21.20	8.75	24.13	2.35	22.28	12.93	17.33	2.08
Uganda	39.92	0.96	29.33	1.58	39.24	2.49	30.72	2.65
IMPORTS								
Burundi	28.46	5.60	28.52	1.60	31.74	8.92	20.89	3.25
Kenya	10.70	7.81	19.40	6.21	9.17	12.17	15.34	4.12
Rwanda	37.38	5.73	24.15	3.02	42.68	7.60	19.45	4.59
Tanzania	18.38	12.55	19.07	3.03	12.80	20.08	11.32	2.64
Uganda	25.36	7.30	19.78	3.31	27.73	10.02	15.56	2.63

Source: Author's calculation based on UNCTAD data

study, intra-bloc trade suffered decrease as the region trade with China rose. On the other hand, EAC where China trade rose at slow pace, the region intra-bloc followed an increasing pattern.

China's key interest in trading with these regions has been to find markets for its own manufacturer products most of which are consumer goods. Consequently, any attempt to establish and develop manufacturing basis in these regions will obviously undermine its trading agenda. As these countries are increasingly becoming dependent on Chinese manufacturing goods, the growth of intra-trade (between members and regions) is seen to be hampered.

We observe that China's trading interest in the region of ECOWAS and EAC has also been primarily to seek member country's energy, mineral and other raw material sources for its own manufacturing interest. China also became the second largest importer of non-fuel materials such as iron ore and copper ore after the EU in 2010. In the same year, non-fuel materials accounted for almost half of China's total import bill (WTO, 2011).

Conclusion

China took over Japan as the third largest importer of fuel and by 2012 also becoming the second largest importer of fuel, over the US. China's own trade with ECOWAS and EAC regions is observed here to have hardly any positive impact on the intra-bloc levels of trade (both member-member/region-region).

The rise in increasing trade by the Chinese with both the regions has mainly been in primary commodities, which has the propensity to then make the region dependent on the foreign country for such primary commodities.

Thus, it is extremely important for Africans to aim for balance and securing their trade interests in managing their economic relationship with their major trade partners. In the case of China, a balance needs to be maintained between the influx of Chinese manufactured products without undermining the continent's quest in utilizing the for-

eign investment to improve its own manufacturing capabilities. We highlight in detail some of these measures and policy reforms in part II to this research article. ■

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Rethinking risk in an integrated Africa

A photograph of a border crossing in Zimbabwe. A sign reads "ENJOY YOUR JOURNEY ZIMBABWE" with an upward arrow. A large truck is visible in the queue, and a building with a "Shop" sign is on the left.

Christopher Wood looks at the impact of major new regional integration efforts on the continent

There are 850 kms between Johannesburg and Bulawayo, a 9 hour straight shot for a freight truck, on nicely tarred roads all the way. Zimbabwe's second city is closer than Cape Town, and should be considered as much a part of the South African marketplace as local destinations. And yet halfway into that drive, trucks reach the Beitbridge border post, the busiest and most notorious border crossing in Southern Africa. Wait times at Beitbridge average 3 days, at the cost of \$400 per day. Crossing the border means overcoming a complex two-step customs process, beset by corruption, and supported by inadequate infrastructure that offers unstable power supply and internet connectivity. Once the border has been crossed, exhausted truck drivers still need to rest, and must plan their onward journey for the safety of daylight hours.

Beitbridge is a nasty reminder of the reality of African regional trade, in which practical barriers to trade - like inefficient border posts and under-developed infrastructure - can be insurmountable for all but the largest firm. It is a long way, in every sense, from Sharm-el-Sheik, where African leaders recently gathered to officially launch the Tripartite Free Trade Agreement. The TFTA is an ambitious initiative to unite three regional economic blocs - the Southern African Development Community, the East African Community, and the Common Market for Eastern and Southern Africa - to form a 26 country free trade zone that includes 6 of the continent's 10 largest economies. The final details of the agreement are yet to be concluded, but once complete it aims to minimize formal barriers to trade, and form a united effort to speed up border efficiency and improve transport infrastructure.

The potential of the TFTA is immense. The 800 million person bloc includes large emerging economies like Ethiopia and Kenya, dynamic smaller economies like Rwanda, resource-rich economies like Angola and the Congo, and the continent's traditional economic hub of South Africa. The greater potential, however, is evidenced in future trends. Total population is expected to surpass 1.3 billion people by 2050, with the working age population more than doubling, and half of the total population settling in cities. The TFTA consumers of the future are expected to be young-

er, richer, and more middle class - and are the target of ever more concentrated attention from the European Union and United States, both of which have made efforts to secure access to some of the last untapped emerging markets.

Even more exciting, the TFTA is to form a stepping stone towards the completion of Continental Free Trade Agreement. The CFTA has been an aspiration for decades, but has remained in the realm of political rhetoric, until now. The African Union has agreed principles governing negotiations towards the creation of a continental deal and seem eager to press ahead as quickly as possible. Those negotiations will be extremely difficult and will take a decade at best, but hold the mouth-watering potential of the addition of Africa's largest economy, Nigeria, and a range of dynamic West and North African countries to the mix.

High growth rates, a demographic boom, and deepening integration are good stories for Africa to tell, from a continent that has had far too little positive news in the past, but there are headwinds on the horizon.

Africa is too large a market to ignore. The base facts of the continent's resource wealth, consumer profile, and untapped industrial potential are hard to deny

The slump in emerging economies is bad news for the continent, as growth in the likes of China was vital to feeding the commodity boom that supercharged African growth in the last decade. Rising interest rates in the United States, and a return to normality in the Northern parts of Europe will lure risk-averse investors away from the continent. Most African economies remain undiversified and over reliant on commodities, which look set to enter a period of prolonged depression.

Decreasing commodity prices and a political environment that emphasises industrialisation have triggered a turn to investment in manufacturing and agribusiness, with countries like Ethiopia targeting jobs leaving China in the face of higher wages. But these efforts may be hindered by increasing government debt loads and depress tax revenues, and by the threat of currency instability. The lack of diversification may also limit the benefits of the TFTA, and is often identified as the central reason for low regional trade: commodity-dominated economies just don't make products that other African countries want to buy.

On the trade side, practical barriers like those encountered at Beitbridge will undermine the effectiveness of grand regional integration efforts. Smaller technical rules are also a problem, with little alignment of certification or labelling regulations, and a diverse set of rules governing freight and distribution. Weak infrastructure remains a problem. Road and port infrastructure have improved dramatically, but rail networks remain very poor, and regional air travel is amongst the most expensive in the world. Domestic constraints, most noticeably the weak supply of energy, continue to put the brakes on growth. The good news is that there is unprecedented finance flowing towards addressing these issues, and various plans in place to put that money to work, but actual implementation remains slow and unpredictable.

Africa is too large a market to ignore. The base facts of the continent's resource wealth, consumer profile, and untapped industrial potential are hard to deny. But there are many problems, and while there is progress, it will remain a difficult market in which to operate for the foreseeable future.

For potential investors, the central question facing them is temporal. Investing earlier will mean facing more of the barriers found at the Beitbridge's and bottlenecks across the continent. Investing too late, however, might mean struggling to compete with established firms that have learned to do business in Africa. A more integrated continent is useful in many ways, but to investors facing this question, it should first and foremost be understood as a shock-absorber.

