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Patrick Minford argues that the right policies will ensure a total post-Covid recovery

The limits and pitfalls of QE in emerging markets are discussed by Daniel Dăianu

Benjamin Zeeb believes that Europe needs a Plan B to thrive post-pandemic

THE GLOBAL TRADE AND FINANCE PLATFORM

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The end of time

The COVID-19 pandemic and governmental response to the virus is compounding and exacerbating threats to the global economy, including higher public debt burdens, de-globalisation and an expanding role of the state. Governments have been quick to accept the assertive and articulate campaigning of various interest groups, covering everything from climate change to transgender rights, and it seems there is a disconnect between the average man on the street and the policy-making elites around the Western world.

The last forty years of economic reform has seen a huge growth in wealth, living standards, welfare and environmental protection. To slow down or reverse this greatest period in history there is a call for sustainable development, and that this will be the sure-fire guarantee to improve living standards. We are told that the only sustainable recovery will be a Green one. The Green recovery programme promised by the likes of the EU, or other multilateral agencies or multinational corporations, boils down to a transition to a low-carbon economy to save the world from what they assure us will be an impending climate catastrophe.

No matter that the likes of India and China, committed to improving the standards of living of their citizens by the only means available, will ensure that their people have access to cheap energy and electricity powered by fossil fuels.

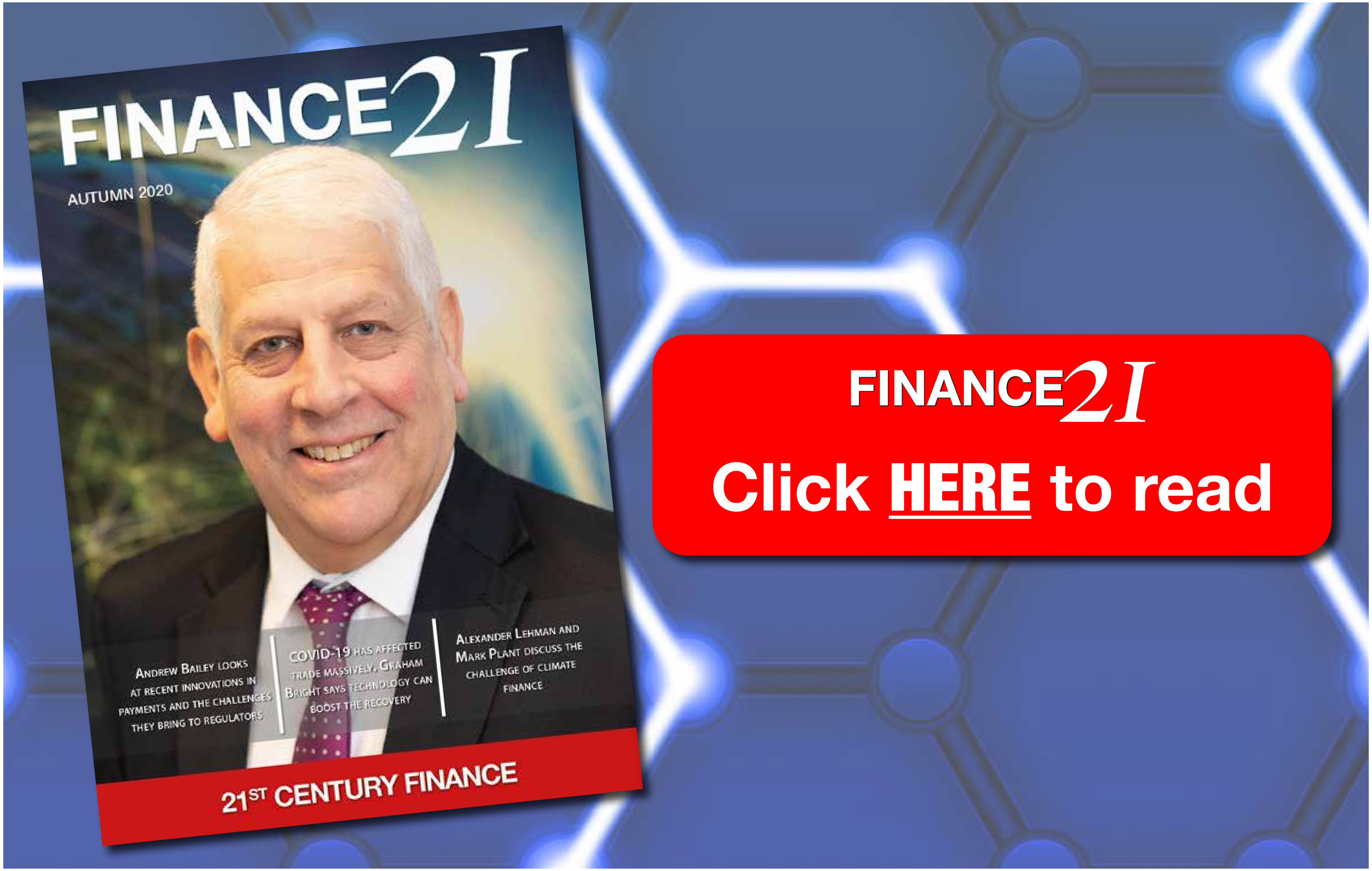
What are low-carbon technologies? Curiously, they seen to exclude nuclear energy. And as the example of California has shown, the push for renewable energy seems to have ushered in an age of 'Third-Worldism' in America's most advanced state, where residents cannot be assured of electricity 24/7. Green energy advocates propose a huge increase in the use of wind, solar power, and electric cars as part the sustainable recovery post-COVID-19.

There is no room for debate. Some might say that there is no room for facts. There is an acceptable position on mankind's influence on the climate, just as there is an acceptable position on Trump, one acceptable position on Brexit, one acceptable position on slavery, and so on, and so forth.

This is a symbol of a deeply unhealthy society, and of a political and a cultural elite that is insecure when it comes to opposition. The COVID-19 impact can be seen as an inflection point on how the global economy will operate in future decades.

Will it be a continuation of the high growth of the last forty years, with the billions of people in Africa and India reaching first world standards of living? Or will it be a dystopian future of a process of de-industrialisation, a first in modern history?

Time will tell. ■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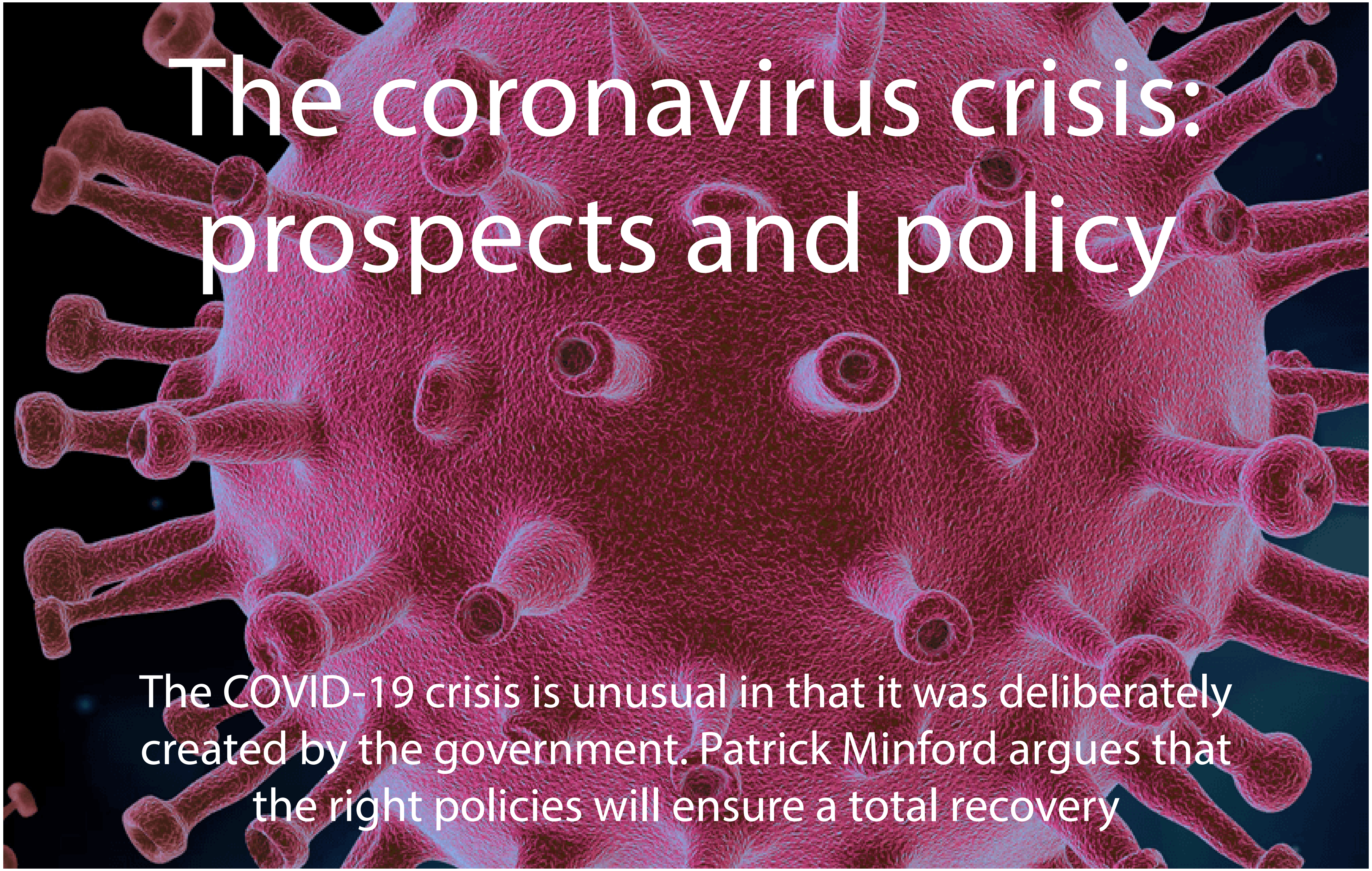


The coronavirus crisis: prospects and policy

The COVID-19 crisis is unusual in that it was deliberately created by the government. Patrick Minford argues that the right policies will ensure a total recovery

Forecasters protect themselves by being gloomy. This is because their clients want the future to be bright and will tend to act on bright forecasts. The forecasters who provide those will then be blamed if things go wrong, as the firm will have overspent assuming the best. A gloomy forecast, if things turn out better, will not be remembered in the firm's delight at events. This imparts a gloomy bias to forecasts.

The virus crisis is no exception. Yet it is an unusual crisis, in being mainly created by deliberate suppression of the economy by the government. In principle the lifting of the lockdown removes that suppression, so automatically regenerating activity.

This is quite unlike a typical recession brought on by say a commodity shortage price shock, or a consumer- or firm-led collapse in demand and confidence; in these cases the government has no control. It can try to offset these things; but its success is hard to predict.

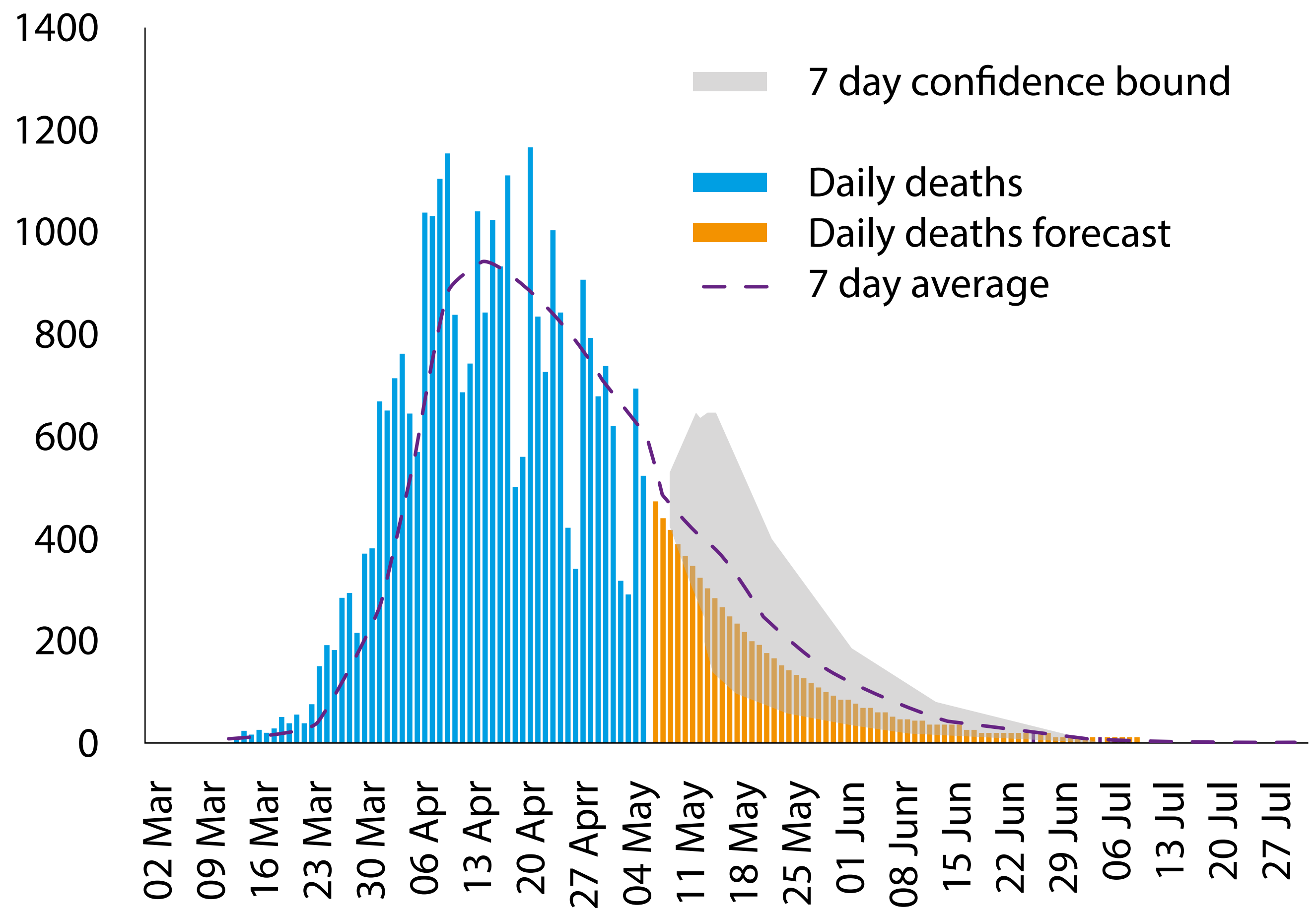
On this occasion the government can remove the cause because it is the cause. It is true that in addition people are fearful of the situation and may therefore spend less, while firms may also conserve cash.

However, much of this fear is the result of government warnings about high chances of dying from the virus. As deaths come down and lockdown easing goes ahead, these warnings should be toned down and popular sentiment will become braver, as well as more impatient of restraint.

Pre-COVID-19, people behaved robustly towards risk; but the crisis has changed that behaviour towards great timidity. This looks unlikely to last as lockdown is eased around the world and deaths continue to fall. Just as people go back to driving normally after accidents, so with attitudes to health risk as this episode winds down and the extreme alarmist forecasts of deaths prove to be false.

Our early-May forecast for COVID-19 deaths in the UK is shown below. Already daily average deaths are close to zero, as forecast. In this respect it is following the standard logistic path of an epidemic, including the effects of government and personal reactions. Our causal model of the epidemic supports this pattern.

Some forecasters build in a second bad wave of infection, starting in the autumn. However, we think this is unlikely because the fatal strains of the virus have been essentially eliminated in the first wave by the deaths of those infected.



The other damaging non-fatal strains will have been killed off by antibodies in the surviving infected. The virus strains that survive will be those that caused less antibody creation and so created weaker symptoms. The death rate per infection of the common flu is around 0.1%; this flu virus coexists with us and we do not react to outbreaks by stopping our lives.

So it will be with new waves of COVID-virus outbreak, evolutionary biology suggests. The evidence so far from countries experiencing second waves supports this view. Out of about 28 such countries, around half have succeeded in avoiding a serious second wave by using localised track/trace/isolate policies. In all second waves the death rate per reported case has fallen sharply since the peak of the first wave.

Even if there is an outbreak worse than this assumes, we assume it will be responded to not by lockdown but by these effective localised responses. This is all without assuming a vaccine or a cure - both of which are possible if unlikely things to appear soon.

It is for these reasons that our forecast is close to a V-shape for the UK economy. Q2, where the lockdown was at its most severe, has predictably seen a large drop in GDP; even within the quarter, June recovered by nearly 10%. Q3 will see a further rebound, and Q4 a yet further one.

By the end of the year the recovery will be total. What is in prospect for the UK is similar in other countries. The very latest indicators support this interpretation

By the end of the year the recovery will be total. What is in prospect for the UK is similar in other countries. The very latest indicators support this interpretation. Purchasing indices for the G7 suggest already GDP has recovered to year ago levels. This is influenced by China, where lockdown started and was lifted first. But other major economies are not far behind.

The fiscal and monetary policy response

A key element in recovery will be policy. Fiscal policy is in bail-out mode currently, issuing huge amounts of debt. Monetary policy is in massive QE expansion mode. Effectively the Bank of England is buying all the debt the government is issuing, creating a false market in gilts; the government is borrowing from itself not the market.

This QE needs to be wound down and gilts sold to the market at yields as close as possible to today's near-zero rates, to keep long term interest costs to the taxpayer as low as possible. Maturities of issued debt need to be lengthened for the same reason.

The time to do all this is in the rest of this year as recovery proceeds. The market in gilts should be able to absorb this debt; given the environment of insecurity that will prevail until the economy has fully recovered, private lenders will pay for safety.

By the end of the year this will change. Confidence will have returned and with it the huge quantity of money printed and lent out will start to fuel inflation. As we go into 2021, it will be necessary to tighten monetary conditions against this.

How fiscal policy copes with wars and other crises- and now the coronavirus

To get an understanding of how far the public finances can stretch to cope with national crises, it is helpful to look at UK debt history. The two charts below come from Martin Ellison and Andrew Scott's VoxEU article chronicling UK debt history.

One can see that twice in UK history has the market value of debt/GDP spiked: once in 1830 after the Napoleonic wars, and once in 1945 after the Second World War. The first spike was to 200% of GDP, the second to about 150% of GDP.

The chart below it is also instructive. It shows the ratio of market/par value of debt. When this is high interest rates are low, a sign that the government is in a strong position to borrow, probably because the private sector is struggling. Notice how this ratio has surged in recent years, with the financial crisis.

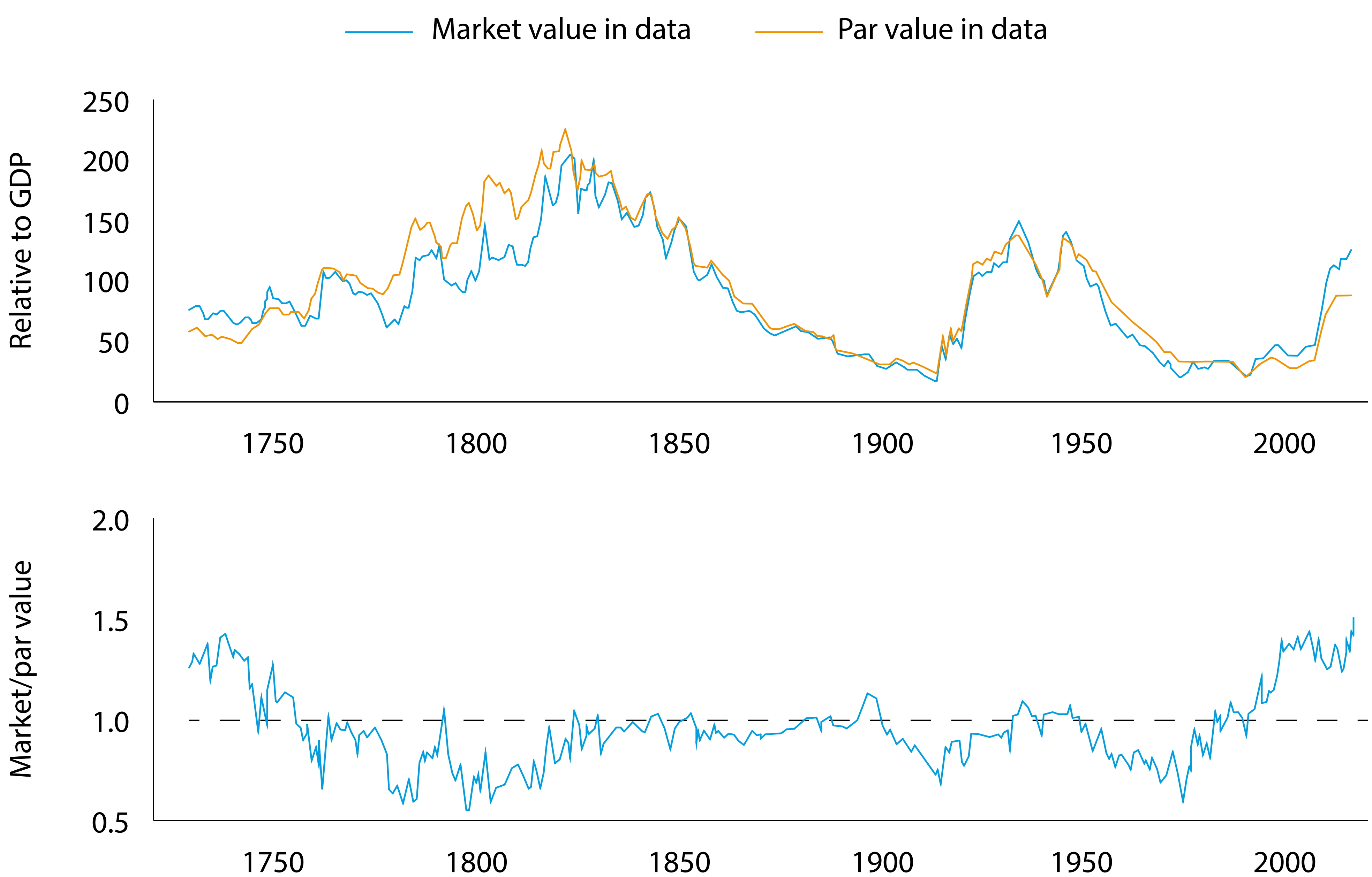
Now look at how the bond market developed as Britain borrowed in the second half of the 18th century. The market/par ratio remained at or above unity, as the government built up debt. By the early 1800s the market/par ratio had fallen sharply. The private economy was resurgent and interest rates rose, devaluing the public debt.

One can see a rather similar pattern over WWII debt. As it was accumulated during the war, the market/par ratio remained a bit below unity. By 1950, the ratio had fallen sharply; interest rates had risen as the economy recovered, devaluing the debt.

How were these huge debt ratios paid off? After Napoleon, income tax was introduced. After WWII, inflation devalued debt while also taxes were raised.

Application to the coronavirus crisis

Apply this to the coronavirus situation. With lockdown threatening a recession lasting three months or more,



Market value in data
Par value in data
Relative to GDP
250
200
150
100
50
0
1750
1800
1850
1900
1950
2000
Market/par value
2.0
1.5
1.0
0.5
1750
1800
1850
1900
1950
2000

the government support package has been put at £400 billion as a rough round number, about 20% of GDP. If lockdown were to go on for longer, as we now think it will not, that number would spiral upwards. To understand how high the number could go, we need to do some basic arithmetic on the government accounts.

National income or GDP breaks down into tax (40%) and disposable income (60%): assume that 50% accrues to non-taxpayers. Imagine now that GDP falls by 10%. This reduces tax takings by 4% of GDP, and also reduces disposable income. But as disposable income falls, the government pays tax credits (benefits) to the 50% not paying tax: assume their 50% of income falls by 5% of GDP and the tax credit rate is 80% as now promised in the government package.

Then government benefits rise by 4% of GDP. The total rise in the fiscal deficit is thus 8% of GDP when GDP falls by 10%. Now consider a lockdown lasting six months: that is half a year's GDP, a 50% fall on the year 2020 say. The resulting fiscal deficit would be 40% of GDP.

On top of the UK's existing public debt/GDP ratio of around 80%, this would take the UK ratio to over 100% of GDP, much on a par with the situation post WWII.

However, the government is greatly assisted by two interlocking factors. Interest rates today are nearly zero, with the yield on ten-year gilts around 0.4%. At the same time central banks are bound to help out during the crisis by buying gilts and printing money, keeping interest rates at this zero floor.

This implies that the government can borrow for next to nothing during the crisis and for very long maturities. But afterwards interest rates will rise as the economy recovers, and this rise will lower the repayment burden sharply.

To give an arithmetical example, with the UK government's current average debt maturity of 16 years, if the government borrowed £100 billion at today's rates of around 0.4% pa, its market value at post-crisis interest rates of say 5% pa would be only £50 billion.

This implies that future taxpayers are faced with a much reduced burden of debt to pay off: one can calculate the tax rate needed to pay the debt off as £50 billion times the new interest rate of 5%.

The longer the maturity at which the government borrows, the more favourable this arithmetic, which explains why the UK debt office has typically favoured long-maturity gilts.

Indeed, if it were to reissue all UK debt as indefinitely lasting coupon-paying perpetuities, then £100 billion of that issue would at a post-crisis interest rate of 5% fall in value to only £8 billion.

If we translate this into the need to pay off 100% debt to GDP contracted by the end of the virus crisis, it turns out the necessary tax rise is just 0.4% of GDP. This could be raised quite easily - just 1.3 pence on the standard rate of income tax.

Another way of explaining this favourable arithmetic is to focus on the interest cost of all this debt after the crisis. The 100% of GDP in debt that would have been raised and rolled over before and during the crisis would have required an interest rate of around 0.4% pa. So the interest on it that must be paid by future taxpayers is very low.

One can see from this the powers governments have as monopoly raisers of taxes and printers of money. During crises when people have nowhere else to put their savings, governments can borrow easily as the only safe deposit show in town - the taxpayer sits at their back as repayment guarantee.

Meanwhile the central bank can print money, driving down rates of return on all assets, cheapening the cost of public borrowing.

What all this implies is that a sovereign government with a reliable taxpaying public is in a powerful position to cope with the financial fall out from wars and other fiscal crises.

Nevertheless, one must remember that to have a reliable taxpaying public one must have a functioning economy. That is why the most vital need in this crisis is to find a way to get people back to work, so the economy can revive.

How to handle fiscal and monetary policy after the crisis

Now turn to the moment the economy is released from the virus lockdown and starts to recover. Some commentators, notably those who adhere to 'Modern Monetary Theory' (in fact neither modern nor a coherent theory), have argued for continued monetary and fiscal stimulus, to push the economy all the faster to normal. They have suggested that this would run no risks with inflation.

However, this is bad advice. It is true that inflation has been quiescent for a decade while there have been substantial fiscal deficits in spite of austerity programmes while money has been printed on a massive scale by central banks through their QE programmes.

Essentially highly expansionary monetary policy has failed to prevent a world of moderate deflation. Yet it was a series of mistakes made by central banks that led to this outcome.

First, they fed a credit boom in the 2000s; then as bank balance sheets weakened with rising non-performing loans, they allowed Lehman to go bankrupt, precipitating the banking crisis. After the huge consequential bailouts, when bank credit needed to expand rapidly to create recovery, central banks brought in draconian new rules for banks that stopped them lending.

Their ensuing QE programme duly failed to trigger the upsurge in bank credit and broad money that was intended. Instead it drove interest rates down to zero and drove up other asset prices.

In the aftermath of the coronavirus crisis it is vital these mistakes are not repeated.

Coming out of the crisis, the government will hold large chunks of private equity. And banks will hold large portfolios of credit in private firms that have survived the crisis. In practice the draconian regulations restraining bank credit creation will have been lifted.

To prevent a huge surge in money and credit growth, the government must sell off its private equity stakes and central banks must sell off their massive holdings of government bonds to contract the money supply. This is necessary to prevent a serious inflation from taking hold.

With the government still running fiscal deficits until the economy recovers, there will continue to be substantial fiscal stimulus. With demand surging relative to a supply still getting going, prices will rise.

Provided money is kept under control, interest rates will rise as well, and we will gradually return to a normal monetary environment, with interest rates around 5% and inflation controlled at around 2-3% in line with the targets that central banks are committed to.

The final question to be answered is: how should fiscal policy progress after the crisis? I will use the UK as my illustration, but similar principles apply in all major rich economies.

Some illustrative figures can help us with our thinking. Plainly the UK government will emerge with a large debt/GDP ratio after the crisis package has been rolled out.

Our forecasts are that it will cost £300 billion overall, on top of existing debt of around 80% of GDP (which is around £2,000 billion), which we can assume is being refinanced at current low interest rates as far as possible. That would together imply a total debt of £1,900 billion at par having been issued by the end of 2020, 95% of GDP.

Let us assume as above that this debt will be rolled over into very long maturity at current low interest rates and that by 2022 interest rates have risen to about 5%, with gradually tightening monetary conditions. This would imply that at market value debt would only be some 10% of GDP.

What we are seeing here is that debt interest being so low on the debt that was issued, its being discounted at interest rates some ten times higher than at issue, its market value is greatly reduced.

These figures reveal that 'fiscal reentry' is reasonably manageable after the crisis. There will be those that will focus on the new high nominal debt/GDP ratio and urge austerity to bring it down. But they will be missing the point, imposing short-run fiscal rules that make no long run sense in the light of the very low long run interest rates at which the public debt will have been issued.

The UK Budget after coronavirus and Brexit

No budget is yet scheduled for when the UK has left the EU at year end and the economy will have recovered from the virus recession, as we currently forecast. However, it is necessary to focus on what should be in the next set of Budget plans.

In its election manifesto the Conservative party committed itself to following a fiscal rule for balancing the current budget by 2023. While that may have made sense as a tactical election decision to create clear blue water between it and the reckless spending promises in the Labour manifesto, it creates a problem for post-Brexit fiscal policy in the current economic context.

The true cost of borrowing is now negative: in other words lenders are offering to pay the government to borrow from them. Furthermore, the reforms Brexit will bring in on trade, regulation and immigration promise faster future growth in the long term - even if most officials and the many private sector economists who backed Remain still take an opposing gloomy view.

Finally, there is a need for fiscal policy to give the economy a boost not just to put a firm end to Brexit uncertainty, but also to cut taxes to stimulate entrepreneurs, to raise essential spending on public services, and, last but not least, to push interest rates higher to a range where monetary policy can get traction again.

For all these reasons we need fiscal policy to become much more expansionary over the next decade. The tactical issue of how to square this with the manifesto commitment can in fact be dealt with quite easily, since the fiscal rules include the 'golden rule' that investment can be funded by borrowing.

What is 'public investment' is in the process of being redefined potentially in ongoing technical discussions within the government.

It has never made sense to limit it to infrastructure and other physical investment in this age where 'human capital' is ever more important: human capital is the discounted present value of people's productivity.

Much current government spending contributes to or directly creates human capital, notably the two big departments, health and education. Arguably most if not all public spending does, since its aim is to empower, train, and keep safe the country's population, so enhancing their ability to work and produce.

By redefining current spending on a par with investment spending, we can shift the focus of 'fiscal limits' to where they belong: the long-term sustainability of the plans for debt, spending and tax. In other words, are these plans consistent with solvency and the health of the long-term government balance sheet?

All these policy areas are at the heart of democratic decision-making, so to try and short-circuit decisions on them by imposing ad hoc short-termist operating rules is both lazy and damaging in the long term.

Let us therefore get back to the substantive issue of what fiscal policy should be and why. The most serious aspect of the situation we are in relates to the crisis of monetary policy, as noted above. With monetary policy powerless until interest rates get back up to normal levels where world savings do not dwarf world investment, we need a period where fiscal policy is highly expansionary, to shift the world balance back towards a savings shortage and drive up rates.

Fortunately this is the approach of the US government so far and looks likely to be that of Boris Johnson's government also. Fortunately again, there are now signs that German and so EU thinking is finally moving in this direction.

Now turn to what this Conservative government could do and the long-term prospects this could help unleash.

Our calculations suggest the government could spend or cut taxes by an extra £100 billion a year (about 5% of GDP) quite safely by borrowing more, and spreading it across personal and business tax cuts, and infrastructure spending.

According to our UK modelling, in the Liverpool supply side model of the UK, every 2% off the average tax rate, or equivalent cost reductions via public spending, gains 1% on GDP in the long run by making the economy more competitive. On this basis we could assess that this programme would raise growth by about 1% a year over the next decade and a half.

This would come on top of the gains from Brexit itself which we put at about 0.5% per annum. By achieving higher interest rates, the government would reduce the market value of its large existing, mostly long term, debt to a rather low percent of GDP as set out above.

What would this programme do to the long-term government balance sheet? By the end of the 2020 decade the debt/GDP ratio at market value would be well below today's level that is getting close to 100%, and would be around the 60% ratio usually regarded as safe. The government, with a much higher GDP, would be spending 40% of GDP on programmes including debt interest, with tax revenues running at around a higher 41%. All this is highly sustainable.

It may well seem that the aftermath of the COVID virus crisis would not be a good time to launch such a bold programme. On the contrary, such economic uncertainty needs to be confronted with a strong fiscal stance, to ensure it does not become self-reinforcing.

The government needs to scotch all talk of new taxes, pledge to underpin the economy with any necessary borrowing in the short term, and chart a new course along the lines above to unleash the economy's long run economic potential. ■

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Freedom during the COVID-19 crisis

Fleur de Beaufort and Patrick van Schie consider the measures taken to combat the pandemic and how state intervention can be reigned back

The world has been in the grip of the COVID-19 outbreak since early 2020. While initially, many aspects of the virus were still shrouded in uncertainty – with governments unable to make a sound assessment of its impact – by March, it had become clear that the world was facing a full-blown crisis.

Intensive care units rapidly filled up with patients and the medical care sector was overloaded with cases. Citizens started stockpiling en masse, and on 11 March the WHO officially characterised the COVID-19 outbreak as a pandemic.

Governments had to hastily determine which measures they needed to take to mitigate the crisis. And as the Dutch Prime Minister Mark Rutte reminded the press, they had to base their decisions on a very limited understanding of what they were actually up against. 'A veritable struggle,' as Rutte put it, that led to 'diabolical dilemmas'.

Around the world, it quickly became clear that it would be necessary to restrict people's freedom of movement in an effort to rein in the pandemic. At first, fear of the unknown virus and the mounting number of infections created widespread public support for all the emergency measures.

However, in the period that followed, we also saw new scope for reflection and criticism. Particularly now that in many countries, what has become known as 'the first wave' seems to have abated – and the associated, nation-wide panic with it – the adopted containment measures are the subject of heated debate. And almost everywhere, we can see certain groups resisting any form of intervention whatsoever.

Over the past months, different governments have also decided on radically different forms of 'crisis management'. Some governments opted for a total lockdown, during which almost every civic freedom was initially restricted in some way and citizens found in breach of regulations could count on hefty fines.

Schools and universities had to close their doors, working from home – wherever possible – became the standard, and citizens were generally expected to stay indoors as much as possible. Physical contact was kept to a bare minimum by government order, and in certain locations – nursing homes and care homes, for example – banned altogether.

The only stores allowed to stay open were those selling essential products – supermarkets, for instance. Many countries in Southern Europe adopted a total lockdown, but in Asia too, governments didn't hesitate to take the crisis as an opportunity to further strengthen their hold.

Other countries, in contrast, adopted a far less rigorous response. In some cases, in any case initially, this was due to the government underestimating the gravity of the situation – as witnessed in the US and Brazil.

One thing's for sure: sooner or later, our citizens – as taxpayers – will be footing the bill for all the funds currently being doled out – seemingly free of charge

In other cases – Sweden for example – the government consciously decided to let things run their course. While Sweden's citizens were advised to work from home wherever possible and keep travel to a minimum, its schools, hospitality venues and shops remained open. The Scandinavian country only prohibited gatherings of over 50 people, and care homes were also closed to the public.

During a press conference the Swedish Prime Minister Stefan Löfven announced that he trusted people to be responsible in their decisions. These were times, according to Löfven, when people not only needed to make sacrifices in their own interest but also for others' sake.

The Swedish government did not deem it necessary to legally enforce these sacrifices, pointing to people's personal responsibility to do the right thing.

In the meantime, the Dutch government had implemented what was known as an 'intelligent lockdown'. While this encompassed a large number of measures – a number of which were also enforced via emergency ordinances – the country consciously wasn't put into total lockdown.

Shops, for example, remained open and people working in essential occupations were allowed to drop off their children at school or childcare – albeit in limited numbers. And citizens could still relax in the outdoors – provided they continued to socially distance.

In the Netherlands too, the authorities appealed to citizens' sense of personal responsibility, although in terms of enforcement they wielded a bigger stick than their colleagues in Sweden.

Public support for the official COVID-19 policy tends to fluctuate according to the current crisis situation. In the Netherlands, for example, the government's measures initially enjoyed widespread support – in early March, many people even felt that the government could be more incisive in its response. Were we doing enough to prevent the virus from spreading? Or should we follow the example of our neighbours to the south and adopt far stricter measures?

As the country gradually brought the outbreak under control and the economic consequences of the intelligent lockdown came into sharper focus, public confidence in the government's performance as crisis manager diminished.

Reflecting on and criticising the government's handling of the corona crisis, people frequently draw comparisons with other countries. Opponents of far-reaching government intervention consistently point to Sweden as an example of how it should be done, while the media keep close tabs on this country's infection rate and death total.

A big risk of looking abroad for answers is that in many ways it amounts to comparing apples and oranges. After all, taken by themselves the COVID-19 data only tell part of the story. Other factors that play a key role in this context are the state of healthcare in the country in question (available care and, above all, IC capacity), population density, national character, etc. Aspects like these make drawing a direct comparison very difficult.

European liberals show a preference for the Swedish approach on ideological grounds. After all, citizens' individual freedoms and personal responsibility are two core values for this movement. At the same time, liberals also acknowledge the 'harm principle' as articulated by John Stuart Mill.

Over 150 years ago, the British philosopher worded this principle as follows in his work *On Liberty*: 'The only purpose for which power can be rightfully exercised over any member of a civilised community, against his will, is to prevent harm to others'.

In line with this principle, Rutte reminded the public during a press conference that one individual's freedom should not come at the expense of the other's health. In the present COVID crisis, this seems to open the door for a possible total lockdown.

After all, until we have developed a vaccine or effective treatment the potential risk of infection is such that people will continue to pose a threat to each other almost by definition. But is this actually the case? Since individual freedom is never entirely without risk, one could also make any number of other considerations.

For those who attach strong importance to individual freedom, restricting said freedom is not a step taken lightly – even during a pandemic. After all, as far as the concrete risk of infection is concerned, citizens do not all threaten their neighbours to the same degree.

A lot of people aren't infected with the virus – meaning they don't pose a threat to others. And among those who do contract it, quite a few don't suffer serious symptoms.

Moreover, greater freedom of movement for everyone does not preclude different considerations at the individual level. Anyone can decide for themselves whether they prefer to avoid large gatherings or physical contact with too many other people – or skip their annual holiday, for example.

Members of the various high-risk groups in particular will probably make different decisions than eg. young people, who feel more or less immune to this threat.

In organised societies, authorities are taking a variety of measures to minimise risks – health-related and otherwise – not least because of the impossibility of collectively bearing the possible consequences of inaction. It is vital to find the right balance in these endeavours.

Considering the number of people killed or injured in traffic accidents every year, those seeking an entirely risk-free society would be best served by far-reaching, government-imposed restrictions on road traffic. Nevertheless, no one would deem such a proposal realistic.

However, almost everyone accepts the legal requirement to wear a seat belt – a prescription that prevents numerous casualties – although this takes away the individual's freedom to make this particular risk assessment. In other words, it needs to be consistently evaluated which measures aimed at minimising a risk can still be considered proportionate.

An uncontrolled outbreak would put such pressure on the country's IC capacity that liberals will also agree to some measure of government intervention. However, the eagerness with which certain governments are seizing more power at the expense of individual freedom is unacceptable to liberals. After all, in times of crisis, individual freedom and people's individual responsibility remain as important as ever.

In the fight against COVID-19, an array of measures that reduce risk could be considered – isolating infected people, for example, protecting vulnerable groups who agree to this step, a temporary ban on large-scale public events like festivals or unnecessary travel abroad – while better safeguarding citizens' individual freedom. A freedom – and this we all understand – that will always entail some risk or other.

At first glance, this careful navigating between one person's individual freedom and risks to the other's health seems a temporary phenomenon. As soon as an effective vaccine or antiviral drug has become widely available, these deliberations will no longer be necessary.

We can return from the 'new normal' – as virologists and politicians have dubbed the current, rather inconvenient and unpleasant arrangements – to the one-and-only 'real' normal. At least, that's what you'd expect…

However, in the present public debate, quite a few people believe that we won't be going back to the way things were – or shouldn't. To start, there are those who believe that our behaviour will be structurally changed by our present forms of interaction.

This ranges from the idea that we will no longer greet each other in the same way – no more shaking hands, let alone kissing – to changes to our travel behaviour. In this outlook, we will be taking far fewer flights than we used to, for instance, which – as an added bonus – contributes to our efforts to combat the 'climate problem'.

From a historical perspective it does not seem very likely that human interaction will be structurally changed by the present crisis. After all, after previous pandemics like the plague or (as recently as the 20th century) the Spanish flu, people didn't keep more distance between them or seek each other out less often either. Human beings are highly social creatures who need to interact with others and who receive positive stimuli from these experiences.

Indeed, we can see in the present crisis how difficult it is for people – even with the threat of the virus still looming large – to keep the requisite distance. And this past summer, we saw how masses of well-to-do Europeans took a holiday abroad, viewing this as an inalienable 'right' – crisis or no crisis. Think what we like of such behaviour, the fact remains that human nature is unlikely to be changed by temporary threats like the COVID crisis.

What we could see happening is that working from home becomes a more common practice in occupations that allow for this. It will be necessary in that case to ensure that one still meets colleagues, clients, course participant and other work-related contacts face to face with some regularity.

It has become clear from the numerous Zoom sessions held over the past few months that while digital communication tools can be handy, they are also somewhat restricted. We will still have to meet each other in person every now and then. But it doesn't have to be every workday.

Now that it has become clear that employees can do a lot of work from home, we no longer have to submit to the 'daily grind' of commuting to and from the office five days a week. In this case, a change of behaviour is quite plausible because daily commutes were already considered inconvenient, due to wasted time and annoying congestion, for example.

From the very start of the COVID-19 crisis, there were also calls to grasp this pandemic as an opportunity to fundamentally change our way of life. For example, the outbreak was said to highlight the crisis that capitalism itself was going through. Or – under the motto 'never waste a good crisis' – it was seen as an opportunity to make thorough work of the 'climate problem'.

As was clear from the speed with which they were presented, these conclusions were hardly supported by a solid underlying analysis. Indeed, this call did not stem from a logical scientific inquiry into the issues at hand, but was made by a group of 'true believers' – be it in Socialism or in man's need to pay obeisance to the 'climate gods' – who latched onto the pandemic as a way to politically capitalise on their 'vindication'.

Was the pandemic caused by capitalism? Well, it actually originated in the world's foremost Communist dictatorship: the People's Republic of China. And that particular system also made things worse by attempting to cover up the outbreak for several weeks, and punishing whistle-blowers rather than giving them a fair hearing.

Is a Communist country like the PRC better able to combat the virus than a capitalist one? Well, in this respect, free China – Taiwan – has definitely outperformed its unfree counterpart on the mainland.

Nor could one say that free countries with stronger government intervention have done a better job. In Europe, countries like Italy, France and Great Britain with a nationalised system of healthcare have done worse than countries with a more mixed system.

This is not to suggest that there is a causal relationship as such, but simply that anyone who states that we will need to step up government involvement if we intend to weather the future will have to provide substantial evidence in support of this claim. For the moment, the opposite view seems to hold.

Nevertheless, one of the few structural changes that have come out of the COVID-19 pandemic seems to be increased state intervention in our economy. Across the planet, governments have come to the aid of citizens and companies with support measures large and small.

During major crises, governments need to offer temporary emergency aid. But at the same time, we have also seen how in the aftermath of the two major crises of the 20th century – the two world wars – it became next to impossible to once again dial back this extra state intervention.

While this will be applauded by some – the Socialist faithful, for instance – we fear that once we have overcome this pandemic, our societies will be continue to groan for far too long under governments that believe they can 'steer' and stimulate our economy.

One thing's for sure: sooner or later, our citizens – as taxpayers – will be footing the bill for all the funds currently being doled out – seemingly free of charge. ■

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To thrive in the post-COVID world, Europe needs a Plan B

Benjamin Zeeb considers the EU's COVID-19 rescue package and argues that government by consensus rather than majority is not the right method in times of crisis

Hailed as a bold move and new chapter in the EU's development, the COVID-19 rescue package still follows a logic that is doomed to failure. On 5 August 1943, Jean Monnet declared: *"There will be no peace in Europe, if the states are reconstituted on the basis of national sovereignty... The countries of Europe are too small to guarantee their peoples the necessary prosperity and social development. The European states must constitute themselves into a federation..."*

But after the European Defence Community failed in 1954, Monnet took on a more practical approach, aiming to gradually integrate bits and pieces of national sovereignty until little was left for the state to decide over. Some in Brussels and Europe's capitals have taken this workaround as gospel and to this day misunderstand its intention.

The Methode Monnet was always intended to be directed at a final state of European federalization. It was never intended to be an endless process of baby steps aimed at an 'ever closer union' whose realization is projected into some distant past.

Europe paradoxically has come to fully endorse Monnet's Method, without approving its goal. Like a race car driver that is fundamentally and on principle opposed to reaching the finishing line, Brussels continues to make mockery of the man it holds in such high esteem.

This same mechanism is on display in the handling of Europe's latest crisis, one that once again requires the entire continent to act, when only few are capable and even fewer willing to do so.

Yes, a common debt is a step in the right direction, but what we are witnessing now is a far cry from the Hamiltonian moment required. Government by consensus rather than majority was never a great idea. In times of crisis it can prove fatal.

It is this lack of clarity and focus, this intellectual weakness, more so than any pandemic, that presents the largest danger to the European idea and by extension its citizenry. It could not come at a more critical time.

Across Europe, advocates of liberal democracy, rule of law, equality, solidarity, and free civil society have been pushed in a defensive position. The very same individuals and organisations who had traditionally been engaged in the drive to move the continent forward are finding themselves in the trenches of a hard-fought political, cultural, and ideological clash.

Rather than moving ahead, so it seems, in many European countries the order of the day has moved to defending what has been achieved in previous decades, by previous generations.

If one wants to Europeanize executive power, this means that democratic process needs to be Europeanized as well

The classical divides between left and right, conservatism and progressivism, individualism and solidarity no longer apply. It is not only historians who are increasingly listening for the echoes of the 1920s and 30s in the speech, policies and demeanour of illiberal governments and movements around Europe.

Are we paranoid or is a second coming at hand? What if it is true that - in the words of William Butler Yeats - things are falling apart, the centre cannot hold, and a new rough beast is slouching towards Bethlehem to be born? Isn't it our responsibility then to try and kill it before it reaches its destination?

In this critical moment Europeans cannot leave politics to politicians alone. What is required is a strong civil society. This includes business and requires industry leaders to rediscover their sense of responsibility for the shared security and health of the continent.

What is happening here, too slow for many to catch on, has already happened elsewhere. And happened after business elites had failed to respond adequately to a moment in history that required more than just economic savvy.

The very same night that Donald J Trump was elected the 45th president of the United States, early trading on stock exchanges around the world saw prices plummet. The investor Carl Icahn, who was worth an approximate 20 billion dollars at the time, and a Trump supporter from the very beginning, left the election party before midnight. He went on a big shopping tour.

Unfortunately, he was only able to mobilize about one billion dollars on the quick, Icahn told the New York station Bloomberg TV later. Icahn, who would later become Trump's special advisor for economic reform, put everything he was able to scrape together into US stocks - and he turned out to be right. A year later, the S&P 500 had risen by almost a quarter.

One year later, the markets had learned their lesson. When the authoritarian right-wing populist Bolsonaro won the elections in Brazil last October, investors responded to the news with display of financial fireworks. What does this tell us about our economic culture?

At first glance it is not surprising that many business representatives shrug off the fact that Salvini is meeting with the PiS government in Poland, that Steve Bannon together with Gloria von Thurn und Taxis was mobilizing the conservative clergy against Pope Benedict, before being charged for fraudulent activities, or for that matter, that Cambridge Analytica, the dubious company that helped to win Trump the 2016 election, is also in contact with the heads of the Brexit campaign.

Populists, it seems, are good for business. But European industry, and Germans in particular, should be aware that an alternative to the post-war order is being created here. In this world, there is no room for the German business model.

All this requires a new radicalism in the strive for European unity that goes far beyond the tedious processes of the Methode Monnet.

The recent history of the European Union has shown that its members are extremely reluctant to cede sovereignty to the continental bureaucracy and until the creation of the Troika there was no governmental structure to be found anywhere in Europe that would have been worth the trouble for European federalists to even consider taking over.

Historically, nearly all political entities in Europe and elsewhere that successfully changed from authoritarian regimes or monarchies to democratically legitimated nation states achieved this by some sort of internal or external revolution.

Basically either the people took away political authority from those who had ruled them (as in France or in the US), or political authority was given to them by the victors following a conflict (as with Germany).

In nearly all cases, however, centralization had already occurred beforehand. It is hard to find cases in which stable democratic states have been established within a territory not previously consolidated.

However, European history also shows that suspending democracy, even for the briefest of moments is not a very good idea. Already Europeans don't trust the European institutions with the management of the rather mundane duties they are tasked with today.

How could we expect them to trust them with managing the fate of an entire continent? At times European elite's utterances seem to reveal the desire for a new kind of philosopher king that captures the minds of everybody walking the halls of the Berlaymont in Brussels.

Suspending national democracy is not an option until there are institutions in place and ready to take over as a functional equivalent. We cannot allow the state to crumble before we have a very clear gameplan for what comes next.

What we must push for instead is a one single and well-prepared moment of parliamentary fusion, that ensures continued representation and guarantees that democratic accountability remains in place.

This will necessitate something many dread, an element of direct democracy. Simultaneous referenda in all member states and regions of the eurozone that will determine whether or not a country or region joins the new federal Union. The new Union will then be constituted the very same moment in which two or more entities decide to join it.

A European Union that continues to rely on structures that are built from the top down, whether this affects all members at once or only a handful at a time, especially if it doesn't grant citizens the power to collectively decide on varying policy ideas, will never be stable.

If one wants to Europeanize executive power, this means that democratic process needs to be Europeanized as well. In the end, whether or not a state's citizenry is willing to make this change, should be where the line is drawn. ■

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Is BRICS past its sell-by date?

Despite increasing political differences between members, Elizabeth Sidiropoulos sees a continuing role of the BRICS as the global economy rebalances

The demise of the BRICS based on its apparent incoherence has long been predicted by pundits. But as Mark Twain observed about reports of his death being greatly exaggerated, so too the BRICS have defied the critics.