Africa is too often imagined as a single destination, rather than as a continent that is six times larger than Western Europe. Political instability and barriers to doing business never exist on a continental level, they exist in certain countries and areas. A deeply integrated continent should offer a large enough pool of business opportunities to allow space to adjust in the case of problems in one area. Careful observation of the state of regional integration efforts may just hold the answer on whether to take the dive into the last frontier in emerging markets. ■

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Naturally energetic

Combining a reputation for energy investment with a true love of nature, Elk River promises an excellent environment for both businesses and employees, writes Colleen Eddy

Business comes naturally to the City of Elk River, Minnesota. Elk River is one of the fastest growing business communities in Central Minnesota, with a 30 percent job growth rate and over 1,000 businesses now calling the city home, 50 of which are manufacturers and two of which are *Fortune 50* data centres. Our goal is to continue this economic growth and vitality by adding to the city's thriving business environment. The heart of downtown Elk River is located at the convergence of the Elk and Mississippi Rivers. The area offers quaint shops, restaurants and services, along with progressive fitness and wellness offerings. Elk River is a friendly city with big-city conveniences.

Power provision

Elk River has a longstanding history in energy. We'd even go so far as to say it's a tradition - a tradition that keeps on-growing. From the construction of the Elk River dam in 1856 to becoming a hub of energy technology and manufacturing, our community has been on the cutting edge of clean and renewable energy for years. Indeed, this has led to Elk River being designated Minnesota's Energy City.

Elk River has a longstanding history in energy. We'd even go so far as to say it's a tradition - a tradition that keeps on growing

Elk River Municipal Utilities (ERMU) has superb water quality and electrical reliability that has earned it the American Public Power Association's prestigious RP3 designation, signifying a Reliable Public Power Provider.

Its electrical service provides 99.9999 percent reliability, with infrastructure large enough to handle the demands of data centres and manufacturers. What's more, the water used for cooling has very little mineral content.

We are naturally equipped for the development of migrating or expanding businesses. Coupled with the accelerated timeline from ground breaking to completion, you won't find a community that's a better site for business.

The Elk River Area School District is the 8th largest in Minnesota. The schools have each earned a reputation for providing outstanding educational opportunities to students through science, technology, engineering and maths (STEM) and audio and visual technology (AVID) programmes. In addition to the public schools, Elk River is home to several innovative parochial and charter schools.

Steeped in nature

The heart of the city is powered by nature. The Elk River community prides itself on its dedication to outdoor recreation. With 45 parks totalling 1,100 acres, over 75 miles of paved walkways, and myriad hiking and biking trails, there are plenty of recreational options for all outdoor enthusiasts. Elk River is a place for people who live and breathe the outdoors, knowing they have the comforts of the big-city amenities the surrounding area has to offer. Relax by taking the Northstar Commuter Rail into downtown Minneapolis for a day of shopping or sports events, or simply to get to work. The Northstar provides a comfortable way to get to any activity you enjoy.

The City of Elk River Economic Development Department offers a variety of services that can assist any size project or industry looking to relocate. We have stream lined processes to accelerate timelines from ground breaking to fa-

cility completion. We are confident you'll find everything you need for your business in the City of Elk River. ■

For further information:

www.elkrivernm.gov

Colleen Eddy is an Economic Development Specialist at City of Elk River



The social-liberal direction of nineteenth-century liberalism

Patrick van Schie and Fleur de Beaufort look at the
development of social-liberalism in Europe

“It is in the public interest that the distressing circumstances which cause workers to become proletarians come to an end [...] this is not about care for the poor, but about precautions.”

PWA Cort van der Linden

In his book *Richting en beleid der liberale partij* (1886) Pieter Cort van der Linden made it clear that, to his mind, liberalism was facing major challenges on the threshold of the twentieth century. ‘Reforming the social condition of workers is the most urgent issue that must be solved in our times. The urge for increased state intervention springs from the awareness that the regulation of social relationships in the life of workers has been overdue for far too long.’¹

In the course of the nineteenth century there had been a growing awareness among liberals in various European countries that the restraint of government was no longer the only approach in the best interests of individual freedom. Quite the contrary, individual freedom could definitely profit from positive state intervention. As that thought gained shape and substance, a new train of thought emerged within liberalism, one that we know these days as social liberalism, also known as *new liberalism*. What was the historical background against which this school came about, and what was the political theory behind it?²

The Industrial Revolution, the growth of the population and the associated migration to the cities caused increasing problems in nineteenth century Europe. People lived huddled together in small houses without proper sanitary facilities and even the very young and the very old worked long hours in factories in appalling conditions. There was no security in the event of their becoming too old or otherwise unfit for work, neither was there any provision for the widows who were left to care for young children alone after an industrial accident. In many cases, people fell into poverty through no fault of their own, and many liberals were outraged by this state of affairs.

During the first half of the nineteenth century the liberal political agenda in most European countries consisted mainly of laying down a number of fundamental individual rights. Other important liberal freedoms – spiritual, political and economic – still had to be fought for at that time. The omnipotence of the state (or the ruler), the church, the community and the holders of economic power such as the aristocracy and guilds had yet to give way to freedom of opinion, freedom of religion, freedom of association, the rule of law and free trade. The struggle for these freedoms and their realisation coincided with what we would today call classical liberalism.

It was in the upper layers of society that people, mainly liberally minded, in the course of the nineteenth century increasingly started to worry about hygiene, education and the cultural development of the population as well as care for the poor; areas that the government had so far barely engaged with, if at all. Such private initiatives constituted the tentative preliminaries to a more structured state intervention in the lives of the destitute. Philosophers, commentators and politicians in various European countries initiated a debate about the desirability and necessity of actively engaging in 'social issues'. Ideas were exchanged across borders, since the problems arising in other countries with emerging industrial sectors were often of a similar nature.

Because social liberals considered the role of the state to be mainly one of creating and fostering conditions, unlike socialists, they expected much from individuals themselves

A large group of mainly younger liberals agreed that action was needed to cope with the injustices prevalent among factory workers in the cities. There was no consensus, however, about the question of precisely how the issue of poverty should be addressed. There was initially a reliance on private initiatives and employers assuming responsibility for the welfare of their own workforce. Gradually, however, the demand for governments to provide a solution increased.

In the early nineteenth century there were already some factory owners who took responsibility themselves and set up various facilities for their workers. Such facilities ranged from better housing in the vicinity of the factory – often including some provision for recreation outside working hours – to funds for the care of destitute widows and orphans or for workers who had become incapacitated due to industrial accidents. This sometimes involved workers being obliged to contribute a small amount from their wages to such funds. Some factory owners were convinced of their social responsibility towards their workers, whereas others viewed such arrangements chiefly as a way of guaranteeing the work ethic of those they employed.

It was, in particular, the first generation of social liberals who found another solution: the setting up of voluntary cooperatives which allowed people to take responsibility for themselves by means of the principle of self-help. This idea was based upon the bestselling book *Self-help*, published in 1859 by the Scottish journalist Samuel Smiles. Smiles felt that people should be empowered to engage in self-reliance, even in adverse circumstances. Saving jointly within a cooperative would make this possible in the long run. Social liberals, particularly in Germany, remained convinced of the worth of this cooperative idea for a long time.

Eventually, state intervention did begin to play a more important part in the solution. Social liberals felt that, on the one hand, state intervention addressed what we might call the more familiar liberal agenda, focusing on abolishing the inequalities and privileges that ensued mostly from legislation; for example, the abolition of the prohibition on

forming workers associations, which prevented labourers from uniting to fight for better conditions, or the ending of the system which permitted wealthy families to send a substitute (selected by drawing lots) for a son who had been drafted for military service.

On the other hand, social liberals wanted state intervention to achieve much more than merely ensuring equality of rights. Matters such as compulsory education, the prevention of child labour and the protection of women, and later also of adult males, the improvement of living conditions in urban areas and the introduction of social insurance could all be found on the social liberal agenda at the end of the nineteenth century.

This meant an end to the perception that poverty resulted first and foremost from the moral deficiencies of the poor themselves; in other words, the idea that they themselves were mostly to blame. As opposed to an explanation based on moralisation alone, the conviction grew that social and economic causes could also be pinpointed to explain the issue of poverty. Social legislation can be seen as a manifestation of the insight that society as a whole is responsible for social problems whereby the state – as the representative of society – is also under the obligation to make an effort to solve such problems.

Social liberals considered social legislation to be the first step towards stimulating increased responsibility and development among the poor and destitute. They always remained conscious, however, of the possible negative effects of increased welfare provisions for the poor as well as the risks of (excessive) state intervention verging on interference in people's lives. The intention of social liberals was that state intervention by means of social legislation should eventually create a society in which responsible individuals could unite in freedom.

It was by no means their intention that the government should appoint itself as the binding element of society by applying an excessive degree of interference. In the minds of social liberals, this foundation would always have to

be constituted by free and responsible individuals. The social issue had become so urgent during the second half of the nineteenth century, however, that it had begun to pose a threat to the unity of society, including all the risks that damage to that unity would entail; for that reason alone, state intervention was called for.

The switch from minimising or curbing state intervention as much as possible to engaging the government in assisting individuals in the realisation of their freedom was, of course, exceptionally sweeping for liberals. Representatives of the 'old' liberal school criticised the 'modernists' for altering liberal principles so profoundly.

In Great Britain, the classical liberal thinker Herbert Spencer had already taken aim at the forerunners of social liberalism, the politically active liberals under Prime Minister William Gladstone, who had introduced legislation in which a role was allocated to the government. Spencer asserted that Gladstone and his associates were making false use of the name 'liberal'. Genuine liberalism '...diminished the range of governmental authority, and increased the area within which each citizen may act unchecked. [...] in past times Liberalism habitually stood for individual freedom versus State-coercion'. In reality, the 'so-called Liberalism' of increasing state intervention was, according to Spencer, 'a new form of Toryism' which would ultimately and inevitably end in socialism. And: 'All socialism involves slavery. [...] That which fundamentally distinguishes the slave is that he labours under coercion to satisfy another's desires.'³

In the Netherlands, economist Simon Vissering attacked the first generation of social liberals in the 1870s, particularly because they ignored 'the constitution of all things, the individuality of man'. Individuals could only pursue their self-interest: 'One may argue about that at length, but the reality is very simple. I ask you [...] did we – each and every one of us – not eat our own sandwich just now? [...] It is a fact that we all have our individual needs. However, to our mind, this is the organisation of society; in other words, what we do for our own sake should also benefit others.'

Vissering felt that the ideas advocated by the social liberals – also pointedly referred to as ‘lectern socialists’ in the Netherlands – harboured the danger of communism and ‘an arbitrary organisation of society’. And was not one of the core values of liberalism that it had always opposed the supremacy of arbitrariness?⁴

The social liberals, on the other hand, reproached the ‘old school’ liberals for carrying individualism to extremes. Obviously, the social liberals were also concerned with individuals and their freedom, but individuals can be dissociated neither from their environment nor from society as a whole. Individuals and society should always be considered as mutually coherent.

Ideally, individuals were, to the liberal mind, self-reliant and autonomous people, however, they were not so by nature. They came into this world helpless and totally dependent upon others (their parents). And neither did self-reliance come naturally to them in their youth, as they were becoming adults. Autonomous individuals have learned to control their animal impulses and to live by insights inspired by reason. An individual could only achieve such a condition after extensive training and with a self-discipline instilled by others.

Here, we can already detect the bond – inextricable from the social liberal mindset – between individuality and social or environmental factors. Individuals owe the skills necessary for making their own and autonomous choices to their environment. Making such choices is also part of an interaction with the world that surrounds the individual. After all, it is that world which offers the possibility of choice to the individual.

The Spanish social-liberal philosopher Ortega y Gasset pointed out that individuals always relate to their environment intellectually. There is an interaction between the world and myself. My environment shapes my thoughts but I also focus on particular things in my environment. I do not hear and see everything; I hear and see the things that I focus on. Ortega calls this ‘co-existence’. Although my existence was not primarily my choice, it is my choice to give meaning and substance to my life. If I were not to do that I would be a fatalist, but if I do it I exert my freedom.⁵

Exactly how discriminating should those choices then be? On the one hand, a person with a strongly individual character does not simply go along with the crowd; on the other hand, constantly opposing the crowd is not in itself proof of individuality either. Social liberals disagreed with the idea of liberal 'godfather' John Stuart Mill that a liberal individual should always oppose pressure to conform and should think and act as originally as possible. The liberal lawyer James Fitzjames Stephens remonstrated as follows: 'Originality consists in thinking for yourself, and not in thinking unlike other people.'⁶

The interaction between individuals conjures up forces that were initially only latent in the individual. The founder of the 'new liberal' sub-school in Great Britain, Thomas Hill Green, expressed this as follows: 'Social life is to personality what language is to thought.'⁷

Individuals cannot develop themselves in total isolation. Society develops gradually as individuals – mutually influenced but all in their own right – work towards their own development. This development is embodied in the traditions of that very society and its institutions. The traditions and institutions of society, in turn, enhance the possibilities for the individual to develop themselves. And thus individuals and society push one another onwards and upwards.

Social liberals liked to compare this idea with an animal or human organism. In the nineteenth century, it was widely popular to picture society as an 'organic entity'. Just as the hand or the eye cannot function independently of the human body, individuals could not function independently of one another and of society. By working effectively, they served both one another and the societal 'body' and this body in turn nourished the parts. This was called organic thinking. With this form of thinking, some social liberals attributed to society a spirit and objective of its own, while others were very wary of that approach.

Among the latter was the influential social-liberal sociologist Leonard Trelawny Hobhouse, who wrote: 'The true organic theory is that the whole is just what is constituted by the co-operation of the parts, neither more nor less, not more real or less real, not of higher nor of inferior value.'⁸

Then again, there was a consensus among social liberals that this organic process was, or at least should be, focused on harmony. This thought also encompassed the role of the government, the purpose of which ought to be the stimulation of society proceeding in a harmonious manner. Such harmony could not come about if the government did not allow adequate scope for autonomous private initiatives. Neither would there be harmony if the government tried to think and act on behalf of individuals and their associations. The principal duty of the government was to create the conditions which would permit individuals and all their forms of cooperation – associations, cooperatives, businesses etc. – to develop in an optimum manner, and also to ensure mutual support.