They have created BRICS institutions (the New Development Bank and the Contingency Reserve Arrangement), which serve to cement the body, and are now in their second decade. But are these institutions sufficient, and are the growing tensions among the great powers making the BRICS more necessary or less coherent? Is BRICS past its sell-by date?

When the BRIC forum met for the first time in 2009, its leaders affirmed their support for a 'more democratic and just multi-polar world order based on the rule of international law, equality, mutual respect, cooperation, coordinated action and collective decision-making of all states'. It did not expressly define itself as anti-western, although it was non-western and a Global South grouping (despite Russia's membership).

Meeting at the height of the financial crisis, which had its genesis in the US, the BRIC signalled the ambitions of rising (or re-emerging) powers to increase their voice and influence in international affairs and global governance, especially in the international financial institutions, which needed to reform to reflect the changes in the global economy.

With the addition of South Africa in 2011 the grouping could boast members from each of the world's developing regions.

The outbreak of the financial crisis in North America and Europe was a watershed moment in the power shifts that had already been evident since the turn of the century. It showed that the west was not economically invincible, nor that it had all the answers for development. The west's own rising inequality within its societies and its negative consequences for democracy seen in the rise of populism and ultra-nationalism also opened it up to critique of its own political systems.

Traditional western alliances have frayed under President Trump. A Biden presidency may help to revive them, but there is no going back to the status quo ante Trump. Since Trump became US president, the Thucydides trap looks much more likely. A rising power, China, is threatening more than ever to displace an established one, the US. And the escalating tensions between the two make conflict a possibility, even if neither wants it.

As the global power shifts begin emerging more clearly, the BRICS will continually reassess their positions and how the grouping hinders or advances their goals

Meanwhile China's Belt and Road Initiative (BRI) has grabbed the imagination of the developing world and many in Europe too – all while its campaign against the Uighurs in Xinjiang and the Hong Kong demonstrators protesting against the new security regulations show the other side of China, not the champion of economic development, but the authoritarian Chinese Communist Party that brooks no dissent.

In 2009 when the BRIC held their first summit, China still ascribed to the dictum of 'hide your strength, bide your time, never take the lead'. This changed under President Xi Jinping. The time for hiding China's strength and ambitions is over.

The truth is that BRIC(S) were always about China and the rest. The BRICS' potential political and economic importance lay in the fact that China was a member. If China was not a member, the BRICS might have been another IBSA. Over the short to medium term, China's growing global ambitions will affect how it perceives the BRICS in the hierarchy of its membership of various groupings or initiatives, such as the Shanghai Cooperation Organisation or the BRI.

Other members have also undergone significant changes. In India, Prime Minister Modi has moved closer to the US and embraced the concept of the Indo-Pacific, which is driven by an underlying objective to contain Chinese influence. Since he came to power Modi has both cultivated ties with China and not been shy to challenge it on the border, whether in the Doklam plateau in 2017, or in the Galwan Valley earlier this year.

Their differences do not necessarily mean that the two cannot cooperate inside the BRICS on issues of common interest, but if the border disputes and tensions continue to increase, the room for political consensus within the BRICS may narrow. It may also force the others to take sides.

In Brazil the new president, Jair Bolsonaro, has a strong anti-China rhetoric and an affinity for Donald Trump. Unlike his predecessors from the Workers Party, Presidents Lula da Silva and Dilma Rousseff, Bolsonaro's natural foreign policy preferences are to the west, not the Global South, even though China remains an important trading partner.

Russia, where President Putin remains firmly in power, is both threatened by China and recognises it as a necessary ally in its own rivalry with the US. One Russian scholar argued recently that China's siding with the US in the Cold War 45 years ago was 'one of the most important external factors in the defeat of the USSR'.

Russia's partnership with China would not only alter the dynamic along Russia's longest border, but could also help Russia achieve its own foreign policy goals vis-à-vis the west. Russia has long considered the BRICS as a potential anti-western grouping, an aspiration that was never really shared by the other members.

The outlier among the BRICS is South Africa. Ever since the country joined, the BRICS has been given prominence in its international relations as well as in its interdepartmental coordination at home.

Although president Zuma was replaced by President Ramaphosa in 2018, South Africa's foreign policy orientation has not changed. Relations with China in particular continue to be important as does the BRICS.

In 2019 South Africa's foreign minister, Naledi Pandor, emphasised at a BRICS meeting in New York, that the BRICS were coming together at a time 'when the international community requires an alternative narrative to global issues'.

She went on to say that the BRICS had to 'maintain our role as leaders on a path to a more balanced, representative and equitable international order'. But is the grouping what some saw it as, at the vanguard of systemic reform?

What is increasingly clear is that the BRICS don't share a common vision of what a new world order will look like, although they emphasise the importance of multilateralism. Two members, India and South Africa, are part of the Alliance for Multilateralism, which was initiated by Germany and France in 2019. None of the others are.

Earlier this year, two leading Russian scholars proposed that Russia become the guarantor of a new non-alignment and that together with the BRICS and the Shanghai Cooperation Organisation (SCO) it consider establishing a Global Alliance for Sovereignty and Diversity. Russia does not consider itself a follower, but a great power with an independent foreign policy.

As for China it is becoming increasingly clear that it no longer is concerned about diffusing its power through bodies such as the BRICS. It is growing in international confidence to project its military power and its political influence in multilateral bodies.

Furthermore, the New Development Bank was touted as a new innovative instrument that would do things differently from the traditional multilateral development banks, but its approach has been rather orthodox.

The countries have also not stepped up as a collective in the wake of the COVID-19 pandemic. Four of the five have had among the highest number of cases, and China was where the virus was identified first.

China's mask diplomacy has won kudos, but its opaqueness on the issue of debt service rescheduling for the poorest countries has been less endearing. While there were opportunities for BRICS health diplomacy outreach to developing countries, assistance was bilateral rather than collective.

The Trump presidency in the US from 2017 onwards escalated the rivalry between it and China, and this matter now occupies the international agenda, manifesting itself in the first instance through the US-China trade war which is primarily about technological supremacy.

It is how the other BRICS line up in the technology wars over 5G that will highlight the growing security differences and coherence gaps among them. India will not allow Huawei and ZTE to participate in its 5G trials.

On the other hand, there is a tension within the Brazilian administration about whether to allow them to tender. President Bolsonaro supports the US position to steer clear of Chinese companies, but Huawei has not been excluded from participating in the bidding.

South Africa has clearly set out its position that it favours Huawei, with President Ramaphosa emphasising at a 4IR conference in 2019 that *"We support a company that is going to take our country and indeed the world to better technologies, and that is 5G. We cannot afford to have our economy to be held back because of this fight [between China and the US]."* Russia has equally indicated that it is ready to cooperate with Huawei on 5G technology.

So not all the BRICS are geopolitically aligned, if their technology preferences are a proxy for the coming contest.

Yet, for each member the BRICS is useful in different ways. China still sees it as one of a number of platforms to project its influence on the global stage together with four other politically important countries in their regions. Some three years ago, before the Xiamen summit, China proposed a BRICS Plus arrangement.

In announcing this, President Xi said that BRICS was more than its current five members. Cooperation with other emerging market and developing countries was an important dimension of the BRICS. While not a formal expansion of the group, it illustrated China's strategy of developing a network of informal alliances across the developing world (but not only), as its global influence continued to rise.

Its strategy with the BRI summits fulfils a similar goal as does its membership of organisations such as the SCO. However, what is sometimes overlooked is the disquiet China's rise elicits among other Global South powers, not least those in Asia.

For Russia this informal grouping provides it with support in its tensions with the west and at least tacit support, for its own ambitions. While wary of China's rise that inevitably will make Russia a junior partner, it can still derive geopolitical advantage vis-à-vis the west through its membership, especially after it was uninvited from the G8, after the annexation of Crimea.

In South Africa's case, its increasing competition with other African countries such as Nigeria, Kenya and Ethiopia, its membership of the BRICS allows it to stand out from the rest.

South Africa has placed economic opportunities as one of the central reasons for the importance of the BRICS, but China is the dominant economic partner for South Africa, without much progress in increasing the economic links with the other three.

But what about Brazil and India? Under president Bolsonaro, the BRICS has not had much political prominence in Brazil, but it would be unlikely that it would leave it when it still has a large trading relationship with China. In India's case, the tensions with China have been there before, but its presence in the BRICS elevates its global profile. For all China's strong links to Pakistan, India's presence in the BRICS sets it apart its nemesis, sitting as it does in a forum with Pakistan's closest ally.

Therefore, for each BRICS member the grouping serves certain elements of its foreign policy. Even though China is growing in strength and power projection, an issue that not all of the BRICS are comfortable with, none of them considers this development to signal an end to the BRICS utility.

Some, like Russia, have an explicit anti-west agenda; others such as India and South Africa are proud of their Global South and democratic credentials, and do not see the world through Russia's lens, while Brazil under Bolsonaro is perhaps the most explicitly pro-western.

As the global power shifts begin emerging more clearly, the BRICS will continually reassess their positions and how the grouping hinders or advances their goals. It will be less about advancing collective action and more about instrumentalising it for individual gain. ■

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Limits and pitfalls of QE in emerging markets

Daniel Dăianu considers the use of quantitative easing to mitigate the effects of the pandemic, and argues that there are constraints for emerging markets

The pandemic caused by COVID-19 has shocked the whole world and is another huge blow to the world economy after the financial crisis that erupted in 2008. A sanitary crisis is interweaving with a very severe economic and social crisis.

Although most economies seem to have got out of the deep hole caused by The Shutdown, a steady recovery is likely to be difficult and painful, surrounded by big uncertainties and contradictory effects.

Much of economic activity is badly hit, not a few companies may not be able to survive, unemployment has been growing rapidly[1], and repair efforts will be time consuming.

In advanced economies (AEs), governments and central banks have unleashed massive support programs. In the US, for instance, the fiscal and monetary support goes beyond that seen during the Great Recession.

The Fed's intervention in markets is stunning in its depth and breadth, with its balance sheet jumping from over $4 trillion to over $7 trillion this year, and more is probably to come; even junk assets, fallen angels, are liable for acquisition.

In Europe, the ECB has extended its non-conventional operations, while a European recovery plan that amounts to €750 billion, will supplement the EU budget for the period that starts in 2021. As a novelty, the plan will be funded by the issuance of collective EU bonds. All in all, budged deficits have skyrocketed worldwide, as during war times.

Apart from the dire conditions entailed by the pandemic and the economic crisis, an intellectual context favours rising fiscal support. The apparent decline of the natural interest rates in recent decades[2] and very low inflation after the financial crisis seem to prompt governments to rethink allegedly dangerous thresholds for public indebtedness.

Kenneth Roggof and Carmen Reinhart's upper level of 90%[3] may no longer be seen as a discouraging barrier. Olivier Blanchard talks of a new normal (a new regime) for monetary policy by considering lower debt servicing costs when interest rates are inferior to economic growth rates[4], a view that is echoed by Paul Krugman[5] and others.

Kenneth Rogoff argues in favour of deeply negative policy rates as an alternative to large scale QE, which itself is a form of financial repression; he says that such a policy would be a huge blessing to EMs that are plagued by falling commodity prices, fleeing capital, high debt and weak exchange rates[6].

The crux of the matter is that QE in emerging economies can be pretty tricky and littered with pitfalls. The view that a 'silent monetary policy revolution' is taking place in emerging economies, in the sense of undertaking QE like in advanced economies is an overblown assertion

Proponents of the New Monetary Theory argue openly for monetizing fiscal deficits provided inflation is under control[7]; their line of reasoning can be bolstered by the desire to reverse very low (or declining) inflation expectations (the threat of debt deflation) and the extraordinary nature (once in a lifetime) of the coronavirus shock and the related economic and social crisis.

This is the context which made some to examine the feasibility of QE[8],the injection of base money against financial assets, even monetization of budget deficits in emerging economies/markets (EMs).

As a matter of fact, elements of QE are practiced in a series of emerging economies. In Colombia, Indonesia, Poland, Hungary, Thailand, among others, central banks do it. But the size of their programs is significantly smaller than what the Fed, BoE, the ECB and BOJ, etc[9].

Why is it so? The crux of the matter is that QE in emerging economies can be pretty tricky and littered with pitfalls. The view that a 'silent monetary policy revolution' is taking place in emerging economies, in the sense of undertaking QE like in advanced economies is an overblown assertion[10].

Where QE is done in EMs, it takes place as a sort of 'free riding' on the wave of QE in AEs, but not without limits and risks.

There are basic differences between emerging and advanced economies, which asks for caution in judging QE in the former:

- Emerging economies do not issue reserve currencies. This dents the efficacy and autonomy of monetary policy in dealing with severe shocks;

- For not a few EMs there is an issue of institutional credibility and track record in subduing inflation and deficits;

- Monetary policy, as a plus in a policy-mix framework, can be weakened by the exchange rate risk, by insufficient trust in the local currency;

- The volatility of exchange rates in emerging economies does matter, the more so where dollarization/euroization is high[11].

  A flexible exchange rate can help in correcting imbalances, but it can also do harm when a massive depreciation entails substantial wealth and balance-sheet effects, intensifies currency substitution, and may cause inflation to get out of control. A brutal drop of the local currency value can cripple financial stability;

- Local financial markets are frequently quite thin and cannot absorb large issuances of sovereign debt. The exposure limits of commercial banks to local government debt are to be considered as well;

- Although issuing debt in local currencies is preferable[12], a small size of local financial markets can force the issuance of bonds on external markets. And this creates a major vulnerability related to exchange rate dynamics.

  In addition, unless deficits are not perceived by financial markets as reasonable, their funding can be drastically limited and sudden stops can ensue;

- For the EU weaker economies, the free movement of capital can be a headache in moments of market panic.

This has been glaringly shown by substantial flow reversals during the euro area crisis, when money took a flight from South to North; or outside the euro area, when capital sought to flee new member states, which was a reason for the Vienna Initiative to be enacted in 2009;

- Sudden stops can take place in emerging markets even when global financial conditions are relatively benign;

- QE in advanced economies can induce EMs to borrow too much as hot money is searching for higher yields. And when conditions change, larger debts may find their servicing jump quite highly and turn very costly;

- It is not clear whether macropudential policies to deal with large capital inflows and outflows can be effective enough. As a matter of fact, a paradox operates here: QE in AEs may foster a temporary more benign global environment that helps ease monetary conditions in EM too.

  But this can easily turn out to be a nuisance in disguise to the extent there is much over-borrowing (like after the Great Recession) and capital flows reversals harm weaker EMs[13].

The features highlighted above indicate constraints for monetary and exchange rate polices in EMs and, consequently, for QE programs.

Emerging economies that have been quite successful in reducing dollarization/euroization of their domestic transactions, where internal and external deficits are under control, with considerable sovereign bonds issued in local currency and plentiful foreign exchange reserves, can be more daring in practicing QE.

They could also benefit on backups, such as swap and repo lines arranged with reserve currency issuers, like the Fed and the ECB. This room of manoeuvre concerns the flow of liquidity on domestic markets and preventing excessive yields demanded by foreign lenders/inevstors (via asset purchases by local central banks on secondary markets), the easing of policy rates and of overall monetary conditions when interest rates fall in the global economy.

But QE and monetization of deficits are fraught with major risks wherever deficits are large, external debts are considerable, and trust in the local currency is not sufficient.

The case of EMs in the EU deserves attention for some of them have undertaken parts of QE. Among new member states which joined the EU in 2004 and 2007, Poland has announced a QE program that could go up to 5-6% of GDP this year, while the budget deficit could reach more than 8% of GDP. Hungary has a significantly smaller QE program as the budget support for its economy relies extensively on guarantees.

Both these countries have started the war against the COVID-19 pandemic with much smaller domestic and external imbalances and significantly lower euroization of the financial system than Romania. The Czech Republic is quite a peculiar case for the high trust the crown enjoys among its citizen. Sovereign ratings illustrate macroeconomic situations[14], and the cost of issuing debt is indicative of national economic circumstances.

Thus, Romania pays almost double for issuing debt in local and external markets, as compared to Hungary and Poland, not to mention the Czech Republic; CDS term premia are also telling in this regard. Hungary and Romania have repo arrangements with the ECB, whereas Bulgaria and Croatia benefit on swap lines as they entered ERM2 in June this year.

These arrangements are a plus in dealing with possible liquidity squeezes in financial markets. The EU budget funds, together with the European recovery plan, help considerably the fight against COVID-19 and economic reconstruction.

Yield differentials for sovereign bonds and CDS term premia show that markets discriminate among EM, despite the easing of monetary and financial conditions worldwide.

Therefore, caution must operate when contemplating dealing with the pandemic and the economic crisis by resorting to large fiscal stimuli and aggressive easing of monetary policy, to QE and monetization of deficits. The countries that have fiscal space can be more daring in this regard, but not without caution.

In the EU, fiscal rules are temporarily suspended, but markets do discriminate and judge economies according to their robustness, the capacity to absorb shocks, whether backups (as safety nets) are available.

In the euro area, the debt servicing costs for more fragile economies hinge basically on the ECB support, which has saved the single currency via its unconventional operations, including QE. In the global economy, instead, there is no automatic support, in spite of massive operations undertaken by the IMF to support emerging and poor economies.

In the Romanian case, the issue is not the stock of public debt, that was cca. 35% of GDP last year. It is a flow problem, that is rooted in a large structural deficit (above 4% of GDP at the start of 2019) and big pressures to increase permanent public budget expenditure while fiscal revenues are pathetically low (cca. 27% of GDP); there is also a twin deficit problem involved here.

This creates a big policy conundrum since, on one hand, the room of manoeuvre to combat the pandemic is severely curtailed and, on the other hand, there can be considerable depreciation pressures on the exchange rate which enhance inflationary expectations (as the pass-through effect is non-trivial).

A significant rise in permanent budget expenditure would worsen even more the structural budget deficit, it would imperil Romania's investment grade rating and entail a significant rise in the cost of debt service, in the public debt[15].

This would invalidate a key assumption of the new normal for monetary policy in the Blanchard logic (see footnote 3), namely a low interest rate (r) level. And if the economic growth rate (g) falls significantly, apart from an allegedly temporary impact of the pandemic[16], and in conjunction with a sizeable primary (and structural) budget deficit, one ends up with a reinforced invalidation: while (g) comes down, (r) goes up when the primary deficit is considerable and on the rise.

A correction of macroeconomic imbalances has to be undertaken in Romania in the next few years, which will be a pretty tough operation in view of the impact of the sanitary and economic crisis. This situation explains why the Romanian central bank cannot be as aggressive in reducing its policy rate as its peers in the Region, and why it cannot embark on a QE program per se[17].

For it may undermine the trust in and trigger a run on the local currency, ultimately damaging financial stability. If markets would perceive that there is monetization of the budget deficit on a large scale, a crisis of the local currency would be quite inevitable.

The correction of the large structural budget deficit, be it done gradually (so that it does not cripple a tenuous economic recovery after the lockdown) has, therefore, to play a critical role in reducing macroeconomic imbalances. This correction can be much facilitated by EU funds that can uphold public expenditure and help fund external deficits.

Is financial repression the exit out of the current situation with rapidly growing public debt worldwide, as Carmen Reinhart and Sbrancia suggested by referring to the second world war period and its aftermath in the US and Europe?[18] Prima facie, this seems to be the case in view of the staggering rise in public and private debts following the financial crisis and, currently, because of the pandemic.

QE is a form of financial repression as governments try to control the yield curve by purchasing sovereign bonds (and, thereby, by reducing the cost of budget funding) and other financial assets, by going beyond what can be seen as market-making (repair) in periods of distress. But even in AEs financial repression may be difficult to achieve when inflation is very low, which would imply negative nominal interest rates.

And how sustainable are negative interest rates over the longer term is an open question, although Japan provides food for thought in this respect (as well as to the secular stagnation thesis, the Japanization syndrome).

In some new member states, which have experienced labour markets strains for years now (due to massive labour emigration), where the Balassa-Samuelson effect may be larger than some suspect, and where exchange rate dynamics have probably also played a role, inflation is quite considerable – between 3-4% lately in Hungary, Poland, Romania, etc.

When inflation is substantial and currency substitution is an issue, capping interest rates may be risky. The bottom line is that rapidly increasing public debts should not leave us unnerved, be the natural interest rate much lower than a few decades ago[19].

QE may have merits as a means to avoid a lasting depression and, in the euro area having helped to save it, but it is unclear whether it can be the final solution to debt sustainability.

Some may argue that nothing seems to be like before, that economics enters a new 'stage' and that old tools are no longer reliable, that emerging economies should do whatever advanced economies do policy-making-wise. But this is hardly a convincing argument.

The size of public and private debts and of structural deficits do matter, as do economic fundamentals, degrees of wealth and robustness (vs. fragility), policy track records, availability of backups and 'friendly' neighbours, or membership in clubs like the EU and the euro area.

Balance of payments crises will not disappear, and defaults will continue to take place, especially among EMs. Sudden stops can also occur. This is why caution is warranted in EMs in trying to mimic QE as practiced by AEs. For emerging economies, there are limits and pitfalls in undertaking QE[20].

As Agustin Carsten put it, *"fiscal sustainability should be assured, otherwise perceptions may arise that debt can be inflated away"*...and *"crossing the traditional boundaries between fiscal and monetary polices, are only feasible for central banks in advanced economies with high credibility stemming from a long track record of stability-oriented policies."*[21]

A final thought on QE: QE may be useful, indispensable, wherever avoiding a collapse of economies (of financial sectors) is aimed at. But to claim that this is the way to remake the toolbox of central banks radically, for the long haul, is a bold statement.

As a matter of fact, QE is more like 'kicking the can down the road', and it reflects, arguably, an inability to tackle fundamental issues related to resource allocation[22], taming the global financial cycle, over-financialization of economies and feeble restructuring (zombification of many parts of economies), increasing income inequality, etc.

If this is the case, QE in EMs cannot be but a pale side of this state of affairs and can, in no way be an actual breakthrough in policy making.

Moreover, QE, as sort of prolonged crisis management component of monetary policy, has to be examined in a deeper sense: how economies can be remade in order to become more robust/resilient, more inclusive and fair, with an overhauled financial sector that should cater more to the needs of the real economy, antitrust laws that impede abusive concentration of market power, effective fight against tax evasion and avoidance, revamped tax systems that are more equitable, reinstating a sense of genuine ethical conduct in the corporate world, combating climate change which has become an existential threat to mankind, and avoiding a complete collapse of multilateral arrangements in the global economy. ■

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Endnotes

1. An acute social problematique is unfolding, that will be reinforced as temporary relief measures for jobless workers will end. 'Kurzarbeit' type schemes may not be sufficient to mitigate the social impact of this crisis (see also Carmen Reinhart and Vincent Reinhart, "The Pandemic Depression. The Global Economy will Never Be the Same", Foreign Affairs, September/October, 2020). This explains why some countries (Finland, Germany, etc) experiment with minimum guaranteed incomes. The social dimension of the Covid-19 crisis is recurrently highlighted by the managing director of the IMF, Kristalina Georgieva; this dimension should be examined in relation with an ever more skewed income distribution in recent decades, the erosion of the middle class, the declining power of labour (see Anna Stansbury and Lawrence Summers, "The declining worker power hypothesis", NBER Working Papers No.27193, May 2020), declining social inclusiveness, the impact of artificial intelligence. In poor countries things will get ever worse because of the crisis, and IFIs and the international community need to step in to prevent sovereign debt crises in a row (see also Joseph Stiglitz and Hamid Rashid, "How to prevent the looming sovereign debt crisis", Project Syndicate, 31 July, 2020).

2. Mervyn King and David Low, "Measuring the World Real Interest Rate", NBER Working Paper, No.19887, 2014; Kathryn Holston, Thomas Laubach and John Williams, "Measuring the Natural Interest Rate: International Trends and Developments", Journal of International Economics, 108, January 2017 (by using the model used by Thomas Laubach and John Williams (2003) they show that the rate seems to have fallen close to zero in the US during the financial crisis and stayed there since 2016); Rachel Lukasz and Thomas Smith, "Secular drivers of the global interest rate", BoE, Staff WPs No.571, 2015. See also Larry Summers on secular stagnation, "Reflections on the New Secular Stagnation Hypothesis", in C Teulings and R. Baldwin, "Secular stagnation: facts, causes and cures", VoxEU.org EBook, CEPR Press

3. Kenneth Rogoff and Carmen Reinhart, "This Time is Different. Eight Centuries of Financial Follies", Princeton University Press, Princeton, 2011

4. Olivier Blanchard, "Public Debt and Low Interest Rates", American Economic Review, 109(4): 1197-229. Basically, the argument is that when economic growth rates are higher than interest rates, governments can run primary deficits without endangering the state of public finance and welfare as long as public debt as a share of GDP stabilizes; this can be summed up as (r – g) being negative, where (r) is the interest rate and (g) is the economic growth rate (both rates can be in nominal, or real terms). See also O Blanchard, A Leandro, and J Zettelmeyer, "Revisiting the EU fiscal framework in an era of low interest rates", 30 January, 2020. For a much less sanguine view on this scenario see Charles Wiplosz, "Olivier in Wonderland", CEPR, VoxEU, 17 June 2020

5. Paul Krugman, "The Case for Permanent Stimulus", VoxEu, 10 May 2020

6. Kenneth Rogoff, "The Case for Deeply Negative Interest Rates, Project Syndicate, 4 May, 2020

7. William Mitchell, Randall Wray and Martin Watts, "Macroeconomics", London, Red Books, 2019. See also N Gregory Mankiw, "A Skeptic's Guide to Modern Monetary Theory", American Economic Review, May, 2020, pp.141-45

8. QE is not to be equated with normal capital markets operations, as they take place in EMs as well.

9. An IMF document says that "Among the 81 economies classified as EMs, 55 took measures to support financial markets during the COVID-19 pandemic…as central banks aimed at easing pressures in short-term funding markets. However, EMs intervened more in FX markets than AEs reflecting partial dollarization and capital outflows. EMs seldom intervened in securities markets, reflecting the bank-centric nature of their financial systems" ("Central Bank Support to Financial Markets in the Coronavirus Pandemic", IMF, MCMCO, 2020, p.6)

10. Piroska Nagy-Mohacsi, "The Quiet Revolution in Emerging Market Monetary Policy", Project Syndicate, 18 August, 2020

11. Agustin Carstens , the head of BIS, notices that "…emerging market economies have a quasi-managed floating exchange rate regimes where central banks lean against swings in the exchange rate, both on the way up and on the way down….this approach is one where the practice outruns the theory and it is arguably the theory that needs to catch up".