In this respect, social liberals distinguished themselves from socialists, who often attributed a major role to the government in society and the economy. Moreover, far from considering harmony to be the essence of society, socialists felt that the conflict between classes with irreconcilable interests was at its core. Socialists thought that they could solve this conflict by engaging the state in the interest of the class that they felt was being suppressed: the proletariat.

This reflected a one-sidedness that social liberals were careful to avoid. If anything, the government had to encompass all the interests that were discernible within society and further the mutual reconciliation of these interests. Individuals and their associations, as well as society as a whole, stood to gain most from that.

Because social liberals considered the role of the state to be mainly one of creating and fostering conditions, unlike socialists, they expected much from individuals themselves. The state creates a society in which the scope is provid-

ed to give individuals equal opportunities to develop their individual talents. Individuals can then be expected to seize those opportunities and ensure their own self-sufficiency as much as possible. This was not only the expectation of social liberals at the end of the nineteenth century; it remains a train of thought within liberalism today.

Education is key to that thought. After all, it gives individuals the opportunity to discover and develop their talents, even when the stimuli from their direct environment is insufficient. Education enables children to develop into responsible and autonomous citizens who can provide for themselves to the greatest possible extent. Where classical liberals are particularly intent on creating framework conditions that will empower individual development, social liberals take things one step further.

To their mind, it is reasonable to expect of individuals that – to a degree – they make the most of their talents; not because they have received these talents from a higher power (such would be the reasoning of a Christian Democrat) but because those talents constitute the foundation from which individuals can make a useful contribution to the society to which they belong.

Social liberals were therefore in favour of compulsory education right from the start, and they continue to take a critical view of the attempts of parents who seek to appeal for exceptions to compulsory education. Likewise, social liberals also take a positive stance as regards the attempts being made in many European countries to reduce absences from school and to emphasise the individual's responsibility to obtain at least a basic level of qualifications. Compulsory education no longer simply stops at the age of sixteen, but continues until a starter qualification has been obtained.

This is the only way in which people will be empowered to be self-sufficient and to make a contribution towards society in their own way. For anyone who takes social liberalism seriously, obtaining a starter qualification is not just

an option, it is an obligation for anyone who has the capacity to do so. It remains up to individuals to choose the direction of their development; the option to do nothing, however, does not chime with the social liberal body of thought. This example illustrates that social liberalism is, in general, more prescriptive than other schools of liberalism. ■

Dr PG (Patrick) van Schie and Dr FD (Fleur) de Beaufort are respectively the director and a scientific staff member at the Prof. Mr BM TeldersStichting, the liberal think tank of the Netherlands

Endnotes

1. PWA Cort van der Linden, *Richting en beleid der liberale partij* [transl. *Direction and policy of the liberal party*], Groningen, 1886.
2. December 2014 saw the publication in Dutch of the book *Sociaal-liberalisme* by Fleur de Beaufort and Patrick van Schie (Boom Editors, Amsterdam, 2014), which deals with these questions in detail.
3. Herbert Spencer, *The Man versus the State* (1884), pp. 10, 29 and 55 (incorporated into the edition *The Man versus the State. With Six Essays on Government, Society and Freedom*, Indianapolis, 1981).
4. Quoted in: Stefan Dudink, *Honest liberalism. Social liberalism in the Netherlands 1870-1901* (Amsterdam, 1997) pp. 51-52.
5. José Ortega y Gasset, *What is philosophy? (a range of 11 lectures, delivered in 1929; The Hague, 1960)* lesson viii, pp. 162-181.
6. Quoted by: David George Ritchie, *The Principles of State Interference: Four Essays on the Political Philosophy of Mr Herbert Spencer, JS Mill and T.H. Green* (London, 1891) p. 88.
7. Thomas Hill Green, 'Prolegomena to Ethics', pp. 255-257 (as incorporated in Paul Harris & John Morrow eds., *Thomas Hill Green: Lectures on the Principles of Political Obligation and Other Writings* (Cambridge, 1986)).
8. Leonard Trelawny Hobhouse, *The Metaphysical Theory of the State. A Criticism* (Honolulu, 2004 [originally 1918]) pp. 129-130.



EBACE proves enduring and forward- looking

WCR reviews the recent EBACE event to examine the latest trends and opportunities the sector provides

Corporate aviation has proven to be a vital tool in maximizing profitability and competitiveness, its flexibility critical to gaining contracts and business in new markets. With this in mind WCR has reviewed the recent EBACE event to examine the latest trends and opportunities the sector provides.

The event brought together customers and service providers as well as airframe manufacturers and suppliers.

The network opportunities were appreciated by all and were found to be most informative.

As the 2015 European Business Aviation Convention & Exhibition (EBACE2015) concluded, organizers said this year's event once again underscored the show's value to exhibitors and attendees, and its continuing importance to the industry's advancement in Europe and beyond.

EBACE is jointly hosted by the National Business Aviation Association (NBAA) and the European Business Aviation Association (EBAA).

"As we marked this 15th year of EBACE, it was clear that the event has always been, and will continue to be, a trade show featuring new products and cutting-edge technologies, and a premier venue for networking and getting the latest information about the trends shaping this dynamic industry," said EBAA CEO Fabio Gamba.

NBAA President and CEO Ed Bolen agreed, stating: *"EBACE remains a forward-looking event, which is why it will always be a can't-miss show on the industry's calendar."*

Bolen and Gamba also noted that this 15th EBACE offered an opportunity to consider the show's phenomenal growth since the first edition of the show, held in 2001.

For example, that inaugural EBACE featured 200 exhibitors, and about 30 aircraft on static display. This year, the event drew nearly 500 exhibitors and nearly 60 aircraft on display. EBACE2015 attendees came from more than 100 countries, from the European region and beyond.

The attendees had an opportunity to hear from industry thought-leaders who participated in a variety of education sessions, an International Transactions Seminar and a Safety Workshop.

This year's EBACE also featured the first-ever Inspiration Zone with a dedicated focus on the industry's future. The Inspiration Zone, positioned on the exhibit floor, was the location for a session on Unmanned Aircraft Systems, an inaugural Young Professionals Networking Event, and a session on Skills and Careers. A Career Day for European post-secondary students interested in aviation was attended by 70 students from Switzerland, Germany and Spain.

A host of exhibitor press conferences, held on and off the EBACE show floor, provided news-making announcements about companies' products and plans. More than 400 representatives with news organizations from around the world attended and covered EBACE2015.

EBACE remains a forward-looking event, which is why it will always be a can't-miss show on the industry's calendar

As it has every year, EBACE2015 also served as an advocacy platform, showcasing the industry's importance to government leaders. At the show's Opening General Session, Francois Longchamp, state counsellor of the Canton of Geneva, reiterated his support for business aviation as essential to regional commerce. Patrick Ky, the executive director of the European Aviation Safety Agency, outlined his plans to ensure that future policymaking by the agency reflects the diversity of companies and mission profiles in business aviation.