This is because "…the behavior of the exchange rate can fundamentally affect the dynamics of inflation and the capacity of monetary policy to produce the expected results"(Exchange rates and monetary policy frameworks in emerging market economies", Lecture at the London School of Economics, London, 2 May 2029

12. But even issuing debt in the local currency and selling it to non-resident investors can create an implicit debt-rollover risk", named as the original sin 2.0." During periods of higher risk aversion, when local currencies are under pressure and domestic assets are sold off, foreign investors are likely to reduce their exposure and might not roll over maturing positions("Managing volatile capital flows in emerging and frontier markets", Reinout De Bock et.al. VoxEu, 19 August 2020).

13. Andrea Presbitero and Ursula Wiriadinata rightly argue that although interest rate-growth differentials (r – g) have turned negative in many countries, which may facilitate fiscal expansions, there can also be (r-g) reversals when public debts grow massively and much of these debts are denominated in foreign currencies. Clearly, the specter of substantial currency depreciation, the exchange rate risk, is involved in such dynamics ("The risks of high public debt despite a low interest rate environment", VoxEU, 5 August 2020).

14. The Czech Republic has AA-, Poland has A-, Hungary has BBB, while Romania is rated BBB- by S&P.

15. Eurostat figures show that, before the pandemic struck, Romania was the only EU member state where public debt as a share of GDP was rapidly growing in the absence of fiscal consolidation measures: from cca 35% in 2019 to 62,3% in 2025 and to 91,2% in 2030 ("Debt Sustainability Monitor 2019", European Commission, Brussels.

16. More likely is that the COVID-19 crisis and the related economic and social crisis will reduce potential economic growth in most economies.

17. As a matter of fact, the NBR has become a net creditor of the banking sector since March this year, via irreversible operations as a means to stem depreciation pressures on the Leu (the local currency). But the loss of net foreign assets could not continue indefinitely, which shows why fiscal consolidation is a must in the not too distant future.

18. Carmen Reinhart and M Belen Sbrancia, "The Liquidation of Government Debt", IMF Working Paper, January 7, 2015

19. See also Anne O Krueger, "Financial Repression Revisited?", Project Syndicate, 20 August 2020

20. "QE appears to be a viable macroeconomic policy response to COVID-19 for countries with a credible institutional framework in which the central bank operates a floating exchange rate regime and the sovereign issues debt in its own currency" (G Benigno, J Hartley, A Garcia-Ferrero, E Ribakova, "Credible emerging market central banks could embrace QE to fight COVID-19", VoxEu, 29 June, 2020. But this assertion has to be qualified when structural deficits are large and currency substitution is significant (the issue of trust in the local currency).
"When hit by a crisis, economies with less credible monetary frameworks and weaker fundamentals my find themselves between a rock and a hard place. Capital outflows can put heavy pressure on the exchange rate, with the twin risks of a disorderly adjustment (currency crisis) and a persistent upsurge in prices (if inflation expectations are poorly anchored and pass through from the exchange rate is high"(Gaston Gelos, Umang Rawat and Hanqing Ye, "'COVID-19 in emerging markets: Escaping the monetary policy procyclicality trap", VoEU, 20 August 2020.
21. Agustin Carstens, "Countering Covid-19: The nature of central banks' policy response", BIS Speech, Zurich, 27 May 2020
22. As BIS experts stress, The Great Moderation years hid huge resource misallocation (Jaime Caruana, "Stepping out of the shadow of the crisis: three transitions for the world economy", BIS Speech, 29 June, 2014). Overburdened monetary policies during the past decade can be compared with monetary policies in post-command economies. Following the collapse of the command system and a dramatic change in relative prices, many enterprises became unprofitable. Massive and rapid resource reallocation was impossible. Thence the need to subsidize firms and even sectors involving monetization of quasi-fiscal deficits. Firms themselves created an own pseudo-money via inter-enterprise arrears (Daniel Daianu, "Inter-enterprise arrears in post-command economies, IMF Working Papers, 74, 1994 and "Resource misallocation and strain. Explaining shocks in post-command economies", William Davidson Institute WP, No.96, 1997)". The quasi-fiscal task of central banks during the initial stage of post-command transition is to be compared with QE practiced by major central banks in advanced economies – where a similar fiscal dominance takes center stage. But inflation is very low in AEs, whereas money printing after price liberalization in post-command economies created high inflation (after years of suppressed inflation and considerable money balances). This is due to an overwhelming liquidity trap and low inflation expectations.

Building the world we want to live in

Ursula von der Leyen presents her vision for a Europe that emerges stronger from the pandemic and leads the way towards a new vitality in a world of fragility

One of the most courageous minds of our times, Andrei Sakharov – a man so admired by this House - always spoke of his unshakeable belief in the hidden strength of the human spirit. In these last six months, Europeans have shown how strong that human spirit really is.

We saw it in the care workers who moved into nursing homes to look after the ill and the elderly. In the doctors and nurses who became family members for those in their last breath. In the front-line workers who worked day after night, week after week, who took risks so most of us didn't have to. We are inspired by their empathy, bravery and sense of duty – and I want to start this speech by paying tribute to them all. Their stories also reveal a lot about the state of our world and the state of our Union.

They show the power of humanity and the sense of mourning which will live long in our society. And they expose to us the fragility all around us. A virus a thousand times smaller than a grain of sand exposed how delicate life can be. It laid bare the strains on our health systems and the limits of a model that values wealth above wellbeing.

It brought into sharper focus the planetary fragility that we see every day through melting glaciers, burning forests and now through global pandemics. It changed the very way we behave and communicate – keeping our arms at length, our faces behind masks.

It showed us just how fragile our community of values really is – and how quickly it can be called into question around the world and even here in our Union.

But people want to move out of this corona world, out of this fragility, out of uncertainty. They are ready for change and they are ready to move on. And this is the moment for Europe.

The moment for Europe to lead the way from this fragility towards a new vitality. And this is what I want to talk about today.

I say this because in the last months we have rediscovered the value of what we hold in common. As individuals, we have all sacrificed a piece of our personal liberty for the safety of others. And as a Union, we all shared a part of our sovereignty for the common good.

We turned fear and division between member states into confidence in our Union. We showed what is possible when we trust each other and trust our European institutions. And with all of that, we choose to not only repair and recover for the here and now, but to shape a better way of living for the world of tomorrow.

For me, it is crystal clear – we need to build a stronger European Health Union. And to start making this a reality, we must now draw the first lessons from the health crisis

This is NextGenerationEU. This is our opportunity to make change happen by design – not by disaster or by diktat from others in the world. To emerge stronger by creating opportunities for the world of tomorrow and not just building contingencies for the world of yesterday.

We have everything we need to make this happen. We have shaken off the old excuses and home comforts that have always held us back. We have the vision, we have the plan, we have the investment. It is now time to get to work.

I have sent a Letter of Intent to President Sassoli and Chancellor Merkel – on behalf of the German Presidency - outlining the Commission's plans for the year ahead. I will not present every initiative, but I want to touch on what our Union must focus on in the next twelve months.

Pulling through together: making good on Europe's promise

The people of Europe are still suffering. It is a period of profound anxiety for millions who are concerned about the health of their families, the future of their jobs or simply just getting through until the end of the month.

The pandemic – and the uncertainty that goes with it – is not over. And the recovery is still in its early stage. So our first priority is to pull each other through this. To be there for those that need it. And thanks to our unique social market economy, Europe can do just that.

It is above all a human economy that protects us against the great risks of life - illness, ill-fortune, unemployment or poverty. It offers stability and helps us better absorb shocks. It creates opportunity and prosperity by promoting innovation, growth and fair competition.

Never before has that enduring promise of protection, stability and opportunity been more important than it is today. Allow me to explain why.

First, Europe must continue to protect lives and livelihoods. This is all the more important in the middle of a pandemic that shows no signs of running out of steam or intensity.

We know how quickly numbers can spiral out of control. So we must continue to handle this pandemic with extreme care, responsibility and unity.

In the last six months, our health systems and workers have produced miracles. Every country has worked to do its best for its citizens. And Europe has done more together than ever before.

When member states closed borders, we created green lanes for goods. When more than 600,000 European citizens were stranded all over the world, the EU brought them home. When some countries introduced export bans for critical medical goods, we stopped that and ensured that critical medical supply could go where it was needed.

We worked with European industry to increase the production of masks, gloves, tests and ventilators. Our Civil Protection Mechanism ensured that doctors from Romania could treat patients in Italy or that Latvia could send masks to its Baltic neighbours. And we achieved this without having full competences.

For me, it is crystal clear – we need to build a stronger European Health Union. And to start making this a reality, we must now draw the first lessons from the health crisis.

We need to make our new EU4Health programme future proof. This is why I had proposed to increase funding and I am grateful that this Parliament is ready to fight for more funding and remedy the cuts made by the European Council.

And we need to strengthen our crisis preparedness and management of cross-border health threats. As a first step, we will propose to reinforce and empower the European Medicines Agency and ECDC – our centre for disease prevention and control.

As a second step, we will build a European BARDA – an agency for biomedical advanced research and development. This new agency will support our capacity and readiness to respond to cross-border threats and emergencies – whether of natural or deliberate origin. We need strategic stockpiling to address supply chain dependencies, notably for pharmaceutical products.

As a third step, it is clearer than ever that we must discuss the question of health competences. And I think this is a noble and urgent task for the Conference on the Future of Europe.

And because this was a global crisis, we need to learn the global lessons. This is why, along with Prime Minister Conte and the Italian G20 Presidency, I will convene a Global Health Summit next year in Italy. This will show Europeans that our Union is there to protect all.

And this is exactly what we have done when it comes to workers. When I took office, I vowed to create an instrument to protect workers and businesses from external shocks. Because I knew from my experience as a Minister for Labour and Social Affairs that these schemes work. They keep people in jobs, skills in companies and SMEs in business. These SMEs are the motor of our economy and will be the engine of our recovery.

This is why the Commission created the SURE programme. And I want to thank this House for working on it in record time. If Europe has so far avoided mass unemployment seen elsewhere, it is thanks in large part to the fact that around 40 million people applied for short-time work schemes.

This speed and unity of purpose means that 16 countries will soon receive almost €90 billion from SURE to support workers and companies. From Lithuania to Spain, it will give peace of mind to families who need that income to put food on the table or to pay the rent. And it will help protect millions of jobs, incomes and companies right across our Union.

This is real European solidarity in action. And it reflects the fact that in our Union the dignity of work must be sacred. But the truth is that for too many people, work no longer pays.

Dumping wages destroys the dignity of work, penalises the entrepreneur who pays decent wages and distorts fair competition in the Single Market. This is why the Commission will put forward a legal proposal to support member states to set up a framework for minimum wages. Everyone must have access to minimum wages either through collective agreements or through statutory minimum wages.

I am a strong advocate of collective bargaining and the proposal will fully respect national competencies and traditions. We have seen in many member states how a well-negotiated minimum wage secures jobs and creates fairness – both for workers and for the companies who really value them. Minimum wages work – and it is time that work paid.

The second promise of the social market economy is that of stability. The European Union and its member states responded to an unprecedented crisis with an unprecedented response. By showing it was united and up to the task, Europe provided the stability our economies needed.

The Commission immediately triggered the general escape clause for the first time in our history. We flexibilised our European funds and state aid rules, authorising more than €3 trillion in support to companies and industry: from fishermen in Croatia and farmers in Greece, to SMEs in Italy and freelancers in Denmark.

The European Central Bank took decisive action through its PEPP programme. The Commission proposed NextGenerationEU and a revamped budget in record time. It combines investment with much needed reforms. The Council endorsed it in record time. This House is working towards voting on it with maximum speed.

For the first time – and for exceptional times - Europe has put in place its own common tools to complement national fiscal stabilisers. This is a remarkable moment of unity for our Union. This is an achievement that we should take collective pride in.

Now is the time to hold our course. We have all seen the forecasts. We can expect our economies to start moving again after a 12% drop in GDP in the second quarter. But as the virus lingers so does the uncertainty – here in Europe and around the world. So this is definitely not the time to withdraw support.

Our economies need continued policy support and a delicate balance will need to be struck between providing financial support and ensuring fiscal sustainability. In the longer-term there is no greater way to stability and competitiveness than through a stronger Economic and Monetary Union. Confidence in the euro has never been stronger.

The historic agreement on NextGenerationEU shows the political backing that it has. We must now use this opportunity to make structural reforms in our economies and complete the Capital Markets Union and the Banking Union.

Deep and liquid capital markets are essential to give businesses access to the finance they need to grow and invest in recovery and in the future. And they are also a pre-requisite to further strengthen the international role of the euro. So let's get to work and finally complete this generational project.

The third enduring promise is the promise of opportunity. The pandemic reminded us of many things we may have forgotten or taken for granted. We were reminded how linked our economies are and how crucial a fully functioning Single Market is to our prosperity and the way we do things.

The Single Market is all about opportunity - for a consumer to get value for money, a company to sell anywhere in Europe and for industry to drive its global competitiveness. And for all of us, it is about the opportunity to make the most of the freedoms we cherish as Europeans.

It gives our companies the scale they need to prosper and is a safe haven for them in times of trouble. We rely on it every day to make our lives easier – and it is critical for managing the crisis and recovering our strength. Let's give it a boost.

We must tear down the barriers of the Single Market. We must cut red tape. We must step up implementation and enforcement. And we must restore the four freedoms – in full and as fast as possible.

The linchpin of this is a fully functioning Schengen area of free movement. We will work with Parliament and member states to bring this high up our political agenda and we will propose a new strategy for the future of Schengen.

Based on this strong internal market, the European industry has long powered our economy, providing a stable living for millions and creating the social hubs around which our communities are built.

We presented our new industry strategy in March to ensure industry could lead the twin green and digital transition. The last six months have only accelerated that transformation – at a time when the global competitive landscape is fundamentally changing. This is why we will update our industry strategy in the first half of next year and adapt our competition framework which should also keep pace.

Propelling Europe forward: building the world we want to live in

All of this will ensure Europe gets back to its feet. But as we pull through together, we must also propel ourselves forwards to the world of tomorrow.

There is no more urgent need for acceleration than when it comes to the future of our fragile planet. While much of the world's activity froze during lockdowns and shutdowns, the planet continued to get dangerously hotter.

We see it all around us: from homes evacuated due to glacier collapse on the Mont Blanc, to fires burning through Oregon, to crops destroyed in Romania by the most severe drought in decades.

But we also saw nature come back into our lives. We longed for green spaces and cleaner air for our mental health and our physical wellbeing. We know change is needed – and we also know it is possible.

The European Green Deal is our blueprint to make that transformation. At the heart of it is our mission to become the first climate-neutral continent by 2050.

But we will not get there with the status quo – we need to go faster and do things better. We looked in-depth at every sector to see how fast we could go and how to do it in a responsible, evidence-based way. We held a wide public consultation and conducted an extensive impact assessment.

On this basis, the European Commission is proposing to increase the 2030 target for emission reduction to at least 55%. I recognise that this increase from 40 to 55 is too much for some, and not enough for others.

But our impact assessment clearly shows that our economy and industry can manage this. And they want it too. Recently 170 business leaders and investors – from SME's to some of the world's biggest companies - wrote to me calling on Europe to set a target of at least 55%.

Our impact assessment clearly shows that meeting this target would put the EU firmly on track for climate neutrality by 2050 and for meeting our Paris Agreement obligations. And if others follow our lead, the world will be able to keep warming below 1.5 degrees Celsius.

I am fully aware that many of our partners are far away from that – and I will come back to the Carbon Border Adjustment Mechanism later. But for us, the 2030 target is ambitious, achievable, and beneficial for Europe.

We can do it. We have already shown we can do it. While emissions dropped 25% since 1990, our economy grew by more than 60%. The difference is we now have more technology, more expertise and more investment. And we are already embarking towards a circular economy with carbon neutral production.

We have more young people pushing for change. We have more proof that what is good for the climate is good for business and is good for us all. And we have a solemn promise to leave no one behind in this transformation.

With our Just Transition Fund we will support the regions that have a bigger and more costly change to make. We have it all. Now it's our responsibility to implement it all and make it happen.

Meeting this new target will reduce our energy import dependency, create millions of extra jobs and more than halve air pollution. To get there, we must start now.

By next summer, we will revise all of our climate and energy legislation to make it 'fit for 55'. We will enhance emission trading, boost renewable energy, improve energy efficiency, reform energy taxation.

But the mission of the European Green Deal involves much more than cutting emissions. It is about making systemic modernisation across our economy, society and industry. It is about building a stronger world to live in.

Our current levels of consumption of raw materials, energy, water, food and land use are not sustainable. We need to change how we treat nature, how we produce and consume, live and work, eat and heat, travel and transport.

So we will tackle everything from hazardous chemicals to deforestation to pollution. This is a plan for a true recovery. It is an investment plan for Europe. And this is where NextGenerationEU will make a real difference.

Firstly, 37% of NextGenerationEU will be spent directly on our European Green Deal objectives. And I will ensure that it also takes green financing to the next level. We are world leaders in green finance and the largest issuer of green bonds worldwide. We are leading the way in developing a reliable EU Green Bond Standard.

And I can announce that we will set a target of 30% of NextGenerationEU's €750 billion to be raised through green bonds.

Secondly, NextGenerationEU should invest in lighthouse European projects with the biggest impact: hydrogen, renovation and 1 million electric charging points. Allow me to explain how this could work.

This summer in Sweden a unique fossil-free steel pilot began test operations. It will replace coal with hydrogen to produce clean steel. This shows the potential of hydrogen to support our industry with a new, clean, licence to operate. I want NextGenerationEU to create new European Hydrogen Valleys to modernise our industries, power our vehicles and bring new life to rural areas.

The second example are the buildings we live and work in. Our buildings generate 40% of our emissions. They need to become less wasteful, less expensive and more sustainable. And we know that the construction sector can even be turned from a carbon source into a carbon sink, if organic building materials like wood and smart technologies like AI are applied.

I want NextGenerationEU to kickstart a European renovation wave and make our Union a leader in the circular economy. But this is not just an environmental or economic project: it needs to be a new cultural project for Europe.

Every movement has its own look and feel. And we need to give our systemic change its own distinct aesthetic – to match style with sustainability. This is why we will set up a new European Bauhaus – a co-creation space where architects, artists, students, engineers, designers work together to make that happen.

This is NextGenerationEU. This is shaping the world we want to live in. A world served by an economy that cuts emissions, boosts competitiveness, reduces energy poverty, creates rewarding jobs and improves quality of life. A world where we use digital technologies to build a healthier, greener society.

This can only be achieved if we all do it together and I will insist that recovery plans don't just bring us out the crisis but also help us propel Europe forward to the world of tomorrow.

Imagine for a moment life in this pandemic without digital in our lives. From staying in quarantine – isolated from family and community and cut off from the world of work – to major supply problems. It is in fact not so hard to imagine that this was the case 100 years ago during the last major pandemic.

A century later, modern technology has allowed young people to learn remotely and millions to work from home. They enabled companies to sell their products, factories to keep running and government to deliver crucial public services from afar. We saw years' worth of digital innovation and transformation in the space of a few weeks.

We are reaching the limits of the things we can do in an analogue way. And this great acceleration is just beginning. We must make this Europe's Digital Decade.

We need a common plan for digital Europe with clearly defined goals for 2030, such as for connectivity, skills and digital public services. And we need to follow clear principles: the right to privacy and connectivity, freedom of speech, free flow of data and cybersecurity.

But Europe must now lead the way on digital – or it will have to follow the way of others, who are setting these standards for us. This is why we must move fast. There are three areas on which I believe we need to focus.

First, data. On personalized data - business to consumer - Europe has been too slow and is now dependent on others. This cannot happen with industrial data. And here the good news is that Europe is in the lead – we have the technology, and crucially we have the industry.

But the race is not yet won. The amount of industrial data in the world will quadruple in the next five years - and so will the opportunities that come with it. We have to give our companies, SMEs, startups and researchers the opportunity to draw on their full potential. And industrial data is worth its weight in gold when it comes to developing new products and services.

But the reality is that 80% of industrial data is still collected and never used. This is pure waste. A real data economy, on the other hand, would be a powerful engine for innovation and new jobs. And this is why we need to secure this data for Europe and make it widely accessible.

We need common data spaces - for example, in the energy or healthcare sectors. This will support innovation ecosystems in which universities, companies and researchers can access and collaborate on data. And it is why we will build a European cloud as part of NextGenerationEU - based on GaiaX.

The second area we need to focus on is technology - and in particular artificial intelligence. Whether it's precision farming in agriculture, more accurate medical diagnosis or safe autonomous driving - artificial intelligence will open up new worlds for us. But this world also needs rules.

We want a set of rules that puts people at the centre. Algorithms must not be a black box and there must be clear rules if something goes wrong. The Commission will propose a law to this effect next year.

This includes control over our personal data which still have far too rarely today. Every time an App or website asks us to create a new digital identity or to easily log on via a big platform, we have no idea what happens to our data in reality. That is why the Commission will soon propose a secure European e-identity.

One that we trust and that any citizen can use anywhere in Europe to do anything from paying your taxes to renting a bicycle. A technology where we can control ourselves what data and how data is used.

The third point is the infrastructure. Data connections must keep pace with the rapid speed of change. If we are striving for a Europe of equal opportunities, it is unacceptable that 40% of people in rural areas still do not have access to fast broadband connections.

These connections are now the prerequisite for home working, home learning, online shopping and, increasingly by the day, for new important services. Without broadband connections, it is now barely possible to build or run a business effectively.

This is a huge opportunity and the prerequisite for revitalising rural areas. Only then can they fully exploit their potential and attract more people and investment.

The investment boost through NextGenerationEU is a unique chance to drive expansion to every village. This is why we want to focus our investments on secure connectivity, on the expansion of 5G, 6G and fibre.

NextGenerationEU is also a unique opportunity to develop a more coherent European approach to connectivity and digital infrastructure deployment.

None of this is an end in itself - it is about Europe's digital sovereignty, on a small and large scale. In this spirit, I am pleased to announce an investment of €8 billion in the next generation of supercomputers - cutting-edge technology made in Europe.

And we want the European industry to develop our own next-generation microprocessor that will allow us to use the increasing data volumes energy-efficient and securely. This is what Europe's Digital Decade is all about!

If Europe is to move forward and move fast, we must let go of our hesitancies. This is about giving Europe more control over its future. We have everything it takes to bring it to life. And the private sector is desperately waiting for this too.

There has never been a better time to invest in European tech companies with new digital hubs growing everywhere from Sofia to Lisbon to Katowice. We have the people, the ideas and the strength as a Union to succeed. And this is why we will invest 20% of NextGenerationEU on digital. We want to lead the way, the European way, to the Digital Age: based on our values, our strength, our global ambitions.

A vital Europe in a fragile world

Europe is determined to use this transition to build the world we want to live in. And that of course extends well beyond our borders. The pandemic has simultaneously shown both the fragility of the global system and the importance of cooperation to tackle collective challenges.

In the face of the crisis, some around the world choose to retreat into isolation. Others actively destabilise the system. Europe chooses to reach out. Our leadership is not about self-serving propaganda. It is not about Europe First. It is about being the first to seriously answer the call when it matters.

In the pandemic, European planes delivering thousands of tonnes of protective equipment landed everywhere from Sudan to Afghanistan, Somalia to Venezuela. None of us will be safe until all of us are safe – wherever we live, whatever we have. An accessible, affordable and safe vaccine is the world's most promising way to do that.

At the beginning of the pandemic, there was no funding, no global framework for a COVID vaccine – just the rush to be the first to get one. This is the moment the EU stepped up to lead the global response. With civil society, the G20, WHO and others we brought more than 40 countries together to raise €16 billion to finance research on vaccines, tests and treatments for the whole world. This is the EU's unmatched convening power in action.

But it is not enough to find a vaccine. We need to make sure that European citizens and those around the world have access to it. The EU has joined the COVAX global facility and contributed €400 million to help ensure that safe vaccines are available not only for those who can afford it – but for everyone who needs it. Vaccine nationalism puts lives at risk. Vaccine cooperation saves them.

We are firm believers in the strength and value of cooperating in international bodies It is with a strong United Nations that we can find long-term solutions for crises like Libya or Syria.

It is with a strong World Health Organisation that we can better prepare and respond to global pandemics or local outbreaks – be it Corona or Ebola.

And it is with a strong World Trade Organization that we can ensure fair competition for all.

But the truth is also that the need to revitalise and reform the multilateral system has never been so urgent. Our global system has grown into a creeping paralysis. Major powers are either pulling out of institutions or taking them hostage for their own interests. Neither road will lead us anywhere. Yes, we want change. But change by design – not by destruction.