"We thank the government leaders who joined us at EBACE this year, and also the exhibitors, attendees and others who made EBACE2015 such a success," Gamba said. Bolen echoed Gamba's sentiment, adding: *"We are eager to celebrate the next 15 years, and beyond, for the show."*

Next year's EBACE will return to Palexpo and Geneva International Airport from May 24-26, 2016. ■

This review is sponsored by Hermes Executive Aviation



TechTalk – fraud and fraud investigation

A recent TechTalk in Bermuda found that Bermuda was ahead of the game in the world of data security, writes
Anna Chan

As a jurisdiction, Bermuda was an early adopter of e-commerce and electronic transactions legislation. To the many leading international organisations present on its shores, Bermuda provides a sophisticated technology infrastructure that includes several fibre optic cables connecting the Island to the rest of the world, a full complement of IT services and support, reliable redundancy capability, cloud and digital certificate services, and disaster recovery services. These ICT offerings are key to the country's economy, providing it with the essential tools that allow business to be securely and successfully transacted locally and overseas.

Known as the 'wired island,' Bermuda has fostered a booming e-business environment, evidenced by its success stories. Bermuda is home to leaders in security and payment processing, with these local companies going on to become recognised front-runners who ably deliver services to global customer bases, including some European governments.

Bermuda is home to a significant number of multi-billion dollar insurance, banking and other kinds of business ventures and so data protection and security are critical. The Bermuda Government takes security seriously and believes that privacy and security go hand in hand. It has developed a strong relationship with the Island's private sector, working closely with the companies in the Island's technology and professional services sectors to remain abreast of relevant progress, and active in ensuring that the Island remains a security-friendly jurisdiction.

On the security side, the Government has a digital certificate programme in place and manages its own digital certificate authority. It is also currently working on comprehensive privacy legislation designed to protect personal information. Such legislation is also designed to help to combat cybercrime and to protect personal information and data as it flows to, from and through the Island.

Work on data security is continuous within both the Government and the industry realms. The Island works to ensure that all parts of the local community are comfortable with technology and familiar with the importance of data

security at home, at school, and at work.

Through the Department of E-Commerce, the Bermuda Government's Ministry of Economic Development strives to, among others:

- Provide opportunities for technology education, mentoring and training, as well as encourage opportunities for education through technological means.
- Promote Bermuda as a sophisticated and security conscious technology and e-business jurisdiction, in order to continue to maintain and attract international business to Bermuda.

To further these objectives, the Department of E-Commerce supports the TechTalk initiative in conjunction with ISACA Bermuda and the Business Technology Division of the Bermuda Chamber of Commerce. This program is designed to create a forum for professionals to meet with industry leaders and exchange insights on topics that are relevant to technology governance, strategy, and risk management. The initiative, now in its second year, has partnered with regulatory authorities, government agencies, leading global organizations, professional services firms and local businesses to enable leading experts and professionals to share their knowledge on a variety of topics. Quarterly panel discussions are held and recent topics have included:

- Information/Cyber Security
- Business Continuity and Disaster Recovery
- Bring Your Own Device
- Business Intelligence/Data Analytics

Fraud and fraud investigation

Worldwide, cybercriminals are successfully targeting organizations of all sizes across all industry sectors. Recent me-

dia reports make clear that attacks are becoming increasingly sophisticated, more frequent, and their consequences more dire. The average cost of the worst single breach suffered by organizations surveyed in 2015 was \$2.28 million according to the [Information Security Breaches Survey 2015](#).

The agreement is that it's not enough to focus on defending an organisation's digital perimeter with cyber technologies such as intrusion detection and data loss prevention. Efforts should be made to mitigate the consequences of inevitable breaches which likely affect infrastructure systems and compromise key data.

An incident-response (IR) plan guides the response to related breaches. The primary objective of an IR plan is to manage a cybersecurity event of incidents in a way that limits damage, increases the confidence of external stakeholders, and reduces recovery time and costs.

A recent TechTalk, entitled *Fraud and Fraud Investigation*, gathered several experts in the area to discuss the topic:

Mathew Clingerman (MC), Managing Director – KRyS Global

Brett Henshilwood (BH), Partner, Enterprise Risk Management - Deloitte Ltd

Jeffrey Lawrence (JL), Detective Constable – Bermuda Police Services

Henry Komansky (HK), Group Head of Anti-Money Laundering - Clarien Bank Limited

Shan Senanayake (SS), President - ISACA Bermuda Chapter

From left to right: Shan Senanayake, Jeffrey Lawrence, Mathew Clingerman, Henry Komansky and Brett Henshilwood



Facilitating the event was Sheridan Smith, Director of Management Services and IT at the Bermuda Monetary Authority (the BMA). He kicked off the event by stating that computer fraud is a major threat to businesses, banks, government and individuals. Cybercrime impacts data security– and while we are fully aware that it cannot be ignored, it is always challenging to try to stay ahead of the ‘bad guys’.

How do you stay ahead of the game?

BH Through the lens of audit, staying ahead of the game means having a clear understanding of fraud risks and associated controls and analysis of the effectiveness of these controls – in particular, segregation of duties is key. For instance, changing environments -like the mergers and acquisitions activity we are currently seeing in the reinsurance sector on the Island- may create challenges for employees. These challenges can increase the risk of fraud.

JL To prevent fraud, organizations must develop a culture of honesty. It is no secret that staff take their cues from how senior management behaves, which is why this has become known as ‘setting the tone at the top’.

The agreement is that it's not enough to focus on defending an organisation's digital perimeter with cyber technologies... Efforts should be made to mitigate the consequences of inevitable breaches

How are we responding to fraud and related incidents?

MC From the asset recovery perspective, a critical element of the response is to make sure that parties are capturing and preserving relevant electronic evidence as soon after the discovery of a fraud as is practical. That should help to avoid spoliation and to reduce potential loss of important artifacts. When evidence from a third party is not provided voluntarily, particularly in an international case, it may be necessary to consider what legal avenues are available to compel the production of that information.

SS Practitioners look at timelines and electronic evidence. Increased attention is placed on detecting fraud, minimizing risks and monitoring areas of high risk. However, with so many technical controls, we cannot forget the people aspect to fraud.

What are the red flags that we should all look for?

MC People should be careful not to view any one flag as an indicator in and of itself. Often times, it is necessary to consider the picture that emerges when one examines an aggregate of indicators. Examples of this are negative results from background checks or searches of open-source intelligence, changes in key service providers, unexplained related-party transactions, and inconsistencies in information provided by a party.

BH People missing deadlines and delays in the delivery of requested data can be a red flag. Hotlines provide staff with an anonymous way of raising concerns and internal tips are still the most common source driving the discovery of fraud.

SS Subtle behaviours can also be a warning sign, like disgruntled employees and low morale.

HK Sudden changes in lifestyle eg. employees coming to work in expensive suits. Also, an unwillingness to cooperate is often a sign that something is wrong.

What can we do proactively to prevent incidences from happening?

BH Appropriate user provisioning and providing least privilege is a good starting point. Segregation of duties must also be monitored and frequently tested.

JL Internal controls are an effective tool in preventing fraud, but when these controls make it too difficult for staff to complete their work, they will develop a workaround. These workarounds are extremely susceptible to fraud and it's usually through them that fraud is committed.

Therefore, organizations need to identify where staff members are developing workarounds - and why. It is usually more productive to re-design the internal controls than to try and enforce a control that is too cumbersome.

SS Treat IT employees as regular staff with normal access. If someone has elevated privileges, they must login with the proper access ID. No group accounts should be normalized.

How do you monitor and test the effectiveness of controls?

MC Internal auditing is key. If you are not checking, then you don't know. Actual walk-throughs are necessary to get enough assurance that what is supposed to be happening is actually happening.

BH Appropriate ownership of controls must be with the right people. Often, this is a combination of the business and IT functions. Management is ultimately responsible for controls. The second line of defence would be the risk

management and compliance functions, followed by internal audit.

What should small local firms be aware of?

MC Local firms should keep in mind that when it comes to fraud and cyber-crime, protecting Bermuda's reputation is the business community's collective responsibility. An incident affecting one local firm could affect the reputation of the island as a whole. If existing or potential business don't feel that their assets and information are safe in Bermuda, they may go elsewhere.

JL From a legal perspective, firms should be aware of the difference between civil and criminal law. Criminal Law is used to punish offenders by putting them in jail or issuing fines that are paid to the government. Civil law is used by companies and individuals to recover financial losses and be compensated for damages suffered. This raises two points:

- 1) In order for the police to become involved in a fraud incident, a crime -as defined in law- must have been committed, and
- 2) The role of the Bermuda Police Service is limited to the criminal justice system. This means that our primary objective is to put offenders before the courts with an eye towards imprisonment and/or a fine; not to recover your lost assets.

BH Prevention starts from within. You cannot understate education: staff awareness programs are critical.

HK Current Bermuda laws are continuously reviewed to ensure that they provide a good framework for regulators to work with. It is better to have laws and not need to use them than to not have them when you need them.

MC Processes, controls and technology can be great assets in fraud prevention. However, exercising professional scepticism and applying common sense should not be overlooked. If something seems out of the ordinary, it is important to ask why and to obtain a fuller understanding.

SS Be mindful of senior management members who abuse their position in the organization by bypassing controls. I've seen situations where IT will not question management based on intimidation and lack of an appropriate reporting chain.

BH Management is also responsible for ensuring that third parties (trading partners, for instance, whether locally or overseas) are in line with the organization's culture.

How do you bridge the gap between business and IT controls?

BH Management needs to ensure that there is appropriate ownership, oversight and monitoring of systems in addition to IT controls. For example, database administrators can easily make major changes to data and these changes could include account numbers and passwords. It is therefore crucial that robust change management controls are in place to enable an organization to have visibility and control over changes.

SS Monitoring changes, access, and shared accounts are all essential. So it putting in place dual approvals for anything that is material. Last but not least, it is essential for an organisation to follow an appropriate chain of command between business and IT.

Closing remarks

BH Take time to thoroughly understand risks and associated controls. Test your systems frequently. Stay current and

assess how environmental factors are impacting your fraud risk ie. the economy, any mergers and acquisitions activity, any job insecurity.

HK Ask questions often. Always be sceptical. Be mindful if people are relentless.

MC Culture and training are key. Individuals cannot assume that someone else will say something. Everyone needs to take responsibility for raising concerns to the appropriate reporting officers and/or authorities if they notice suspicious behaviour.

JL Timeliness is key; accuracy gets blurred with each passing second.

SS Cutting corners will often cost an organisation dearly in the long run. Organisations must set priorities on the valuable properties and protect them appropriately. ■

Anna Chan is Membership Director at ISACA Bermuda



A new vision for management education

The AACSB is ready to be a guiding force for business schools as they navigate through the challenges and opportunities they face from new business realities,
Hanna McLeod writes

The world of business is changing—always has and always will be. Through change, global society can progress and improve the lives of the stakeholders it serves. The goal of any business—large or small, local or global—is to improve on its status quo, to move forward. Yet the discussion surrounding new business realities, demand for new skillsets and talent, elusive funding, and a questionable future seems louder than it has been during the last couple decades.

[AACSB International](#)—the premier accrediting body and thought leadership association for business schools worldwide—has been listening to these discussions for some time now and is ready to enter the ring as a guiding force for business schools as they navigate through the challenges and opportunities they face.

Over the past few years, AACSB has engaged in an effort to envision the future of business schools by better understanding the shifting roles of management and the evolving expectations of management education across the globe. This means exploring the wants, needs, and aspirations of people, economies, and societies that rely on effective and ethical business principles and processes. This visioning process will continue to be informed by stakeholders of management education and will evolve publicly through the recently launched [platform](#).

A major dimension of this process is the engagement of various stakeholder groups, including AACSB member business schools, students, other higher education/management education organizations, as well as practitioners and the business community. It is evident that in order for business schools to successfully prepare graduates to meet the changing demands and realities of the global business world, a closer intersection needs to exist between management education and practice.

A closer relationship between the two would entail building on the academic strength of business schools to connect closer with practice, while still maintaining a strong commitment to scholarship. Further, it would involve addressing the overlapping interests of individual companies, industries, and societies through partnerships focused

on knowledge creation and knowledge dissemination. As boundaries between sectors—business, government, and non-profit—continue to blur, opportunities are created for business schools to facilitate new partnerships to address social problems, not just business and management problems.

Many schools have been successful in engaging with local and global business constituents and have created invaluable programs and opportunities for students. Throughout this process, AACSB hopes to highlight such examples and inspire other schools to think beyond the traditions they may have operated under during the last decades as they address their activity within [Research and Scholarship](#), [Pedagogy and Learning](#), [Outreach and Engagement](#), and [Strategy and Administration](#).

... one goal of the Visioning Initiative is to empower business schools to move beyond conceived confines in the types of activities and initiatives they launch, and strive for ways that they can shape their role and the role of management in the societies they find themselves in

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August 07, 2015

As business schools look to the future, they must clarify their purpose by better understanding the impact they currently have and should have on society in the future. In this video, Dan LeClair discusses the visioning process.

See Video

Catalysts for Innovation to Build and Transform Global Communities

August 05, 2015

Business schools are challenged to think of their roles more broadly, beyond teaching and research, and find themselves in a unique position to be catalysts for change and innovation in order to build and transform global communities.

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Best Practices for Business Schools to Lead in Expanding Opportunities for Women in Business and to Adapt to the 21st Century Workforce

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In order to better prepare students to lead the 21st century workforce, the White House convened a meeting between senior Administration officials and business school deans. From that discussion, a list of best practices was compiled for business schools to consider within their various student support activities.

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Initiatives that have already been highlighted include a program that engages research fellows to translate business school research into shorter-read formats for the business community, a partnership between a business school and media source in delivering a global executive program, as well as the creation of an innovation hub in partnership between a business school and leading telecommunications company in order to promote entrepreneurship and small business growth in the local community.

Such examples are indicators that many business schools are already embarking on truly impactful and innovative activities, particularly through a stronger engagement with the business community. Relating to this, one goal of the Visioning Initiative is to empower business schools to move beyond conceived confines in the types of activities and initiatives they launch, and strive for ways that they can shape their role and the role of management in the societies they find themselves in.