And this is why I want the EU to lead reforms of the WTO and WHO so they are fit for today's world. But we know that multilateral reforms take time and in the meantime the world will not stop. Without any doubt, there is a clear need for Europe to take clear positions and quick actions on global affairs.

The latest EU-China leaders meeting has taken place. The relationship between the European Union and China is simultaneously one of the most strategically important and one of the most challenging we have.

From the outset I have said China is a negotiating partner, an economic competitor and a systemic rival. We have interests in common on issues such as climate change – and China has shown it is willing to engage through a high-level dialogue. But we expect China to live up to its commitments in the Paris Agreement and lead by example.

There is still hard work to do on fair market access for European companies, reciprocity and overcapacity. We continue to have an unbalanced trade and investment partnership.

And there is no doubt that we promote very different systems of governance and society. We believe in the universal value of democracy and the rights of the individual. Europe is not without issues – think for example of anti-semitism. But we discuss them publicly.

Criticism and opposition are not only accepted but are legally protected. So we must always call out human rights abuses whenever and wherever they occur – be it on Hong Kong or with the Uyghurs.

But what holds us back? Why are even simple statements on EU values delayed, watered down or held hostage for other motives? When member states say Europe is too slow, I say to them be courageous and finally move to qualified majority voting – at least on human rights and sanctions implementation.

This House has called many times for a European Magnitsky Act – and I can announce that we will now come forward with a proposal. We need to complete our toolbox.

Be it in Hong Kong, Moscow or Minsk, Europe must take a clear and swift position. I want to say it loud and clear: the European Union is on the side of the people of Belarus. We have all been moved by the immense courage of those peacefully gathering in Independence Square or taking part in the fearless women's march.

The elections that brought them into the street were neither free nor fair. And the brutal response by the government ever since has been shameful. The people of Belarus must be free to decide their own future for themselves. They are not pieces on someone else's chess board.

To those that advocate closer ties with Russia, I say that the poisoning of Alexei Navalny with an advanced chemical agent is not a one off. We have seen the pattern in Georgia and Ukraine, Syria and Salisbury – and in election meddling around the world. This pattern is not changing – and no pipeline will change that.

Turkey is and will always be an important neighbour. But while we are close together on the map, the distance between us appears to be growing. Yes, Turkey is in a troubled neighbourhood. And yes, it is hosting millions of refugees, for which we support them with considerable funding. But none of this is justification for attempts to intimidate its neighbours.

Our member states, Cyprus and Greece, can always count on Europe's full solidarity on protecting their legitimate sovereignty rights. De-escalation in the Eastern Mediterranean is in our mutual interest. The return of exploratory vessels to Turkish ports in the past few days is a positive step in this direction.

This is necessary to create the much-needed space for dialogue. Refraining from unilateral actions and resuming talks in genuine good faith is the only path forward. The only path to stability and lasting solutions.

As well as responding more assertively to global events, Europe must deepen and refine its partnerships with its friends and allies. And this starts with revitalising our most enduring of partnerships.

We might not always agree with recent decisions by the White House. But we will always cherish the transatlantic alliance – based on shared values and history, and an unbreakable bond between our people. So whatever may happen later this year, we are ready to build a new transatlantic agenda. To strengthen our bilateral partnership – be it on trade, tech or taxation.

And we are ready to work together on reforming the international system we built together, jointly with like-minded partners. For our own interests and the interest of the common good. We need new beginnings with old friends – on both of sides of the Atlantic and on both sides of the Channel.

The scenes in this very room when we held hands and said goodbye with Auld Lang Syne spoke a thousand words. They showed an affection for the British people that will never fade. But with every day that passes the chances of a timely agreement do start to fade. Negotiations are always difficult. We are used to that.

And the Commission has the best and most experienced negotiator, Michel Barnier, to navigate us through. But talks have not progressed as we would have wished. And that leaves us very little time. As ever, this House will be the first to know and will have the last say. And I can assure you we will continue to update you throughout, just as we did with the Withdrawal Agreement.

That agreement took three years to negotiate and we worked relentlessly on it. Line by line, word by word. And together we succeeded. The result guarantees our citizens' rights, financial interests, the integrity of the Single Market – and crucially the Good Friday Agreement.

The EU and the UK jointly agreed it was the best and only way for ensuring peace on the island of Ireland. And we will never backtrack on that. This agreement has been ratified by this House and the House of Commons. It cannot be unilaterally changed, disregarded or dis-applied. This a matter of law, trust and good faith.

And that is not just me saying it – I remind you of the words of Margaret Thatcher:

> *"Britain does not break Treaties. It would be bad for Britain, bad for relations with the rest of the world, and bad for any future Treaty on trade."*

This was true then, and it is true today. Trust is the foundation of any strong partnership. And Europe will always be ready to build strong partnerships with our closest neighbours.

That starts with the Western Balkans. The decision six months ago to open accession negotiations with Albania and North Macedonia was truly historic. Indeed, the future of the whole region lies in the EU. We share the same history, we share the same destiny.

The Western Balkans are part of Europe - and not just a stopover on the Silk Road. We will soon present an economic recovery package for the Western Balkans focusing on a number of regional investment initiatives. And we will also be there for the Eastern Partnership countries and our partners in the southern neighbourhood– to help create jobs and kickstart their economies.

When I came into office, I chose for the very first trip outside the European Union, to visit the African Union, and it was a natural choice. It was a natural choice and it was a clear message, because we are not just neighbours, we are natural partners. Three months later, I returned with my entire College to set our priorities for our new strategy with Africa. It is a partnership of equals, where both sides share opportunities and responsibilities.

Africa will be a key partner in building the world we want to live in – whether on climate, digital or trade.

We will continue to believe in open and fair trade across the world. Not as an end in itself – but as a way to deliver prosperity at home and promote our values and standards. More than 600,000 jobs in Europe are tied to trade with Japan. And our recent agreement with Vietnam alone helped secure historic labour rights for millions of workers in the country.

We will use our diplomatic strength and economic clout to broker agreements that make a difference – such as designating maritime protected areas in the Antarctica. This would be one of the biggest acts of environmental protection in history.

We will form high ambition coalitions on issues such as digital ethics or fighting deforestation – and develop partnerships with all like-minded partners – from Asian democracies to Australia, Africa, the Americas and anyone else who wants to join.

We will work for just globalisation. But we cannot take this for granted. We must insist on fairness and a level playing field. And Europe will move forward – alone or with partners that want to join.

We are for example working on a Carbon Border Adjustment Mechanism. Carbon must have its price – because nature cannot pay the price anymore. This Carbon Border Adjustment Mechanism should motivate foreign producers and EU importers to reduce their carbon emissions, while ensuring that we level the playing field in a WTO-compatible way.

The same principle applies to digital taxation. We will spare no effort to reach agreement in the framework of OECD and G20. But let there be no doubt: should an agreement fall short of a fair tax system that provides long-term sustainable revenues, Europe will come forward with a proposal early next year. I want Europe to be a global advocate for fairness.

A new vitality for Europe

If Europe is to play this vital role in the world – it must also create a new vitality internally. And to move forward we must now overcome the differences that have held us back.

The historic agreement on NextGenerationEU shows that it can be done. The speed with which we took decisions on fiscal rules, state aid or for SURE – all this shows it can be done. So let's do it.

Migration is an issue that has been discussed long enough. Migration has always been a fact for Europe – and it will always be. Throughout centuries, it has defined our societies, enriched our cultures and shaped many of our lives. And this will always be the case.

As we all know, the 2015 migration crisis caused many deep divisions between member states – with some of those scars still healing today. A lot has been done since. But a lot is still missing. If we are all ready to make compromises – without compromising on our principles – we can find that solution.

The Commission's New Pact on Migration will take a human and humane approach. Saving lives at sea is not optional. And those countries who fulfil their legal and moral duties or are more exposed than others, must be able to rely on the solidarity of our whole European Union.

We will ensure a closer link between asylum and return. We have to make a clear distinction between those who have the right to stay and those who do not. We will take action to fight smugglers, strengthen external borders, deepen external partnerships and create legal pathways.

And we will make sure that people who have the right to stay are integrated and made to feel welcome. They have a future to build – and skills, energy and talent. I think of Suadd, the teenage Syrian refugee who arrived in Europe dreaming of being a doctor.

Within three years she was awarded a prestigious scholarship from the Royal College of Surgeons in Ireland. I think of the Libyan and Somalian refugee doctors who offered their medical skills the moment the pandemic struck in France.

If we think about what they have overcome and what they have achieved, then we simply must be able to manage the question of migration together. The images of the Moria camp are a painful reminder of the need for Europe to come together. Everybody has to step up here and take responsibility – and the Commission will do just that.

The Commission is now working on a plan for a joint pilot with the Greek authorities for a new camp on Lesvos. We can assist with asylum and return processes and significantly improve the conditions for the refugees.

But I want to be clear: if we step up, then I expect all member states to step up too. Migration is a European challenge and all of Europe must do its part. We must rebuild the trust amongst us and move forward together.

And this trust is at the very heart of our Union and the way we do things together. It is anchored in our founding values, our democracies and in our Community of Law – as Walter Hallstein used to call it. This is not an abstract term. The rule of law helps protect people from the rule of the powerful. It is the guarantor of our most basic of everyday rights and freedoms. It allows us to give our opinion and be informed by a free press.

Before the end of the month, the Commission will adopt the first annual rule of law report covering all member states. It is a preventive tool for early detection of challenges and for finding solutions. I want this to be a starting point for Commission, Parliament and member states to ensure there is no backsliding.

The Commission attaches the highest importance to the rule of law. This is why we will ensure that money from our budget and NextGenerationEU is protected against any kind of fraud, corruption and conflict of interest. This is non-negotiable.

But the last months have also reminded us how fragile it can be. We have a duty to always be vigilant to care and nurture for the rule of law. Breaches of the rule of law cannot be tolerated. I will continue to defend it and the integrity of our European institutions. Be it about the primacy of European law, the freedom of the press, the independence of the judiciary or the sale of golden passports. European values are not for sale.

These values are more important than ever. I say that because when I think about the state of our Union, I am reminded of the words of John Hume – one of the great Europeans who sadly passed away this year. If so many people live in peace today on the island of Ireland, it is in large part because of his unwavering belief in humanity and conflict resolution.

He used to say that conflict was about difference and that peace was about respect for difference. And as he so rightly reminded this House in 1998: *"The European visionaries decided that difference is not a threat, difference is natural. Difference is the essence of humanity."*

These words are just as important today as they ever have been. Because when we look around, we ask ourselves, where is the essence of humanity when three children in Wisconsin watch their father shot by police while they sit in the car? We ask where is the essence of humanity when anti-Semitic carnival costumes openly parade on our streets?

Where is the essence of humanity when every single day Roma people are excluded from society and others are held back simply because of the colour of their skin or their religious belief?

I am proud to live in Europe, in this open society of values and diversity. But even here in this Union – these stories are a daily reality for so many people. And this reminds us that progress on fighting racism and hate is fragile – it is hard won but very easily lost.

So now is the moment to make change. To build a truly anti-racist Union – that goes from condemnation to action. And the Commission is putting forward an action plan to start making that happen.

As part of this, we will propose to extend the list of EU crimes to all forms of hate crime and hate speech – whether because of race, religion, gender or sexuality. Hate is hate – and no one should have to put up with it.

We will strengthen our racial equality laws where there are gaps. We will use our budget to address discrimination in areas such as employment, housing or healthcare. We will get tougher on enforcement when implementation lags behind. Because in this Union, fighting racism will never be optional.

We will improve education and knowledge on the historical, cultural causes of racism. We will tackle unconscious bias that exists in people, institutions and even in algorithms. And we will appoint the Commission's first-ever anti-racism coordinator to keep this at the top of our agenda and to work directly with people, civil society and institutions.

I will not rest when it comes to building a Union of equality. A Union where you can be who you are and love who you want – without fear of recrimination or discrimination. Because being yourself is not your ideology. It's your identity. And no one can ever take it away.

So I want to be crystal clear – LGBTQI-free zones are humanity free zones. And they have no place in our Union. And to make sure that we support the whole community, the Commission will soon put forward a strategy to strengthen LGBTQI rights.

As part of this, I will also push for mutual recognition of family relations in the EU. If you are parent in one country, you are parent in every country.

Conclusion

This is the world we want to live in. Where we are united in diversity and adversity. Where we work together to overcome our differences – and pull each other through when times are hard. Where we build today the healthier, stronger and more respectful world we want our children to live in tomorrow.

But while we try to teach our children about life, our children are busy teaching us what life is about. The last year has shown us just how true this really is. We could speak of the millions of young people asking for change for a better planet. Or of the hundreds of thousands of beautiful rainbows of solidarity posted in the windows of Europe by our children.

But there is one image that stuck in my mind from the last six difficult months. An image that captures the world through the eyes of our children. It is the image of Carola and Vittoria. The two young girls playing tennis between the rooftops of Liguria, Italy.

It is not just the courage and talent of the girls that sticks out. It is the lesson behind it. About not allowing obstacles stand in your way, about not letting conventions hold you back, about seizing the moment. This is what Carola, Vittoria and all the young people of Europe teach us about life every day. It is what

Europe's next generation is all about. This is NextGenerationEU. This year, Europe took a leaf out of their book and took a leap forward together. When we had to find a way forward for our future, we did not allow old conventions hold us back. When we felt fragility around us, we seized the moment to breathe new vitality into our Union.

When we had a choice to go it alone like we have done in the past, we used the combined strength of the 27 to give all 27 a chance for the future. We showed that we are in this together and we will get out of this together.

The future will be what we make it. And Europe will be what we want it to be. So let's stop talking it down. And let's get to work for it. Let's make it strong. And let's build the world we want to live in. Long live Europe! ■

Ursula von der Leyen is President of the European Commission

This article is based on the State of the Union Address delivered at the European Parliament Plenary, Brussels, 16 September 2020

Unwoking corporate culture

Robert Oulds and Niall McCrae describe the spread of 'woke' group-think as moralitis - a cultural virus, and show how and why we must protect society from the social justice agitators

There's a right way and a wrong way for businesses to respond to survive the woke onslaught. Recently the British supermarket chain Co-op blundered into an unnecessary spat with the *Spectator* magazine, after a single person complained to the former for advertising in the latter.

Andrew Neil, chairman of Britain's biggest-selling current affairs periodical, showed how to turn the tables on a puritanical culture to which many other companies pathetically acquiesce.

A Co-op customer 'Lisa Fajita' had tweeted:

> *Hey @coopuk as a trans person I was please [sic] to see your adverts featuring a trans women and celebrating diversity, I visited your stores as a result, but why bother if your [sic] going to turn around ignore your members wishes and place adverts and fund transphobia in the spectator.*

A message opening with 'Hey' should immediately alert a company to a woke inquisitor. The complaint was spurred by a statement by Stop Funding Hate, a campaign against media perceived as right-wing (and thus purveyors of hate).

> *Many will be disappointed to see Co-op UK's management supporting a magazine notorious for transphobia and anti-Muslim propaganda.*

The Co-op social media team responded by promising to launch an investigation into its advertising policy, explaining:

> *This advert was placed as part of a package by our media buyers. We are taking up the issue with them with a view to them not using this publication again in the future.*

This submissiveness masquerading as ethics was brought to the attention of Andrew Neil, who immediately banned the Co-op Group from advertising in the magazine.

> *No need to bother, Co-op. As of today you are henceforth banned from advertising in The Spectator, in perpetuity. We will not have companies like yours use their financial might to try to influence our editorial content, which is entirely a matter for the editor.*

Sadly, the *Spectator's* robust stance against cancel culture is a rarity. A few days later the ecological protest organisation Extinction Rebellion blockaded national newspaper distribution centres around Britain, depriving millions of their morning read.

When social justice warriors want to 'start the conversation' it's time to walk away

This act was blasted by politicians as an assault on free speech, but newspaper editors and journalists seemed apologetic, typically pleading that they had regularly publish reports on the climate crisis. This was the wrong response. They should have learned from Andrew Neil: no third party, individually or collectively, should be allowed to dictate content in the free press.

Clearly newspapers have been cowed by the assertive and articulate campaigning of Extinction Rebellion, as they were towards the agitators of Black Lives Matter. For years they have issued uncritical coverage of climate change alarmism, with any sceptics banished.

James Delingpole, a trenchant critic of environmental doom-mongering, warned in his book *Watermelons* (2011) of the Marxist red in a green skin that threatens to destroy the economy and our children's future. No longer invited to write in the *Daily Telegraph*, Delingpole saw newspapers reaping what they had sown.

> *Far from underreporting the 'climate & ecological emergency', Britain's craven print media has stoked this #fakenews crisis by continually running, almost verbatim, press releases handed to them by eco-fascist organisations like Greenpeace and Fiends of the Earth, as well as by bloated rent-seekers on the environmental gravy train such as the wind industry.*

According to Delingpole, newspaper editors are running scared of vexatious legal claims, and of losing the sponsorship of green lobbyists: 'pretty much the entirety of the British print media is now bought and paid for by the Green Blob'. The more that companies allow undue influence in their enterprise, the more they become trapped.

Costly mistakes are being made by big brands that misjudge their market, giving too much licence to the youthful advertising industry to present their product in a progressive light.

In 2019 razor producer Gillette undid decades of brand building that celebrated its core market with the aspirational slogan 'the best a man can get'. Amidst the highly influential #MeToo campaign against sexual harassment, Gillette forsook positive male messaging to hector on 'toxic masculinity'.

As if giving a gender studies lecture, its new advertisements urged men to be more 'accountable' and to stop excusing bullying, sexual harassment and aggressive behaviour. They should learn to be a 'modern man', according to trendy young designers at the agency.

Knowing that this was provocative, Gillette must have expected that bad publicity would be outweighed by liberal plaudits on social media. Instead, it was the alienating misandry of the adverts that proved to be toxic. Following a backlash and calls for a boycott, the owner of the Gillette brand, Procter & Gamble, had $8 billion of its value wiped off.

However, Gillette CEO Gary Coombe was unrepentant: promoting a negative stereotype of men as predatory brutes demonstrated the brand's progressive virtue. Yet the feminising of men would neither succeed commercially, nor culturally. Many men responded to this insult by growing a beard.

Increasingly commercial organisations strive to project values, often of little relevance to their product. The ice cream brand Ben & Jerry's decided to publicly criticise the British government's policy on immigration.

Thousands of migrants who had made their way to the north coast of France from the Middle East and Africa are illegally entering the UK by crossing the English Channel in dinghies. They are sent to large hotels around the country, these being mostly empty due to the coronavirus pandemic. Home Secretary Priti Patel promised action, but she seemed helpless to deport the incomers due to human rights law.

Ben & Jerry's tweeted: 'Hey Priti Patel' (that onerous greeting again) with a thread of Marxist claptrap about refugees, ending 'and lastly, for those at the back of the class, people cannot be illegal'.

This left a sour taste. Not only did it alienate British customers who think that laws should be obeyed and that economic migrants shouldn't simply be allowed to break into an already overcrowded country, but it also gave the media an opportunity to highlight Ben & Jerry's faults, particularly their exploitation of cheap migrant labour.

The tax affairs of its parent company, the Unilever conglomerate, received unfavourable scrutiny. Before a company takes the moral high ground and self-righteously criticises others, it should first check for any skeletons in the cupboard.

As Ben & Jerry's sales slumped their tubs of ice cream were heavily discounted - a bargain for buyers who could stomach Ben & Jerry's hypocrisy. Ultimately, this foolish act of virtue signalling benefited their competitors.

A worrying trend is for businesses to exert influence on elections. Tyre maker Goodyear banned wearing of caps with the slogan 'Make America Great Again' in its workforce. This was the key message of Donald Trump's presidency campaign in 2016, and was well received in the 'Rustbelt' states where millions of jobs have been lost to the forces of globalisation.

Goodyear, a company that is integral to the US automotive industry, seemed to suggest that making America great again was wrong, perhaps too nationalistic, and that it was more important to distance itself from Trump than celebrate the industrial revival.

This petty action insulted not only employees but also the vast market of customers who voted for Trump. From a 'Main Street' perspective, Goodyear's political bias and censorship is reminiscent of the arrogant and out-of-touch elite that caused them to switch their support from the Democrats to the Republican Party. Indeed, the President called for a boycott of this now politicised product. Goodyear's share price instantly fell by 6%.

Dabbling in woke culture is a risky venture. Many companies have stepped into the minefield of gender politics, to their cost. When moviemakers and video-gaming franchises succumbed to feminist pressure to cast more women leads in heroic action roles, the result was box office duds and an exodus of disgruntled gamers.

Films with female leads were remade and defeminised for a woke audience, but Charlie's Angels flopped, as did the all-female remake of Ghostbusters. To deny that boys are drawn to action and girls to relationships and romance is to put political correctness before profit.

When the Always tampon brand removed the female symbol from its packaging to appease the transgender lobby, explaining that 'some men have periods too', a mixture of outrage and ridicule ensued. The TED talks franchise changed the title of its female-focused event with this tweet:

> *Hello you! TedxLondon-Womxn is coming back! That's not a typo: 'womxn' is a spelling of 'women' that's more inclusive and progressive. The term sheds light on the prejudice, discrimination and institutional barriers womxn have faced, and explicitly include non-cisgender women.*

This tweet was savaged on Twitter. India Willoughby, a transgender broadcaster, responded with derision: 'these people are nutters'. Transgender activists argue that trans women are women, based on self-identity, but the concept of 'womxn' creates a new category of sex. Perhaps this will become the accepted norm in progressive ideology, but there is only so far that the ordinary people can be pushed.

A few brave business leaders have taken a stand against woke zealots. The energy drink company Red Bull fired two of its North American executives, Stefan Kozak and Amy Taylor, after they promoted the Black Lives Matter movement. Around three hundred employees had signed a petition opposing the company's reluctance to openly support towards Black Lives Matter.

Austrian billionaire Dietrich Mateschitz, who co-founded Red Bull and owns 49% of the company, saw differently. As Red Bull quenches the thirst of all ethnicities, why favour one race over others? Indeed, why would a company risk upsetting customers by allying with a neo-Marxist movement that is wreaking destruction in American cities and calls to abolish police?

'Go woke, go broke' is a warning that company executives should heed. Fashionable causes change rapidly and are almost always in conflict with the socially conservative attitudes of the majority of the population.

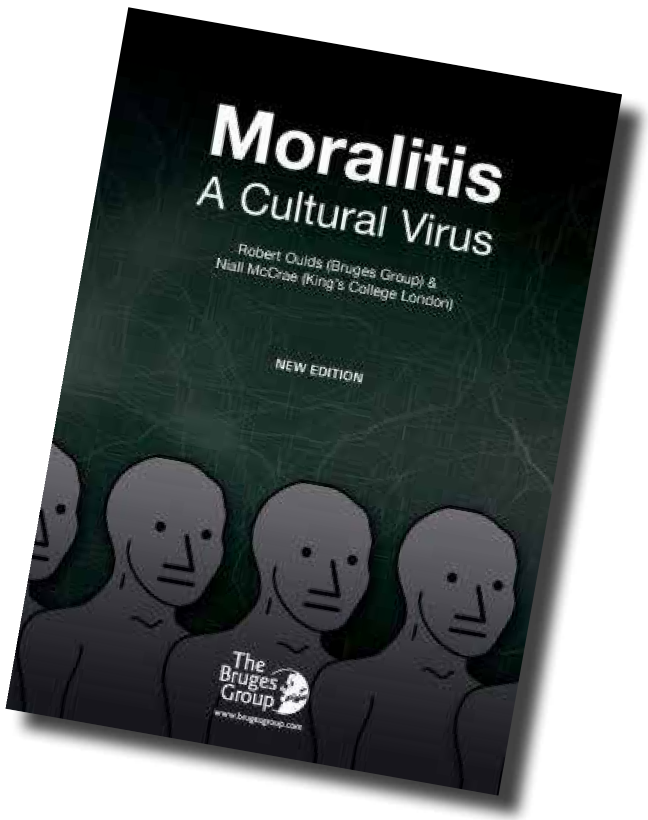
Furthermore, woke ideology is becoming more extreme. In our book *Moralitis, A Cultural Virus*, we conceptualised this flight from reason as a social contagion, spread by memes rather than microbes. Social media facilitate this puritanical invasion of minds, causing a form of mass hysteria.

Having lost or failed to develop their powers of critical reasoning, younger people learn to spout absurd ideas that are ultimately to their detriment, such as internalising of shame for their sex or colour.

The Black Lives Matter campaign called for shaming of white people, using work-base training in 'unconscious bias', micro-aggressions' and 'white privilege'.

Thankfully, Donald Trump saw the damage this is causing and banned such divisive and 'unAmerican' training in federal agencies. The growing industry of 'diversity and equality' advisors have suffered their first defeat. More must follow. When social justice warriors want to 'start the conversation' it's time to walk away. ■

Robert Oulds & Niall McCrae are the authors of Moralitis, A Cultural Virus



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Belize. Securing your future

The global economy is unstable. WCR interviews Caye International Bank's Luigi Wewege on the reasons Belize should be considered as an investment location

The start of this new decade has brought some of the biggest changes and challenges the world has ever seen. As we navigate this new reality, individuals and families are faced with decisions and choices that will affect their legacy and investing abroad is an effective way to protect personal portfolios. World Commerce Review interviews Luigi Wewege, the Senior Vice President and Head of Private Banking at Caye International Bank, who are based in the tropical paradise of Belize, an investment location that is well worth taking into consideration

The global economy is challenging at the moment. How would you describe the current local economic climate and prospects for the future in Belize?

With agriculture and tourism, the key elements of Belize's economy, the country has a core strength to help it bounce back from global economic instability. The land, the ocean and the reef are sustainable natural resources that will help with its recovery.