AACSB has already made considerable efforts in better engaging business practice with management education. Stronger academic and professional cooperation is explicitly stated within the [AACSB Accreditation Standards](#), particularly within both student and faculty activities. AACSB has also engaged a Business Practices Council (BPC), comprised of members representing the public and private business sectors, as well as business schools, that represents a collaborative partnership between the academic and business communities, and that serves as an informative voice to issues of mutual interest.

Further AACSB has recently engaged with UNICON, the Executive MBA Council, and the Executive Core in a research study exploring business needs with regard to developing managerial talent to better understand the implications for business schools and their future strategies, and to better inform the business community of opportunities for better engagement with business schools for management development.

Through the Visioning Initiative, AACSB aims to expand on such collaborative input and encourage business schools to think differently about how they engage with business. Instead, the future relationship between management practice and education may be less linear. Rather than business schools serving as feeders for companies, the two can regard each other as partners for reaching desired goals and creating social impact.

Last fall, the [Business Education Jam](#)—hosted by Boston University’s Questrom School of Business and presented in collaboration with AACSB and several other organizations—engaged nearly 4,000 participants from more than 40 industries and hundreds of academic institutions around the world in 60 hours of dialogue about the future of management education. That global dialogue made evident that greater linkages between academics and industry ought to be established in order to not only prepare students for their future careers but also for business schools to thrive and enhance their value to industry and stakeholders.

AACSB continued some of the dialogue sparked at the Jam as well as in conversations with other groups with a focus on the ‘Future of Work’ during the 2015 Deans Conference in San Diego, California. The [insights and ideas](#) captured during this event continue to inform the themes and directions for a future vision of management education.

In April 2016, AACSB will celebrate 100 years of serving the business education community. During this time, the organization will reflect on the milestones that have been achieved by AACSB and, more importantly, by its member business schools as well as business practice itself. However, AACSB also will use this celebration to look ahead to the next 100 years and shape a future direction for management education worldwide. We invite you to envision the future of management education with us!

Visit www.aacsb.edu/vision

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Developing business leaders



Heider College of Business writes that it is leading the way in preparing the next generation of finance professionals through its cutting-edge curriculum

“I firmly believe that where students spend their next four years of college will determine how they spend the next forty,” states Anthony Hendrickson, PhD, Dean of the Heider College of Business at Creighton University.

Founded in 1878, Creighton is a comprehensive Catholic, Jesuit University. For 12 consecutive years, *US News & World Report* has named Creighton the Midwest’s #1 regional university. Its Heider College of Business offers award-winning programs – the graduate finance program is ranked 14th and undergraduate finance, 17th, by *US News* – to its 965 undergraduate and 400 graduate students. As a nationally ranked business school, it forms ethical leaders of business who promote social justice and improve the world.

As such, the Heider College of Business is leading the way in preparing the next generation of finance professionals through its cutting-edge curriculum, exceptionally qualified and engaged faculty, and close connection to the business community.

“Our curriculum and general pedagogy is highly linked to practitioner-based education; we not only teach theory, but students leave Creighton with ‘real-world’ business experience,” says Lee Dunham, PhD, CFA, Associate Professor of Finance. *“This idea that graduates are able to jump right into the workforce knowing how to apply the theory they learned in the classroom is what we do best.”*

The College’s CFA curriculum consciously linked to what practitioners in the finance industry deem important and thus keeps time with the innovations and evolutions of finance industry practice.

Travel courses, like the New York City travel course for senior finance and accounting students and the two-week South Africa course for business graduate and undergraduate students, immerses students in the workings of Wall Street and introduces them to the unique challenges and opportunities of business in an emerging economy. Packed with company visits, these courses help students envision their future professional lives.

Finance students also gain experiential learning opportunities at the Heider Securities Investment and Analysis Center, a state-of-the-art investment classroom equipped with 11 Bloomberg terminals and 42-foot stock ticker. Through the Center, *“students have access to highly advanced research tools that help them prepare for life on the job,”* says Randy Jorgensen, PhD, CFA, Director of the Master of Investment Management and Financial Analysis program (MIMFA).

The Center’s Bloomberg terminals allow student access to proprietary information not generally available to the public. *“To have a classroom where almost every machine is a Bloomberg terminal is extremely rare and unique,”* states Dr Jorgensen. Since Heider College students are professionally oriented, they take tutorials to establish Bloomberg competency as undergraduates.

A hallmark of a Heider education is small class sizes that allow the professors to get to know their students inside the classroom and out



The University demonstrates its confidence in its students' abilities with a unique practicum course: the Portfolio Practicum. Portfolio Practicum students manage \$5.6 million of University funds and host a Value Investing Panel during the Berkshire Hathaway Annual Meeting in Omaha, Nebraska.

Since the finance curriculum is linked to the CFP and CFA curriculum, undergraduate students, in essence, are preparing for the CFA level 1 exam throughout their undergraduate years, and graduate students gain exposure to the material through their MIMFA classes. Additionally, the department offers weekly CFA review classes and a four-day intensive boot camp, which undergraduates can take for credit. As a CFA Institute Program Partner, the Heider College offers up to 15 scholarships for CFA exams. This past year, Creighton students enjoyed an 80% pass rate for the level 1 exam compared the 42% national pass rate.

Faculty members are experts in their academic fields and bring extensive professional experience to the Heider classroom. Dr Dunham says this lends credibility to faculty teaching because they have *"walked the walk."* He had several years of work experience within banking industry before entering academia. *"To this date, I still use my many real-world examples from my time in the private sector in the classroom,"* he states.

Theories become less abstract when professors are able to offer students insight based on their own business experience.


Furthermore, the Heider College of Business has more CFA charterholders on faculty than any other university in the world, according to the CFA Institute. Dr Jorgensen believes that faculty who hold both a PhD and the CFA designation are uniquely positioned to offer students both the fundamentals of academic finance theory and how it is used in the market place.

A hallmark of a Heider education is small class sizes that allow the professors to get to know their students inside the classroom and out. Kendra Forest Nasser, BSBA '10, calls the Creighton community *"tight-knit:"* *"Each and every one of my professors knew me by name, and five years later I'm still in contact with many of them."* From extending career advice to writing letters of recommendation, her professors demonstrate how *"Creighton cares about developing the whole person, not just the academics."*

Another benefit of a Creighton education is the University's close relationship to Omaha's thriving business community. With five *Fortune 500* companies headquartered and over 50 other *Fortune 500* companies with operations in the city, Omaha is fertile ground for internships and employment opportunities. It is the number one city for paid internships, according to InternMatch, 2015. Over 6000 internship and employment opportunities are available to Heider students; most graduates have worked multiple internships upon graduation.

Nasser traces the trajectory of her entire career to the Heider College of Business: *"It's the school that developed me as a person and a professional. It's the school that landed me my first internship, my first full-time job, my second job, and acceptance into a great Masters program, and ultimately, these experiences led to me Apple"* in Cupertino, CA where she is a program manager.

“Kendra is an example of the kind of student Creighton attracts and the kind of professional the Heider College of Business forms,” says Dean Hendrickson. “Our students are uniquely prepared to face the challenges of the post-graduation professional world. They do ‘go set the world on fire,’ just as St. Ignatius calls us to do.” ■

A man in a dark suit and tie is walking on a red carpet, carrying a black briefcase. The background is a dark red color with a faint, light-colored geometric shape behind him.

Meet the 'teachsultants' and the 'coachstructors' – the future of executive education

Business schools face major challenges if they are to profit from the growth of executive education. One way, says Santiago Iñiguez, is to produce faculty with diverse and hybrid skills

One of the biggest growth opportunities for business schools is at the same time one of the biggest challenges they face: how best to provide in-company training and tailored programmes for organisations.

A number of factors are driving the growth in this particular sector of higher education.

Companies need, more than ever, to attract, retain and develop talent. Research shows that an organisation's commitment to in-house training and professional development are among the most important factors for executives when deciding to join a company, particularly in the case of the so-called millennial generation. (See *Creating Tomorrow's Leaders: the Expanding Roles of Millennials in the Workplace*; Boston College, Center for Work and Family).

In the not-too-distant future, businesses will be able to count on the most multi-generational workforce in history. For many countries, the majority of their populations will soon be aged 50 and over. Longer life expectancy and delayed retirement will provide opportunities and challenges for companies.

They will be able to draw on the experience of older managers, their network of stakeholders, their reputation and their knowledge of the sector. At the same time, a constantly changing environment will require periodic retraining, maintaining older employees' capacity to innovate, as well as having to manage diversity across generations.

The need for businesses to convert knowledge management into a differential competitive advantage links directly to the internal development of talent.

The question we need to ask ourselves is whether most business schools, and not just a few, are ready, willing and able to meet the challenge of designing and delivering tailored programmes for companies.

As things stand, at least based on what Chief Learning Officers (CLOs) have to say, the answer is 'not yet'.

CLOs say that educational content and teaching materials used in custom programmes are not properly adapted to the development and training needs of businesses. They call for less off-the-shelf, packaged, US-centric traditional MBA contents. (See UNICON, *University based executive education markets and trends*, Lloyd and Newkirk, 2011)

But the problem with developing adapted content for executive education is that research incentives at many business schools are not generally aligned with the needs of executive education.

Businesses are demanding faculty who are specialists in a wide range of subjects combined with particular skills that apply global knowledge locally. A global outlook, the quality of faculty and expertise in executive development are now crucial factors when choosing an education supplier. (See Henley Corporate Learning Survey, 2014)

But, of course, not all business schools have teachers that are properly qualified to deliver executive education courses.

A recent survey shows that the 50 top teachers taking part in custom programmes belonged to just 29 business schools. (A Carter, *Poets & Quants* 2012).

The question we need to ask ourselves is whether most business schools, and not just a few, are ready, willing and able to meet the challenge of designing and delivering tailored programmes for companies

What's more, CLOs are demanding that business schools take an approach that integrates education with a thorough knowledge of their company's strategy and development needs. What companies are increasingly calling for might best be described as educational consulting and talent development rather than training per se.

Business schools' dominance in the in-company training sector has recently been challenged by the arrival of diverse new players. For example, engineering schools and departments of psychology or international relations are already offering tailor-made programmes for companies, as are universities' continuous education and extension units.

At the same time, consultancy firms see in-company training as part of their professional services portfolio and are able to offer myriad synergies for their business units as well as the possibility of implementing their programmes in multinationals via their overseas subsidiaries.

Competition is further increasing thanks to the growing numbers of freelancers and coaches offering their services on an individual or associated basis.

Finally, companies are looking for increasingly competitive prices and shorter design and execution times at the same time as requiring programmes to fit in with participants' schedules and locations, added to which they expect deliverers to scale up their offer for larger groups when needed.

In this increasingly demanding in-company training scenario, developing talent and managing knowledge has also sparked the growth of corporate universities with increasingly sophisticated processes and structures, including external quality accreditation systems such as EFMD's CLIP (Corporate Learning Improvement System).

In response to all of the above, what initiatives can business schools come up with to take advantage of the growth of in-company training while meeting the demands of CLOs?

I would like to propose a few avenues that business schools could explore without substantially changing their mission but which might allow them to take better advantage of the opportunities in the custom programmes sector while at the same time building stronger relationships with their corporate clients.

The emergence of the “teachsultant” and the “coachstructor”

Academics with relevant research experience in the business world, experience with companies and contact with senior management are the best deliverers of in-company training.

They combine a thorough technical knowledge of their disciplines with the necessary neutrality to efficiently and independently advise companies on their training needs. To develop such profiles, business schools need to adapt their incentive systems to reward and recognise the involvement of their faculty in executive education.

Business schools may bring in teachers with practical professional experience, people who may participate in the academic community, research and teaching methodologies at schools.

The type of educator businesses are demanding might be called *teachsultants*—a hybrid of teacher and consultant—or *coachstructors*, half-coach, half-instructor. These are people able to orchestrate learning and who are capable of transcending traditional disciplines and understanding from within the decisive issues facing a company.

More than 50% of CLOs say they are unhappy with current learning measurement systems

Applied research

New ways to measure the impact of academic research on the real world are required. This means going beyond bibliometrics or article citation rates. As I have argued elsewhere, (Santiago Iñiguez de Onzoño, *The Learning Curve* London: Palgrave Macmillan, 2011) this means designing systems to measure schools' research and their use as management tools in the business world.

Ideally, this would reflect a wide range of cultural and business practices and thus the heterogeneity of the research.

Blended programmes

The future belongs to programmes that are best able to adapt to the availability of directors, integrating technology and teaching and thus prolonging the learning momentum beyond the traditional face-to-face, classroom sessions.

Integrated learning platforms, managed jointly by business schools and their corporate clients.

These would give participants access to content adapted to their needs and environment, while allowing them to interact with other directors in the company. Such platforms would also allow clients to use assessment schemes to measure personal or group learning progress.

Measuring the efficacy or impact of learning, a need not being met

I do not believe it is possible to measure investment in education in terms of ROI. In my opinion this is akin to trying to measure the impact of implementing diversity measures or business ethics on the bottom line.

More than 50% of CLOs say they are **unhappy** with current learning measurement systems.

This is a growing problem for directors, under pressure to justify the impact of any investment on the bottom line.

Currently, evaluation of the impact of in-company programmes focuses mainly on how satisfied participants are with a programme.

That said, it is possible to develop methods that allow us to measure the impact of a programme on the personal development of participants and subsequently on their performance within the company.

We are entering a fascinating period in the construction of tools based on technology that will allow us to measure better the effects of educational products on the development of directive skills and the behaviour of participants.

Multiple partnerships

Until now, business schools have been very careful about providing any information on their custom programmes. This is changing and it now seems reasonable to hope that we will see alliances between schools and consultancies, coaching networks, and application and technology and content providers.

In response to these challenges, my business school has created an alliance with the *Financial Times* Group, the [FT-IE Corporate Learning Alliance](#), a joint venture whose mission will be to combine academic muscle and direct knowledge of companies with a vocation for integrating technology and learning.

Its reach will be global and it is open to collaboration with other business schools around the world. I believe that similar platforms will appear in the coming years. ■

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