For someone who is thinking of starting a new business or relocating an existing one, what significant advantages does Belize offers as a business location?

Belize offers major tax advantages for foreign investors. In fact, since the International Business Companies Act of 1990, IBCs set up for non-residents of Belize have the ability to operate tax-free. The country also offers ease of doing business. Foreign entities can start businesses in Belize with very similar requirements to local residents.

Bank accounts can even be opened remotely. Belize's location in the Americas offers easy travel from the US, and access to export markets. While it is hard to quantify, one of the biggest benefits of operating in Belize is a more relaxed way of doing business, which leads to a much more personable approach.

Asset protection is vitally important to the investor. What are the pros and cons of investing abroad in general, and Belize in particular?

Investing abroad is a great way to assure privacy and asset protection. This is a unique way of diversifying a portfolio to be separate from the economic, political and other varying conditions in your home country. I would say that one of the Belize pros is that the country has a stable currency tied to the US dollar. Belize's banks have legally required liquidity rates of at least 24 per cent, which are very high, roughly four to five times those required in the United States for their domestic banks.

Also, for those who choose to live near their investments, the country is a tropical paradise. As for the cons, Belize is still considered to be in the 'third world' category, with coinciding risk and lack of infrastructure in certain areas of the country.

Offshore bank accounts are some of the most powerful financial tools that you can employ for managing personal wealth with safety, privacy and asset protection

How is the Belize government encouraging foreign investment and foreign business ownership? What are the short- and long-term goals?

Belize encourages foreign investment to help rapidly increase GDP and develop local capabilities. This includes joint venture and partnership investments, as well as 100 per cent foreign ownership.

The government offers incentive programmes in numerous investment sectors, including agriculture, agro-processing, aquaculture, fisheries, logistics, light manufacturing, offshore outsourcing, sustainable energy, and tourism-related industries.

There are also duty-free Export Processing Zones with multi-decade income-tax holidays. In addition, Belize is a member of CARICOM, enhancing many opportunities for trade within the Caribbean region.

Short-term goals for the country's government include the need to continue efforts to rein in public debt and narrow the fiscal deficit. A longer-term goal for the country is economic diversification, since Belize's economy relies primarily on tourism and exports of marine products, citrus, sugar and bananas. Tourism is one of the biggest growth areas for Belize's economy, meaning on-going demand for new businesses and existing business growth catering to visitors.

Do you see Caye International Bank having a role in the economic growth of Belize?

Yes, absolutely. As mentioned, tourism is one of the biggest growth areas for Belize's economy, meaning on-going demand for new businesses and existing business growth catering to visitors.

Caye International Bank plays a role in providing not just a place for offshore savings accounts, but also a source of funds for investment in these and other opportunities for supporting the country's economy.

The biggest impact is through local financing of everything from commercial mortgages to residential construction loans, which allow foreigners to participate in the economic growth of Belize.

How can foreign ownership of businesses and property benefit the citizens of Belize?

Foreign investment can make a big difference. Belize is a very small country, so investment from external resources is quite important. The Belize government particularly encourages investment in export-oriented businesses and the associated increased employment and development of local technological capacity.

Real estate is one of the prime movers of economic development in Belize. While some of the development comes from domestic sources, a significant amount results from actions of international investors and buyers. It's not just people who plan on retiring to the country eventually who help drive the real estate market growth, but also business owners who seek to purchase and develop properties.

How skilled and knowledgeable is the local workforce? Do you think the foreign business owner or investor has a role to play in the development of these capabilities?

English is the official language of Belize, providing a leg-up for the local workforce in basic skills and development capability, especially in interacting with international customers. More than 70 percent of the country's population has completed secondary education.

Today, while agriculture and tourism make up almost half of the industry in Belize, roughly the other half of the labour force is in services and professional occupations. Also, women are now entering the workforce in greater numbers, thus creating a need for more jobs to be created by the government, so as to keep unemployment down.

Foreign business owners and investors create demand for more workers, often with specific skills not taught through the Belizean education system. Fortunately, most of the developmental training needed is available somewhere in the world and can fairly easily be used to upskill the local workforce through online education modules.

We hear a lot about digitalisation and fintech. What steps has Belize taken to adapt to the digital age vis-à-vis digital infrastructure?

Yes, Belize has not just developed a strategy, but also taken action in the last decade to expand its digital capabilities, partly through the implementation of state-of-the-art fibre-optic connectivity.

Belize's prime minister, Dean Barrow, says that this will give the country core data infrastructure on a par with London, New York, Singapore or even Seoul. This expansion of broadband penetration has enabled an increased rate of GDP growth for the country over the last decade.

There is an increasing concern about the prevalence of money laundering in the global economy. What steps is Belize taking to address these concerns?

Sadly, criminal operations and money laundering are potential concerns in every country of the world. That is why the US passed the Money Laundering Control Act of 1986 and continues extensive activities to prevent money laundering on an on-going basis. Belize passed its own Money Laundering and Terrorism (Prevention) Act in 2008, with additional legislation in 2013 and 2018.

Belize has completed a national risk assessment and is preparing a national plan of action to address those risks. The March 2020 *International Narcotics Control Strategy Report on Money Laundering* from the US State Department recognises Belize's rigorous anti-money laundering legal, policy and regulatory framework and praises the strong political will to combat money laundering. Thus, I believe progress has been made and the right things are happening to minimise risk.

What does Caye International Bank offer as a partner for foreign investors in Belize?

Offshore bank accounts are some of the most powerful financial tools that you can employ for managing personal wealth with safety, privacy and asset protection.

One of the great things about having offshore savings, checking and investment accounts is that they remain relatively untouched by whatever is happening within your home jurisdiction, such as a local recession or a political shift.

Assets held in offshore accounts aren't subject to judgments awarded by domestic courts. With offshore bank accounts in place, people can have a foundation for getting back on their feet after personal or national setbacks.

Diversification can also allow investors to engage in currency exchanges, which makes it possible to build more wealth. Caye International Bank fulfils the dual role of facilitating this investment and acting as caretaker.

You have a long history of involvement with the financial services industry, particularly with regards to developments in technology. What does the financial sector need from its senior managers to adapt to the quickly-changing financial environment?

Leaders who are able to develop an adaptive vision and implement responsive systems to meet clients' new needs are the ones who will be the most successful.

There are two ways of dealing with rapid change. One way is through reactive protectionism. This is often through trying to stop the bleeding when change is forced upon you. This can be done by tweaking costs here and there to still be in the black for each quarterly budget.

The other is a nimbler, proactive approach. Knowing that most changes are not short-term, recognise that the first inkling of any change is a signal of potential opportunity.

Leaders who are able to develop an adaptive vision and implement responsive systems to meet clients' new needs are the ones who will be the most successful. Often the big breakthrough successes come from leveraging disruptive change.


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It's important to note that getting to this point also requires helping employees develop skills to deal with this rapid change and as always, communicating 'what' and 'why' is critical to success.

EXECUTIVE PROFILE

Luigi Wewege is the Senior Vice President and Head of Private Banking at Caye International Bank. Outside of the bank he serves as an Instructor at the FinTech School which provides online training courses on the latest technological and innovation developments within the financial services industry. Luigi is also the published author of The Digital Banking Revolution which is available in audio, Kindle and paperback formats throughout all major international online bookstores and is now in its third edition.

The complexity of business schools

Kai Peters and Howard Thomas wonder how long business schools can survive the growing complexity of their industry

Increasingly, universities and, relatedly, business schools have become more complex and complicated – with multiple activities, multiple locations and multiple audiences. For example, state-wide higher-education systems exist across many US states including California, Texas, Virginia and Illinois while complex groupings of different Catholic clerical orders run universities around the world.

Complexity is increasing even at the more mundane level of individual universities and business schools, be they integrated or stand-alone institutions. Many work across multiple sites bridging urban and suburban campuses.

Add to this feeder/foundation-year activities and expanding online education often delivered in conjunction with for-profit partners, international campuses, academic partnerships and validation activities.

For another layer of complexity, consider the different products and services ranging from "business to consumer" items such as undergraduate and post-graduate pre-experience degrees, to post-experience programmes, part-time programmes for working professionals through to business to business executive education where corporate learning and development managers purchase education on behalf of their staff.

Lastly, scale these elements up to a global level. At last count, there are close to 200 countries in the world. Many of these countries are involved in international student mobility either as exporters or importers of students. In some, direct student recruitment is possible. In most, educational agents intermediate between the university and a school.

One can thus view the managerial challenges of these more complex institutions as a three-dimensional Rubik's cube with one axis representing products, another location and third markets. Defining the suitable strategies and structures for institutional success, alas, is neither simple nor as well developed as it ought to be.

Recent trends

In some cases, institutions were brought together through mergers policies instigated by local, regional or national governments. In France particularly, funding that had previously been provided by local Chambers of Commerce for business schools began to dry up leading to new constellations of multi-location institutions. French schools KEDGE and SKEMA are examples of these top-down driven mergers.

Business subjects are lucrative cash cows for universities and are often used by the central university administration to fund more 'proper' university activities. One could be significantly harsher here but at last glance university presidents seem to view business schools more as funding sources than as legitimate university departments

In other cases, mergers have occurred in more of a 'mergers and acquisitions' manner to achieve critical mass. Reading University's acquisition of Henley Business School in the UK, Arizona State's acquisition of Thunderbird in the US and Hult's UK acquisition of Ashridge are all examples along these lines. Invariably there was an acquirer and the target.

Taking place mostly (but not exclusively) in the private sector and often (but not solely) originating from US or UK for-profit educational groups, a 'buy and build' strategy has been pursued. In some cases, the portfolio of schools has become significant and invariably the range of institutions acquired have covered a wide range of subjects and degree levels. A particularly interesting example to watch is EM Lyon in France, which not only has multiple locations but has also recently been acquired by a consortium of investment firms.

A number of individual institutions have expanded to the point where they have become small groups in and of themselves, having added suburban or urban campuses, international locations, and online activities. One of the authors' own institution, Coventry University, now has five sites in the UK, three internationally, extensive online provision and a range of partnership arrangements.

This article thus has two goals. The first sets out to investigate what these market changes mean for increasingly complex business school internal management. The second is to reflect on what these developments mean for business school associations and accreditation activities.

Management consequences

There are two key effects of this scaling-up that deserve attention. The first is definitely paramount for many university-based business schools. It is simply that business schools are often no longer, if they ever were, masters of their own destinies. Decision making on scaling-up locations and activities largely happen beyond their control.

New initiatives such as branch campuses are almost always determined at a central university level, especially given that they often offer multiple subject area courses. Mergers and acquisitions are also centrally run.

Over time, this leads to business school activities in a variety of different forms and locations. A business school will no doubt have opinions and may well be consulted but generally does not have the final say on the original initiatives or management later on.

Similarly, how support services are organised across a university is also not in the gift of the business school. There is presently a noticeable trend in many universities to centralise a whole host of services in the name of efficiency and of avoiding duplication or divergence.

One clear factor, at least in the UK, is the increasingly stifling set of regulations faced by all institutions. There is thus a marked increase in centralised marketing, student recruitment and admissions; of centralised student advisory services, and of careers planning in addition to centralised registry, legal, financial, IT and HR services.

There clearly are benefits here but also down-sides in relation to the increased adoption of command/control, micro-management styles of management at university level.

Business subjects are lucrative cash cows for universities and are often used by the central university administration to fund more 'proper' university activities. One could be significantly harsher here but at last glance university presidents seem to view business schools more as funding sources than as legitimate university departments.

For both the university-based and multi-location stand-alone business schools, the increased complexity has also, of course, led to multiple challenges on the more prosaic educational delivery tasks such as developing common educational goals among the various campuses; paying attention to the different groups of students and faculty members; ensuring that the curriculum, the standards of admissions and progression and professional support services are of high quality and consistent; and lastly, ensuring that geographically separated staff members can meet each other and collaborate rather than compete.

Sometimes these challenges have been met and group cohesion is successful; often the consequence is a group of largely autonomous entities related fundamentally but in name only.

Higher education institutions increasingly ought to reflect on how corporations, professional service firms or for that matter hotel groups or supermarkets manage local responsiveness with overall cohesion. This is a theme we are investigating at the moment. We live too much in a business school/university bubble.

Consequences for accreditation

While business school accreditation bodies nobly seek to be aware of trends and developments in the 'sector' insufficient attention has been paid to the role of the university and the expansion of institutions into complex groups.

Increasingly, there is thus a need to expand the lens from a focus on the business school to a focus on the business school within its national context and especially within the context of a broader university.

Presently, many accreditation guidelines assume business school have autonomy and control, which is simply not the case in many institutions. This can lead to ambiguity and disconnect between the 'rules' and the realities.

In touring the business school landscape extensively, one comes across myriad institutions where business subjects are taught in other locations and often in other faculties where faculty members are not 'academically qualified, research-active and fully participating'.

Validation and franchising arrangements, which exist widely in the UK and many Australian and Canadian universities, mean that parent university degrees are awarded to distant students. These partnerships tend to generate modest incomes but can also be seen as a positive form of sharing expertise and thus worthy activities. It depends on one's lens.

It must also be noted here that expecting business schools in developing markets like West Africa or Indonesia to adhere to Western expectations is unrealistic. Whether they are the other side of a validation agreement or independent, they rarely have the history or resource base to engage in a research paradigm that is considered 'proper' in developed nations.

In terms of the control of the marketing, student recruitment and management mechanisms, there are also issues where rules and realities diverge. Clearly, ring-fencing the business school and suggesting it should control all of these means of production is laudable as the business school would almost always prefer this, but it is unrealistic in the context of university vice-chancellors and presidents who make the rules.

Making sense of all of this and passing appropriate accreditation judgement is, therefore, a significant challenge but one that must continuously be tackled.

Conclusion

If, from a management side, we posit that structure should follow a strategy and we also add some insights from professional service firms then we can examine these issues more dispassionately.

If we look at income versus cost control on one axis and centralisation versus decentralisation on another, we can draw some conclusions in those realms.

For example, on the income-generating side, overall brand cohesion and undergraduate recruitment in markets where there is a centralised governmental student application system make sense as centralised collective university or group endeavours.

At the time of writing (late March 2020) it seems certain that the present COVID-19 pandemic will lead to further closures and mergers. Additionally, the pandemic will stimulate important changes in learning approaches, involving perhaps even more novel mixes of on-line and F2F teaching.

Specific 'product' marketing, especially at the post-graduate level, requires specific knowledge about the subject, local conditions, student recruitment markets, and the ecosystem of actors and employers in that field. This, we suggest, is best left to individual business schools and faculties.

On the cost management side, professional services are generally best structured in a centralised manner for cohesion and fairness across an institution. We would nevertheless posit that physical centralisation creates 'them and us' conflicts and that embedding professional services within business schools and faculties while drawing them together as a collective is preferable.

Matrix management is clearly unavoidable here but there are ways to make it work. In all cases, open and honest discussions rather than turf wars are necessary.

On the accreditation side, it is hard to suggest a simple solution but it is clear to us that increased competition leading to financial difficulties for some institutions will continue the trend towards increased size, complexity and ambiguity in those institutions that survive.

By way of focus, since 1984 the US Department of Education's Federal Student Aid database notes that over 12,000 branch campuses and complete institutions have been shut because they were unsustainable.

This will improve the quality, effectiveness and reach of responsible management education. It will also alter the business model of business schools significantly.

For anyone in higher education, these developments ought to sharpen the mind and suggests to us in any case that we all need to balance the rights bestowed through academic freedom with the responsibilities for competent and prudent management and an acknowledgement of the challenges we face.

From both a management and an accreditation perspective, we believe that an open dialogue about these realities for business schools should be ongoing and very worthwhile.

Business schools need to continue to prove their academic legitimacy and value in order not to descend into a permanent cash cow status.

There will be no simple answers but awareness and collaborative acknowledgement of these realities is paramount. ■

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Focusing on sustainability

Ed Bolen writes that even in the midst of the COVID pandemic sustainability remains a focus for business aviation

Among the many effects from the COVID-19 pandemic has been a noticeable reduction in greenhouse gas (GHG) emissions around the globe, as demand across all modes of air, land and sea transport dwindled earlier this year, due to international travel restrictions and regional lockdown efforts stemming from the virus.

That hasn't gone unnoticed, and as travel demand inevitably rebounds, this places even greater emphasis on the need for sustainability in the worldwide aviation sector, including the business aviation community.

Although global business aviation operations represent but a tiny fraction of overall CO_2 emissions, the industry is committed to exploring ways to further improve on this figure.

The National Business Aviation Association (NBAA) is working proactively along several fronts to reduce our industry's already-low carbon footprint in the years ahead. One of the most promising and accessible means to lower carbon emissions from business aircraft is sustainable aviation fuel (SAF).

This cleaner-burning alternative to straight petroleum-based Jet-A can be derived from any number of renewable feedstocks and offers the potential for reducing net lifecycle carbon emissions by at least 50%, while still meeting ASTM D1655 standards.

SAF is not new to our industry; in fact, it was recognized back in 2009 as a pathway toward our industry's shared Business Aviation Commitment on Climate Change (BACCC), an aggressive program led by the International Business Aviation Council (IBAC) and endorsed by business aviation associations worldwide.

While we've made inroads to promote use of SAF in the decade since, it's clear more work needs to be done, particularly in the changed post-COVID environment. This extends not only to increasing availability and access to SAF, but also educating operators and other industry stakeholders about the fuel's many benefits and its use as a true drop-in replacement for conventional Jet-A.

Earlier this year, the Business Aviation Coalition for Sustainable Aviation Fuel (SAF Coalition) released its updated and enhanced SAF 'Guide' for our industry. Titled *Fueling the Future*, the revised guide serves as an educational and informational resource for leaders in our industry about the practicalities of SAF development, industry adoption, and pending expansion of supply and use.

Once again, business aviation is demonstrating its important part in the global sustainability conversation

In addition to coverage by aviation media, the guide's rollout was also covered by sustainability focused news outlets including *Biofuels Digest*, *Renewable Energy Magazine* and others, perhaps offering the audience for those outlets a new look at business aviation.

The news was also picked up by DC-policymaker-focused outlets. For example, Politico noted that *"[b]ackers of sustainable aviation fuel are pushing to spread their message across the industry, ahead of a summit next month."* The website also highlighted the recent addition of the Commercial Aviation Alternative Fuels Initiative to the SAF Coalition.

Highlighting SAF's many benefits

The revised SAF guide builds upon other recent efforts by NBAA and other members of the SAF Coalition to build enthusiasm and support for sustainable fuels. In January 2019, our association helped stage at California's Van Nuys Airport the first business aviation demonstration of the viability and benefits of SAF. The event, attended by media representatives and civic leaders alike, was a major industry milestone.

The Van Nuys showcase was followed four months later by a similar SAF event, held for the first time in Europe at Farnborough Airport. Just days later, 23 SAF-fuelled business aircraft flew from several US and European airports to Geneva for the European Business Aviation Convention & Exhibition (EBACE).

At the 2019 Business Aviation Convention & Exhibition (NBAA-BACE) in Las Vegas, NV, every refuelling turbine aircraft on display departed from Henderson Executive Airport powered by SAF. Earlier this year, SAF was also made available at Zurich Airport for those traveling to the World Economic Forum in Davos, further emphasizing how sustainability is increasingly intertwined with the global economic community.

At that time, plans were also underway for a new Business Aviation Global Sustainability Summit, to be held in March 2020 in Washington, DC, to accelerate the industry's development, availability and use of the fuels. Unfortunately, COVID-19 forced the Summit's postponement, in line with the pandemic's impact on nearly all other events – including the 2020 edition of NBAA-BACE, where SAF was once again to be front-and-centre.

Even as so much in our world has changed, however, the importance of SAF as a key path toward ever greater sustainability across business aviation has not changed – and that's a message that needs to be shared, now more than ever.

A virtual event, a vital dialogue

As this issue of *World Commerce Review* was published, business aviation stakeholders around the world convened online for a first-of-its-kind Virtual Business Aviation Global Sustainability Summit.

Taking place September 14-15, the summit brought together industry leaders, executives and representatives from business aviation OEMs and a host of other noted experts and officials to discuss pathways to accelerate the market for SAF.

Topics addressed at the virtual summit included:

- Why SAF is important to business aviation, how the fuel performs with business jets and SAF's role in the BACCC.

- Perspectives from international fuel providers on near-term supply strategies and SAF transaction models

- Regulator and stakeholder insights on long-term solutions to encourage SAF adoption

- Expediting access when operators say, *"I want my SAF!"*

The ongoing COVID-19 crisis did not negate the need for business aviation to highlight its continued work toward sustainability; in fact, this moment has only made the issue an increasingly critical priority, as we all ask how we may reduce emissions further and faster.

Once again, business aviation is demonstrating its important part in the global sustainability conversation. We expect the Virtual Business Aviation Global Sustainability Summit to be a watershed moment for our energetic, innovative and international industry and its work toward a greener, more sustainable future.

On behalf of NBAA, I encourage you to participate in this effort as well and examine how your operations may also utilize SAF to realize our shared goal of reduced carbon emissions. ■

Ed Bolen is President and CEO the National Business Aviation Association (NBAA)

Global value chain transformation to 2030

GVCs have been hit hard by the COVID-19 crisis. James Zhan, Richard Bolwijn, Bruno Casella and Amelia U Santos-Paulino consider the overall direction and policy implications of the restructuring of GVCs

Global value chains will undergo a drastic transformation in the decade ahead. The change will be driven by a push for greater supply chain resilience due to COVID-19, which adds to existing pressures from the technology revolution, growing economic nationalism, and the sustainability imperative.

Based on UNCTAD's *World Investment Report 2020*, this column argues that the global trade and investment landscape will be reshaped by the restructuring of global chains, build-up of new regional chains, and distributed manufacturing. While these will present daunting challenges, they will also offer ample opportunities for firms and states alike and will lead to a GVC-development paradigm shift.

Global value chains have been hit hard by the COVID-19 crisis. A number of recent columns in VoxEU warn against the risks of a reversal in economic globalisation and an unprecedented downsizing of the existing international production system (Bamber *et al*. 2020, Baldwin and Freeman 2020, Espitia *et al*. 2020, Kilic and Marin 2020, Mirodout 2020, Pitsch 2020, Seric and Winkler 2020, Stellinger *et al*. 2020).

However, COVID-19 is not the only gamechanger. The crisis caused by the pandemic arrives on top of existing mega-challenges to the system of international production arising from the new industrial revolution (Baldwin 2019, Bolwijn *et al*. 2019, Brun *et al*. 2019, Casella and Formenti 2018), growing economic nationalism (UNCTAD 2018, Blanchard 2019, Bellora and Fontagnè 2019, Zhan 2019) and the sustainability imperative (UNCTAD 2015, De Backer and Flaig 2017, Kolk *et al*. 2017, Zhan 2016). These challenges were already reaching an inflection point; the demand, supply and policy shocks caused by the pandemic are set to tip the scales.

UNCTAD's *World Investment Report 2020* (*WIR20*) not only takes stock of the impact of COVID-19 on FDI, but it also looks well beyond at the likely transformation of international production over the next decade 2021-2030. Recognising the uncertainty facing the global production system, it aims to provide a broad analytical framework to encompass the likely future trajectories and address the range of policy options for navigating the expected decade of transformation ahead.

2030 is also the horizon for the implementation of the United Nations Sustainable Development Goals. With less than a decade left and a huge investment gap to fill in developing countries, *WIR20* comes at a critical juncture, making it all the more important to evaluate the implications of the expected changes on the FDI landscape over the coming years (UNCTAD 2014, UNCTAD 2019, Zhan *et al*. 2020).

The pandemic magnifies existing challenges

The *World Investment Report* has monitored FDI and the activities of MNEs for 30 years, during which time international production saw two decades of rapid growth followed by a decade of stagnation. Flows of cross-

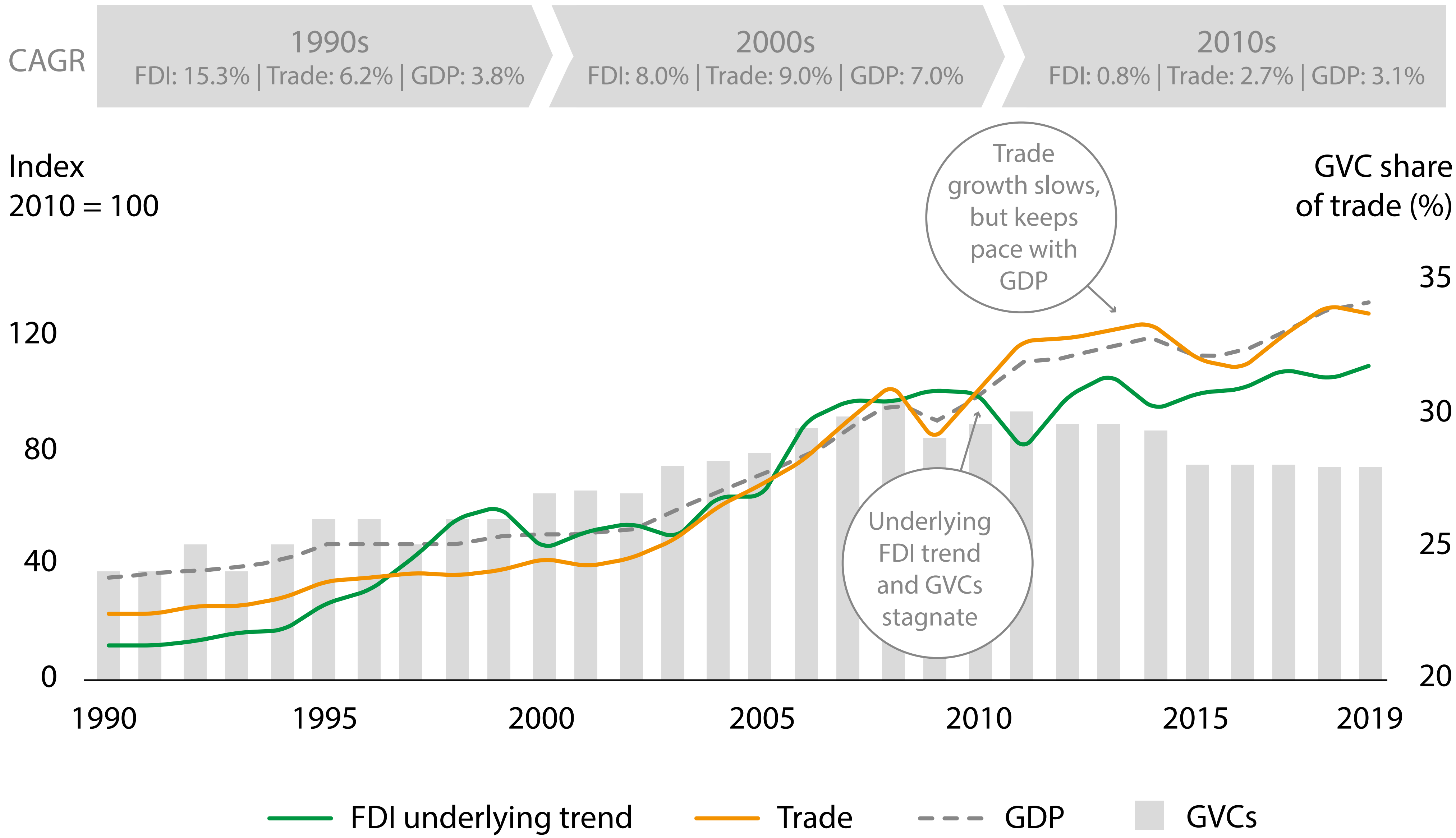
Policymakers need to prepare for the challenges arising due the transformation of international production and be ready to capture the opportunities border investment in physical productive assets stopped growing in the 2010s, the growth of trade slowed down and GVC trade declined (figure 1).

The 2010s were only the quiet before the storm. The crisis caused by the COVID-19 pandemic arrives on top of existing challenges to the system of international production arising from the new industrial revolution (NIR), growing economic nationalism and the sustainability imperative (Table 1). The decade to 2030 is likely to prove a decade of transformation for international production.

Table 1. Megatrends shaping the future of international production

Technology/ New Industrial Revolution	• Advanced robotics and AI • Digitalisation in the supply chain • Additive manufacturing (3D printing)
Policy and economic governance	• More interventionism in national policies • More protectionism in trade and investment • More regional, bilateral and ad hoc economic cooperation
Sustainability	• Sustainability policies and regulations • Market-driven changes in products and processes • Physical supply chain impacts

Figure 1. The long-term trend of international production



Note: Trade is global exports of goods and services. GVC share of trade is proxied by the share of foreign value added in exports, based on the UNCTAD-Eora GVC database (Casella et al., 2019). The underlying FDI trend is an UNCTAD indicator capturing the long-term dynamics of FDI by netting out fluctuations driven by one-off transactions and volatile financial flows. (FDI, trade and GDP indexed, 2010 = 100; GVCs per cent)

Direction of the transformation in the post-pandemic era

WIR20 develops an analytical framework to assess the prospects for international production and GVCs. It shows that the megatrends listed above play out in three dimensions via four trajectories across five industry groupings.

Trade and investment trends unfold in three key dimensions of international production: the degree of fragmentation and the length of value chains (short to long), the geographical spread of value added (concentrated to distributed), and the governance choices of MNEs that determine the prevalence of arm's length trade vs FDI.

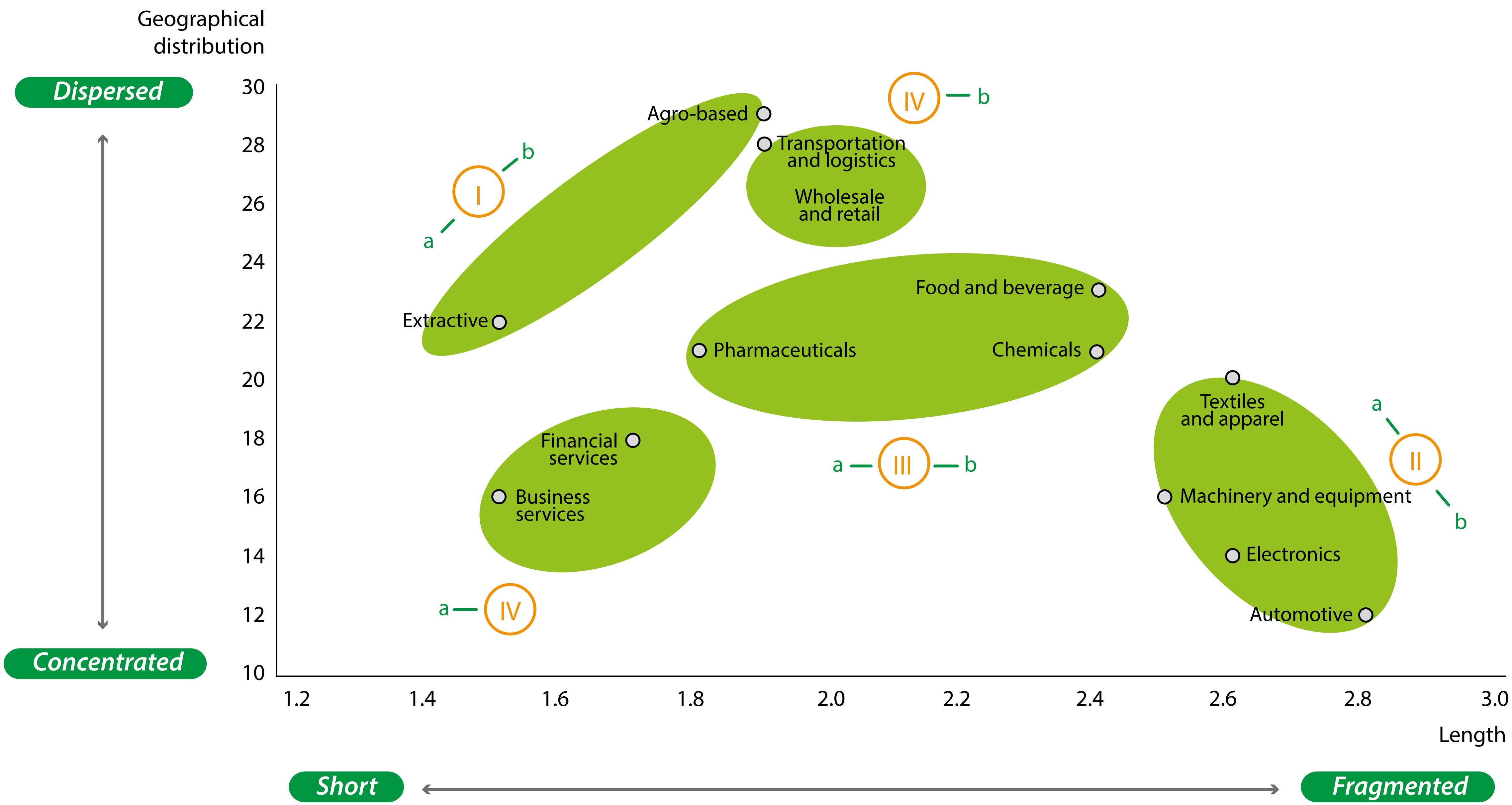
Several archetypical configurations can be identified covering industries that, together, account for the lion's share of global trade and investment. They include capital- and labour-intensive industries in the primary sector; high- and low-tech GVC-intensive industries; geographically dispersed processing and hub-and-spoke industries; and high and lower value-added services industries (Figure 2, upper section).

The effects of the technology, policy, and sustainability trends on international production are multifaceted. They are at times mutually reinforcing, and at others push in opposite directions; also playing out differently across industries and geographies.

Depending on the starting point of individual industries – their archetypical international production configurations – they will tend to favour one of four trajectories (Figure 2, lower section).

- *Reshoring* will lead to shorter, less fragmented value chains and a higher geographical concentration of value added. It will primarily affect higher-technology GVC-intensive industries. The implications of this trajectory include increased divestment and a shrinking pool of efficiency-seeking FDI.

Figure 2. Current configurations of international production and future trajectories



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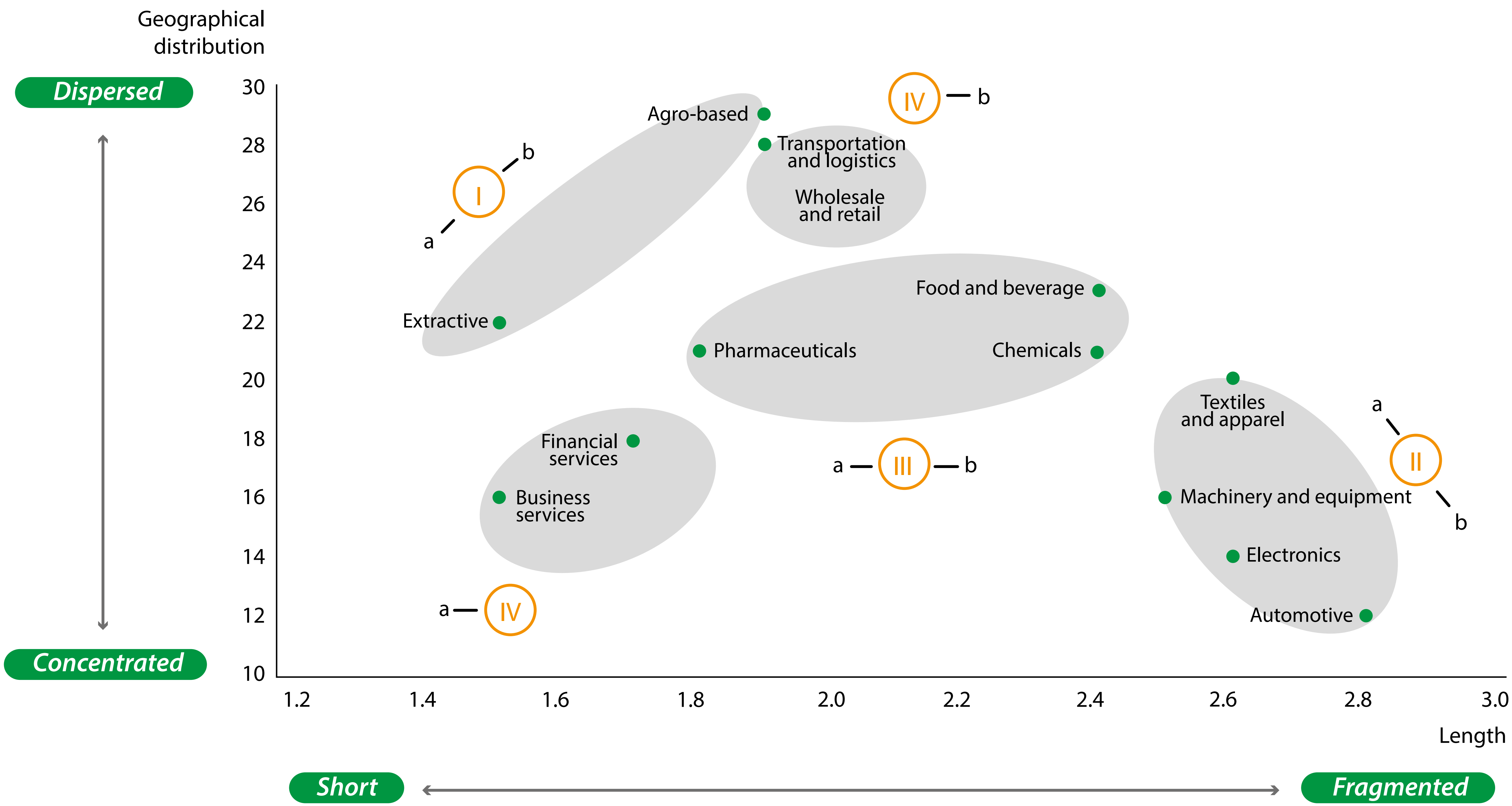

Figure 2. Current configurations of international production and future trajectories

Note: Geographical distribution refers to the number of countries accounting for 80% of value added in a specific GVC industry, based on UNCTAD calculations using data from the Eora 26 database. Length is measured by the number of production stages in a specific GVC industry based on Miroudot and Nordström (2015).

- *Diversification* will lead to a wider distribution of economic activities. It will primarily affect services and GVC-intensive manufacturing industries. This trajectory will increase opportunities for new entrants (economies and firms) to participate in GVCs, but its reliance on supply chain digitalization will cause those GVCs to be more loosely governed, platform-based and asset-light.

- *Regionalisation* will reduce the physical length but not the fragmentation of supply chains. The geographical distribution of value added will increase. This trajectory will affect regional processing industries, some GVC-intensive industries and even the primary sector.

- *Replication* will lead to shorter value chains and a rebundling of production stages. It will lead to more geographically distributed activities, but more concentrated value added. It will be especially relevant for hub-and-spoke and regional processing industries.

Although the different trajectories show that the expected transformation of international production is not unidirectional, the overall direction of travel points towards:

- Shorter and less fragmented value chains
- More concentrated value added
- More platform-driven and asset-light value chain governance
- A shift from global to regional and sub-regional value chains
- Downward pressure on global efficiency-seeking FDI in favour of regional market-seeking FDI
- Downward pressure on global trade in intermediate goods, less on trade in final products
- A shift in some industries from large-scale investment to smaller-scale distributed manufacturing
- Continued growth and fragmentation in services value chains

- Resilience and national security concerns as key drivers of GVC diversification
- A shift from GVC-investment to cross-border investment in infrastructure, domestic services and in the green and blue economies driven by the sustainability imperative

Policy implications: towards a new GVC-development path

Policymakers need to prepare for the challenges arising due the transformation of international production and be ready to capture the opportunities.

Challenges include increased divestment, relocations, investment diversion, and a shrinking pool of efficiency-seeking investment implying tougher competition for FDI. Value capture in GVCs and development based on vertical specialisation will become more difficult.

Industrial infrastructure built for a world of GVCs will see diminishing returns. Changes in locational determinants of investment will often negatively affect the chances of developing countries to attract MNE operations.

Opportunities arising from the transformation include attracting investors looking to diversify supply bases and building redundancy and resilience. The pool of regional market-seeking investment will increase. Shorter value chains will bring more investment in distributed manufacturing and final-goods production with broader industrial capacity building and clustering.

And digital infrastructure and platforms will enable new applications and services and improve bottom-up access to GVCs. The sustainability imperative will lead to more green and blue investment and value chains.

Confronting the challenges and capturing the opportunities requires a change in the investment-development path (figure 3). From a focus on export-oriented efficiency-seeking investment in narrowly specialised GVC segments, the focus needs to be reoriented towards a broader export-led strategy which extends to investment in production for regional markets and regional industrial clustering.

Similarly, there needs to be a shift in focus from cost-based competition for single-location investors to competition for diversified investments based on flexibility and resilience. And from prioritizing large-scale industrial investors with 'big infrastructure' to making room for small-scale manufacturing facilities and services with 'lean infrastructure'.

Finally, a shift in investment promotion strategies towards infrastructure and services is necessary. For the past three decades international production and the promotion of export-oriented manufacturing investment has been the pillar of development and industrialisation strategies of most developing countries.

Investment geared towards exploiting factors of production, resources and low cost labour will remain important, but the pool of such investment is shrinking. A degree of rebalancing towards growth based on domestic and regional demand and on services, as well as the green and blue economy, will be the new path forward. ■

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Figure 3. Towards a new GVC development path

From	To
Export-oriented	Export 'plus plus' - plus protection for local makets - plus infrastructure development
Efficiency-seeking investment	(Regional) market-seeking investment
Targeting GVC segments/tasks	Building diversified industrial clusters
Prioritizing large-scale industrial investors	Competition for diversified investments based on flexibilty and resilience
Cost-based competition for single-location investors	Room for small-scale manufacturing facilities and services
'Big infrastructure'	'Lean infrastructure' - digital and sustainable

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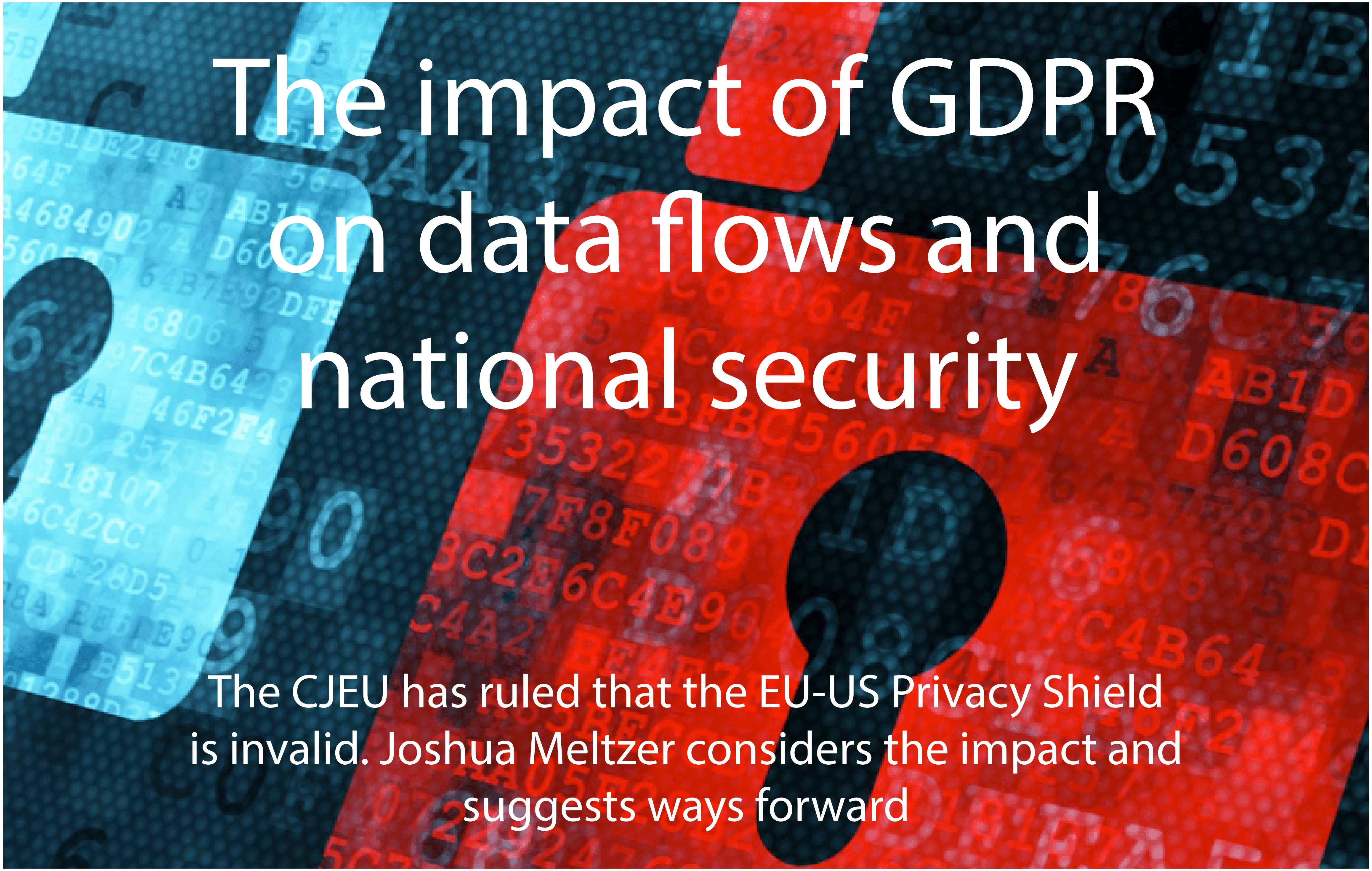

The impact of GDPR on data flows and national security

The CJEU has ruled that the EU-US Privacy Shield is invalid. Joshua Meltzer considers the impact and suggests ways forward

The Court of Justice of the European Union recently delivered its verdict in the Schrems II case, ruling that the EU-US Privacy Shield is invalid. This column addresses the implications for adequacy and standard contractual clauses as well as the broader issue of how to balance national security and privacy goals. It concludes with observations about the potential impact of the decisions for the US and beyond and suggests some ways forward.

The recent Court of Justice of the European Union (CJEU) decision in Schrems II finding that the EU-US Privacy Shield is invalid and its additional findings with respect to standard contractual clauses, closes off key mechanisms for transferring persona data from the EU to the US, with important impacts on trade and the development of technologies such as cloud computing and artificial intelligence (AI).

This is the second time the CJEU has found that the General Data Protection Regulation (GDPR) mechanisms for transferring personal data from the EU to the US is invalid[1]. The earlier CJEU decision in Schrems I found that the European Commission adequacy decisions with respect to the EU-US Safe Harbour was invalid[2]. An adequacy decision is a finding by the European Commission that a third countries privacy laws are essentially equivalent to the rights and obligations under the GDPR[3].

The importance of data flows for transatlantic economic relations necessitates that the US and EU engage in a third attempt to develop a mechanism that can enable data flows and pass muster with the CJEU.

However, whether this remains a fruitful path forward is uncertain in light of what we now know about the approach of the CJEU to adequacy under GDPR. In particular, the focus on how government agencies access data for national security purposes is becoming the key barrier to data flows between the EU and the US.

More broadly, the CJEU decision makes clear that all the key GDPR mechanisms for transferring personal data from the EU to third countries are unstable, namely adequacy decisions, standard contractual clauses (SCCs) and binding corporate rules (BCRs)[4].

In this respect, the CJEU decision will have ramifications beyond its immediate impact on data flows between the EU and the US. The following addresses the explicit CJEU findings on adequacy and SCC as well as the broader issue of how to balance national security and privacy. The paper concludes with observations about the potential impact of the decisions for the US and beyond and suggests some ways forward.

…what is needed is an international agreement on how to balance national security and access to data, with other key goals such as privacy

In this column I focus on two key issues at play in this most recent Schrems case: (1) the disconnect between application of EU law to national security agencies in third countries compared with domestic security agencies; and (2) and the severe limits the decision places on existing GDPR mechanisms for transferring personal data from the EU to third countries. I also offer observations on what this will means for data flows, and in particular the implications for small and medium sized enterprises (SMEs).

Privacy and security in a world of global data flows

A core issue in both Schrems cases was how national security agencies operate to preserve security and also ensure sufficient levels of privacy, and whether this is consistent with GDPR.

The attempt by GDPR to extend EU privacy rights and obligations to countries and entities receiving EU personal data reflects a broad dynamic, which is that as the global free flow of data increases the scope for national security agencies to access the personal data of everyone, national privacy standards need to be globalised as well to be effective.

Yet, governments often provide different levels of privacy protection and redress depending on whether a person is a citizen and where they are located. Under the Fourth Amendment to the Constitution, the US provides different levels of legal redress to people in the US compared to those outside the US, including access to US courts. GDPR in effect seeks to extend the full suite of rights and obligations available in the EU under GDPR, to any country receiving EU personal data.

Underlying the CJEU decision in Schrems I and Schrems II that invalidated the EU-US Safe Harbour agreement and in this most recent case, has invalidated the EU-US Privacy Shield, is a disconnect between the GDPR's international impacts, and its domestic application to member state national security agencies.

In both Schrems cases, the issue was US government access to personal data for national security purposes and the rights of EU citizens in the US to judicial review and redress. In both cases the CJEU found that the US fell short in that the US was not according EU personal data the protection and rights of redress available in the EU.

When it comes to access to data for national security purposes, under EU law, including GDPR, any limitation on EU rights to privacy must be 'necessary and proportionate'[5]. At the same time, national security is the sole responsibility of member states[6].

In effect, each EU state is given the discretion to balance national security needs with data privacy rights. Yet, the EU is not according a similar discretion to third countries.

In fact, GDPR uses the threat of withdrawing access to EU personal data as a tool to seek reform of other country's security agencies to reflect the CJEU notion of proportionality, while exempting member state governments from similar expectations or threats. This effectively sets up the CJEU as the arbiter of whether other countries' approaches to accessing data for national security purposes are proportional[7].

This disconnect between GDPR's international and domestic application when it comes to national security also risks EU demands becoming increasingly detached from the reality and practices of national security agencies.

On the one hand, the outcome in the US between security and privacy reflects US constitutional constrains, national security needs and privacy concerns.

In the EU, it does not appear that any such balancing took place, leaving the EU approach to privacy untouched in important ways by the equities and needs of member state national security agencies.

The result is a set of demands on third country national security agencies that the EU does not, and could not, make of its own national security agencies. This dissonance between what the EU is expecting of other governments and what it is able to ask of its member states is compounded by various findings that EU data may in fact be safer and accorded better due process when in the US than in the EU[8].

The inadequacy of adequacy decisions

The issue with how the US government accesses data for national security is what lead the CJEU in both Schrems cases to invalidate the European Commission's adequacy finding with respect to the US. This Schrems decision also makes clear that not only adequacy decisions but also SCC and BCRs are much more limited than originally thought.

Another consequence of the Schrems decision is to underscore the fragility of these GDPR data transfer mechanism. As the Irish High Court and CJEU overturns a second adequacy finding by the Commission, the CJEU has made clear that SCCs (and BCRs) may require data flows to be terminated at any point should the processor in the third country be unable to comply with GDPR, either due to requests from a third government for access to data or due to changes in legislation.

These outcomes will inevitably increase risk for businesses that rely on cross-border transfers of personal data. This will affect not only the large tech companies but also those in manufacturing and services that are increasingly data driven.

To understand the implications of this decision for these GDPR transfer mechanisms, it is helpful to reflect on the institutional incentives and priorities driving the different finding by the European Commission on the one hand, and EU domestic courts and the CJEU on the other.

The European Commission in making an adequacy decision weighs a range of goals that are in tension with each other. While focused on assessing whether US laws and practice are adequate under GDPR, the Commission also takes into account the impact of stopping flows of personal data on international trade, investment and diplomatic relations.

In contrast, the process for challenging an adequacy finding rests upon findings by a National Data Commissioner, findings by domestic courts, and finally the CJEU. None of these bodies is expected to consider the range of issues at play for the Commission.

Instead, the question is more narrowly whether the third country provides a level of privacy protection consistency with the Charter of Fundamental Rights of the European Union. It is these competing institutional incentives and focus that helps explain the different conclusions as to whether the US confers adequacy.

These internal institutional tensions raise several issues for the EU. First is the validity of other adequacy findings. For instance, what does the Commission really know as to how national security agencies in Israel, Japan or Argentina collect, use or share EU personal data.

Second is the stability of any adequacy findings. The narrow focus of the CJEU on consistency with the EU Charter and demand for essential equivalence leads very little room for different approaches to privacy in other countries, reducing scope for adequacy findings and to using any transfer mechanism under GDPR.

When it comes to determining whether the actions of other governments in collecting data for national security purposes are consistent with GDPR and the EU Charter, the vague standard of proportionality has led the Commission and CJEU to different conclusions regarding the adequacy of US limits and safeguards[9].

Taken together, this suggests that all adequacy decisions by the Commission must be treated as potentially suspect and open to being declared invalid by the CJEU.

Another impact of this Schrems case is to limit the availability of SCC (and BCRs)[10]. The issue with SCC (and BCRs) is that it is a contractual obligation that does not bind other governments. Therefore, where practices by national security agencies for accessing personal data are inconsistent with GDPR, SCCs do not obviously remedy this problem.

The CJEU nevertheless held that SCCs remain valid where the controller adduces additional safeguards that rectify these gaps[11]. It is not clear what these safeguards are or how they could work in practice.

Another wrinkle here is the finding by CJEU of the accountability for processors in the EU to ensure that the legislation in the third country allows the data processor to comply with the SCC, before transferring personal data[12].

It is not clear whether this merely requires comparing third party laws with GDPR or also the practice of national security agencies, which is harder to assess but arguably what should matter the most.

The result is that after Schrems II, all GDPR mechanisms for transferring personal data to third countries are much more limited in scope, durability and stability.

Some implications of Schrems II for cross-border data flows, trade, privacy and security

The first thing this Schrems case makes clear is the extent of the tension created by GDPR between balancing access to and use of data, and the privacy rights and obligations in GDPR (Mattoo and Joshua Meltzer 2018).

The EU view is that they can have strong privacy and a strong digital economy, including cross-border data flows, and this is likely correct at a certain level of abstraction.

However, the details of GDPR now make clear how GDPR sets up real tensions and trade-offs in terms of getting what the EU wants under GDPR in terms of privacy, and access to and use of data consistent with a robust engagement in the digital economy and digital trade (Jia *et al*. 2019).

In practical terms, Schrems II calls into question the availability of adequacy findings, SCCs (and BCRs) as reliable and stable mechanisms for cross-border data transfers. If the US is still not adequate, then it must be the case that other countries, including China will never be adequate and not only that, but it is hard to see how any Chinese company collecting EU personal data can transfer it back to China consistently with GDPR. Large companies may have to localise data storage and process in the EU.

Yet for small companies, the impacts are most pronounced. For many, setting up in the EU is not an option. There are SCCs, but depending on the government, additional safeguards may be needed for SCCs to be viable.

Again, it is unclear what such safeguards may be or whether SMEs could implement them even if they exist. The CJEU decision also establishes an obligation on processors in third country to notify controllers in the EU of changes in legislation that prevent compliance with a SCC.

This is an additional monitoring burden on SMEs in third countries and failure here can expose these companies to liability for harm caused to EU data subjects. The difficulties with SCCs also create additional costs and disincentives for EU companies to develop digital supply chains with SMEs in third countries.

As discussed, another issue at play is the balance between how security agencies use data for security, and also protect personal privacy in a globalised world. It is likely that GDPR is too unilateral and too EU-specific, and that national security is too important, for GDPR to lead to the types of changes the EU needs for an adequacy finding to work.

The EU bet with GDPR has been that the economic importance to US companies of allowing cross-border data flows of EU personal data will be enough to force the US to reform how its national security agencies collect and use data.

This has been a somewhat reasonable bet so far in that the US has shown a willingness to negotiate and engage in some reform. But even here, US reforms in order to obtain an adequacy decision have been limited and as we now know, not enough.

It is also the case that the trend is not in the EU's favour. For while the economic importance of data grows, so do the security issues related to data flows. In fact, the trend is arguably towards security becoming a more important organising principle for how digital economies develop and where data flows.

Given this, the risk is that GDPR fails to lead to enough US reform that can justify another adequacy finding, forcing the EU into self-imposed data isolation.

In such an outcome, large US and other companies will still service the EU market but the EU will become increasingly closed, reducing access to large global data pools and the opportunities for insights and the machine learning that underpin AI developments that the EU seeks to develop (European Commission 2020).

Given these risks and developments, what is needed is an international agreement on how to balance national security and access to data, with other key goals such as privacy. Such an outcome could be deemed an international agreement under GDPR article 45(2(c) that would support an adequacy finding and by extension, short up access to SCC and BCRs. ■

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Author's note: the author was an expert witness for Facebook in the latest proceedings before the Irish High Court.

Endnotes

1. Schrems and Facebook Ireland v Data Protection Commissioner (hereinafter "Schrems II")(2020) CJEU Case C-311/18

2. Schrems v Data Protection Commissioner (hereinafter "Schrems I") (2015) CJEU Case C-362/14

3. EU General Data Protection Regulation, 27 April 2016, L119/1 (hereinafter 'GDPR'), art. 45(3)

4. SCCs are included in contracts that bind entities in a third country to processing personal data consistent with GDPR; BCRs are commitment international conglomerates make to treat personal data consistent with GDPR when transferring data overseas within other units, to treating personal data consistent with GDPR,

5. Charter of Fundamental Rights of the European Union, article 52(1); GDPR art. 23

6. Treaty of the European Union, article 4(2) provides that "national security remains the sole responsibility of each EU member state."

7. Schrems II, paragraph 178

8. European Agency for Fundamental Rights 2015. "Surveillance by Intelligence Services: fundamental rights, safeguards and remedies in the EU"; Sidley Austin 2016. "Essentially Equivalent -A comparison of the legal orders for privacy and data protection in the European Union and the United States", January 2016; Opinion of Geoffrey Robertson QC, 14th January 2016.
9. Schrems II, paragraph 176
10. Commission Decision of 16 December 2016 amending Decisions [2001/497] and [2010/87] on standard contractual clauses for the transfer of personal data to third countries and to processors established in such countries, under Directive [95/46] (OJ 2016 L 344
11. Schrems II, para 133
12. Schrems II, para 144

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The impact economy: balancing profit and impact

Dirk Schoenmaker examines how governments and companies can cooperate in the pursuit of sustainable development

How can governments and companies be jointly empowered to have a positive impact on the sustainable development goals? The current economic system is largely geared towards increasing economic growth. But this could come at the expense of rising social inequality and environmental degradation.

This paper examines the link between economic system outcomes and corporate sustainability outcomes and provides evidence that governments and companies can reinforce each other in their pursuit of sustainable development.

Sustainable development is based on three pillars: economic, social and environmental. These pillars should be assessed and balanced in an integrated way. An impact economy, in which governments and companies balance profit and impact, is best placed to achieve the sustainable development goals.

Introduction

Society faces several challenges both on the social front (eg. inclusiveness, poverty, gender equality and human rights) and on the environmental front (eg. climate change, biodiversity loss, natural food production and freshwater shortages). The answers to these challenges are summarised in the United Nations Sustainable Development Goals (SDGs) (UN, 2015). The SDGs form the global strategy to promote sustainable development, which aims for a dignified life for current and future generations.

The SDGs are an agenda for all to act on: governments, companies and citizens. But the academic and policy literature separates the actors. Some promote a broader role for government (Stiglitz, 2009; Stern, 2018; Mazzucato, 2018), while others promote the broader responsibility of companies (Mayer, 2018; Edmans, 2020).

Each group uses its own language and concepts for the common good of sustainable development. Stiglitz *et al.* (2018) promoted a framework of indicators to measure current and future wellbeing, which encompass material conditions, quality of life and preservation of natural resources.

Schoenmaker and Schramade (2019) suggested that companies should be purpose driven and pursue long-term value creation, which integrates financial, social and environmental value.

This paper examines how governments and companies can be jointly empowered to have a positive impact in terms of achieving the SDGs. The current economic system, which is largely geared towards maximising economic growth, might hold companies back in their attempts to balance profit and impact.

It is now time to put economic and financial capital at the service of social and natural capital in order to deliver lasting prosperity for all

For business to be purpose driven, broader change of the governance of the economic system (including institutions with long-term orientations) is necessary. The central premise of this paper is that the choice of governance for the economy and for the corporate sector cannot be studied in isolation (Figure 1).

Corporate governance must fit within the broader economic system to be successful. This paper investigates the link between economic and corporate governance.

Figure 1. Stylised governance model

Source: Bruegel.

In this paper we provide a broad classification of economic systems and discuss welfare beyond GDP (Stiglitz, 2009). The choice of economic system appears to be linked to corporate sustainability outcomes. The market economy is capable of delivering economic growth and profits, but less capable of providing social equality and environmental preservation. The state economy produces public and private goods, but at the cost of efficiency, individual development and environmental preservation.

This paper introduces the impact economy, which takes the middle ground. The government produces the classical public goods, while the government and companies care jointly about the common good of sustainable development.

The impact economy model is well-positioned to find an appropriate balance across all three pillars: economic, social and environmental. This translates into higher SDG scores at country level and higher CSR (corporate social responsibility) scores at firm level.

The market and state economy models score lower on the overall SDGs and on the separate social and environmental aspects.

Table 1 outlines the contours of the impact economy. The steering of the economy moves from stimulating GDP to enhancing broad welfare, which includes wellbeing and sustainability. Companies transform from profit-maximising entities into purpose-driven organisations.

Importantly, decision-making is no longer based on economic and financial factors only, but also on social and environmental factors. The defining criterion of the impact economy is taking a broad approach in government

Table 1. Contours of the impact economy

Aspect	Current paradigm	New paradigm
Objective		
- Economy	Stimulating GDP growth	Broad welfare
- Corporate	Profit maximisation	Purpose driven
Decision-making		
- Economy	Public good based on fiscal and economic indicators	Public good based on fiscal, economic, social and environmental indicators
- Corporate	NPV based on financial factors (Max FV)	NPV based on integrated value (Max IV = FV + SV + EV)
Control		
- Economy	Parliament	Parliament
- Corporate	Shareholders	Stakeholders
Reporting		
- Economy	Budget	Wellbeing budget
- Corporate	Financial report	Integrated report

Note: NPV = Net Present Value, IV = Integrated Value, FV = Financial Value, SV = Social Value, EV = Environmental Value.
Source: Bruegel.

policymaking (spending, taxation and regulation of economic, social and environmental issues) and in corporate decision-making covering all stakeholders (shareholders, employees, consumers, society and environment).

The institutions in an impact economy are geared towards the common good and multiple value creation (ie. economic, social and environmental value) and have long-term orientations.

New Zealand, which is often a pioneer of innovation (for example, with the introduction of inflation targeting in the 1990s), is the first and only country so far to publish a wellbeing budget. The New Zealand wellbeing budget takes a longer-term view and balances the need to grow the economy, create jobs, balance the books, and look after the people and the environment. Some leading companies have also started to publish integrated reports, showing how they balance profit and impact.

The central message of this paper is that sustainable growth is the only growth that serves society in the long-term. Anything else will be ultimately self-defeating. If we want to foster sustainable development built on social inclusion and environmental preservation, we need to move from maximising GDP and profit to balancing welfare/profit and impact[1].

This paper shows how governments fostering broad welfare and purpose-driven companies can generate positive impact. The financial sector can fulfil a stewardship role by steering companies towards sustainable business practices. Institutional investors, in particular pension funds, are leading the move to sustainable investment.

Economic systems

This section provides a typology of economic systems and sketches the performance of the main economic systems on key economic, social and environmental indicators.

Typology of economic systems

The economic system, responsible for the production of public and private goods in a country, can be organised in various ways. We provide a high-level analysis of the three main economic systems for comparative purposes. Gregory and Stuart (2013) provide a more detailed and nuanced classification of economic systems.

The typology starts with the market economy, in which the government is responsible for public goods (ie. goods that are non-excludable and non-rival) and sets the conditions for economic growth (narrow GDP). Private companies produce and sell private goods on the market without regard to social or environmental externalities. Companies are run for the private benefit of their shareholders, which we classify as the shareholder model. The common good is the exclusive domain of the government.

Another main economic system is the state economy, in which the government ('the state') is all powerful and is responsible for producing public and private goods. While companies may produce private goods, they are state-owned. They are steered by the state for the common good, but often at the cost of efficiency and individual initiative.

The impact economy takes the middle ground. The concept of impact economy aims to balance welfare/profit and impact (as defined by the SDGs) and is a modern-day version of the *Soziale Marktwirtschaft* introduced by Adenauer in the 1950s and the 'Coordinated Market Economy' of Kopstein and Lichbach (2005).

More recent versions have highlighted the common-good feature of the economy (Scharmer and Kaufer, 2013; Felber and Hagelberg, 2017). While the government still produces the classical public goods, such as justice and defence, the government and companies jointly care for the other public goods directed at the common good of sustainable development, including clean air, equal treatment and social equality.

In this model, the government aims to improve broad welfare, which contains both material wellbeing (production of goods) and immaterial wellbeing (eg. health, education and environment), at present and in the future (Stiglitz, 2009; Hoekstra, 2019).

Companies are run for profit to promote entrepreneurship and efficiency. They also aim for a positive impact on society and environment. These companies integrate profit and impact in their pursuit of long-term value creation (Mayer, 2018; Schoenmaker and Schramade, 2019; Edmans, 2020).

While most countries adopt a hybrid model containing elements of the main economic systems, we attempt to classify the main economic blocs in geopolitical terms. The United States is an example of the market economy with a strong focus on maximising production and consumption (reflected in a high GDP per capita), but also with excesses such as major inequalities and environmental degradation.

China is an example of the state economy (though it has introduced some elements of the market economy) with economic inefficiencies, environmental degradation and human right violations. While China, as an emerging market economy, is catching up through high economic growth, the solvency and efficiency of state-owned enterprises and banks are questionable and the interests of the state override the interests of individuals.

Europe with its social market economy is more societal-oriented, but less dynamic and innovative in economic terms. Europe's societal orientation is not only supported by social policies, but also environmental policies, such as the European Green Deal. Europe is thus close to the envisaged impact economy model, which supports the common good and multiple value creation.

It should be stressed that the three major economic blocs do not exactly fit into our typology. We only suggest that the United States comes close to the market economy model, China to the state economy model and Europe to the impact economy model.

Performance economic systems

As a follow-up to the Stiglitz report on broad welfare (Stiglitz, 2009), Stiglitz *et al*. (2018) developed a detailed framework of indicators to measure current and future wellbeing, encompassing material conditions, quality of life and preservation of natural resources. The statistics for this detailed assessment are not available on a standardised basis, nor are they available for all countries.

Hoekstra (2019) noted that several methods to measure broad GDP have been developed. To accelerate acceptance of broad GDP, he proposed to create a multidisciplinary community for replacing GDP by 2030. This new community must find a common language and common practices in order to supersede the current macroeconomic community centred around GDP.

As we are only interested in a high-level comparison of the performance of the main economic systems, we start with the SDG index, which aggregates performance across the 17 SDGs and can be seen as an aggregate indicator of societal performance (Sachs *et al*. 2019).

Next, we provide key indicators on the three broad pillars (economic, social and environmental) relevant for achieving the SDGs. For each pillar, we show two to three of the most important indicators. The key indicator for economic strength is GDP. We take the level (GDP per capita adjusted for purchasing power parity) as well as the annual change (GDP growth). As we are interested in the structural features of economic systems, we calculate a 5-year average of GDP growth in line with the length of the average NBER business cycle since 1945 (NBER).

For the social pillar, we take key indicators of income inequality (GINI index), gender inequality (gender gap) and human rights. Other often-used social factors are health and education, but these are highly dependent on a country's relative wealth, which we already measure with GDP per capita. On the environmental front, we use consumption-based carbon emissions and material footprint per capita.

Using material footprint is one way of incorporating other ecological aspects, as material extraction from terrestrial and marine ecosystems has an impact on land-use change and biodiversity loss (Hickel, 2020).

To assess the conditions for creating broad welfare, we look at the competitiveness of the economy, the size of the government and the forest area as a percentage of the land area. We take the competitiveness indicator for markets (average of product, labour and financial markets), business dynamics and innovation capability from the World Economic Forum's *Global Competitiveness Report* (WEF, 2019).

The tax-to-GDP ratio measures the share of the government in the economy, which enables social redistribution. The forest area is an indicator of the state of the ecological environment (Wang and Li, 2014).

Table 2 provides a high-level overview of the performance of the main economic systems for illustrative purposes. The overview starts with the aggregate SDG score, which balances economic, social and environmental goals. The European Union has the highest SDG score at 79.5 followed by the United States at 74.5 and China at 73.2. The European Union outperforms the other two blocks by 5 percentage points on the SDG index, which ranges from 59 to 85 (see Table A2 in the Appendix).

Turning to the separate pillars, the United States scores high on the economic (GDP per capita) and competitiveness indicators, but China is catching up with high economic growth. On the social indicators (income inequality, global gender and human rights), the European Union shows the best performance, followed by the United States and China.

On the environmental indicators, China has the lowest carbon and material footprint, because of a lower GDP per capita. The consumption-based footprints are related to the level of consumption (proxied by GDP per capita) and the carbon and material intensity of that consumption. The United States has larger footprints than Europe.

As we are interested in the overall societal performance of the main economic blocs, we do not analyse synergies and trade-offs between the separate pillars[2]. Lima de Miranda and Snower (2020) also suggested a balanced dashboard to evaluating wellbeing.

Table 2 indicates that the European Union achieves its societal goals better, at a higher tax rate used for public spending as well as redistribution.

Are economic and corporate social performance linked?

This section investigates the link between the organisation of the economy and corporate social responsibility. It analyses the relationship between economic and corporate social performance.

Linking economic systems to corporate social responsibility

Corporate social responsibility (CSR) is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.

The key element is that companies go beyond the legal or regulatory requirements of relevant markets and/or economies. Both governments and private companies are thus channels to provide public goods. Besley and

Table 2. Performance indicators of economic systems (2019)

Indicator	Economic systen		
	Market (USA)	Impact (EU)	State (China)
Performance indicators			
0. SDG index (0 – 100 best)	74.5	79.5	73.2
1. Economic dimension			
- GDP per capita PPP ($)	65,112	44,539	19,504
- Real GDP growth (5-year average)	2.4%	2.2%	6.6%
2. Social dimension			
- GINI index (0 - 100 unequal)	38.2	33.2	41.2
- Global gender gap (0 - 1 parity)	0.72	0.76	0.68
- Human rights (-3.8 - 5.4 better)	0.2	2.0	-1.3
3. Environmental dimension			
- Carbon emissions per capita (metric tons)	22.8	11.9	6.7
- Material footprint per capita (tons)	31.9	21.7	19.7
Conditions for creating broad welfare			
1. Competitiveness dimension			
- Product, labour, financial markets (0 – 100 best)	79.2	68.0	63.9
- Business dynamics (0 – 100 best)	84.2	70.9	66.4
- Innovation capability (0 – 100 best)	84.1	68.9	64.8
2. Tax to GDP ratio	24.3%	40.3%	18.9%
3. Forest area (as % of land area)	33.9%	38.1%	22.4%

Notes: SDG index from Sustainable Development Report, GDP from IMF World Economic Outlook, GINI index from Standardised World Income Inequality Database, Gender gap from WEF Global Gender Report, Human Rights from OurWorldinData, CO_2 emissions from Eora MRIO database, Material footprint from MaterialFlows.Net, Competitiveness from WEF Global Competitiveness Report, Tax-to-GDP ratio from OECD Revenue Statistics, Forest area from World Bank. EU figures are calculated as a weighted average of the EU28 countries with population or GDP as weight.
Source: Bruegel.

Ghatak (2001) indicated that public goods provision has shifted from public to mixed public-private ownership, because of a retreat of public production.

There are various reasons for companies to engage in CSR. Kitzmueller and Shimshack (2012) identified three types of pressure that might discipline companies into certain social behaviour:

1. Markets: employees in labour markets and/or consumers in product markets;

2. Politics: NGOs or civil society in private politics and/or governments in public politics; and

3. Social norms: commonly accepted norms, views and values in a community.

Which channels could link economic and corporate social behaviour? The literature distinguishes, broadly speaking, three main channels. The first channel that determines CSR behaviour is the **legal channel**. Following the seminal work of La Porta *et al.* (2008), Liang and Renneboog (2017) focused on the law and regulations and reported that the origin of the legal system (civil, common or socialist law) in the country where a firm is domiciled explains a significant portion of the heterogeneity of CSR behaviour among firms.

The origin of the legal system in a country is an indication of the discretion that company executives and asset owners have to make decisions. The prime contrast is the *ex-ante* regulation found in French-type civil law and the ex-post litigation-heavy Anglo-Saxon common law. The empirical evidence indicates that civil-law countries have higher levels of CSR than common-law countries, with very low levels for socialist-law countries.

The second channel relates to **taxation policies**. Economists prefer pricing externalities through a Pigouvian tax, which reflects the social costs of the damage. A Pigouvian tax incentivises companies to reduce their carbon emissions, which may in turn prompt a further improvement of their CSR practices. Stern (2008) argued for a carbon tax to guide the transition to a low-carbon economy.

In a similar way, appropriate pricing of natural resources (virgin materials) helps to avoid depletion and provides an incentive for material savings and recycling. Only 20 percent of global carbon emissions are currently covered by a carbon price and less than 5 percent of those are currently priced at levels consistent with reaching the temperature goals of the Paris Agreement (World Bank, 2019).

The third channel relates to **culture and values** and is based on the seminal work of Inglehart (1990). Dyck *et al*. (2019) showed that asset owners that are domiciled in a country with a high level of social norms have a positive influence on the CSR behaviour of foreign companies of which they own stock.

Schoenmaker and Stevens (2020) explored whether the value dimension of materialism is a driving force of the differences in CSR performance among companies. Materialism measures the importance people place on wealth and possessions. Attaching more value to buying and having possessions could cause overconsumption and indicate self-importance.

They found that CSR ratings are positively related to post-materialist values, such as freedom of speech, interpersonal relations and the environment. A country's post-materialist values are found to be more important than its wealth (GDP per capita) in explaining the level of CSR. The level of CSR investment of companies depends thus more on a population's willingness than on its means.

The results have implications for corporate governance because post-materialist values are a proxy for the social mindedness of a country's citizens, both in personal and professional settings.

The three channels – legal origins, taxation and culture – are not mutually exclusive. Nevertheless, the lower CSR performance of companies in common-law countries found by Liang and Renneboog (2017) seems to be driven by the large number of US companies in the common-law group. United Kingdom corporates in the common-law group exhibit a higher level of CSR performance, which is closer to that of European civil-law countries (see Figure 1 and Table A2).

Empirical link between economic and corporate social performance

To analyse the relationship between the societal performance of economies and companies, we need broad indicators that cover the overall performance. At the country level, we take the earlier mentioned SDG index from the Sustainable Development Report that measures societal performance at the aggregate level (Sachs *et al.* 2019).

Corporate social responsibility (CSR) or environmental, social and governance (ESG) ratings first emerged in the 1980s as a service for investors to screen companies not purely on financial characteristics, but also on characteristics relating to social and environmental performance (Berg *et al.* 2019).

Our CSR ratings are taken from Thomson Reuters ASSET4. We use the integrated CSR ratings, which includes three dimensions – environmental, social, and governance (see Table A1 in the Appendix). For completeness, we also report the separate environmental and social ratings. CSR ratings at the country level are constructed as a weighted average of company ratings in that country.

Figure 2 shows SDG and CSR ratings in a scatter diagram (Table A2 shows the ratings for individual countries). As expected, there is a positive relationship between the two. The Pearson correlation coefficient denoted by r_{xy} is 0.59. This relatively high correlation suggests that there is a strong relationship between SDG and CSR ratings. Further research is needed to investigate the causality between SDG and CSR ratings and underlying common factors.

Table 3 provides an overview of SDG and CSR ratings for the main economic systems. Europe has the highest ratings and China the lowest, with the US in between. While all ratings are measured on a scale from 0 to 100, the differences in overall CSR ratings (from 53 to 79) are more pronounced than these in SDG ratings (from 70 to 78).

For the individual country ratings on corporate social and environmental responsibility, the differences are even starker. Table 3 shows that Europe scores even higher on the social and environmental ratings (84 respectively 88) than on the overall rating (79), while China is at the bottom at 52 and 60, and the US is in-between at 65 and 71. European companies thus perform much more strongly on the social and environmental fronts than their US and Chinese counterparts.

This finding is consistent with the earlier message from Table 2 at the country level, where the European economy has a stronger performance on the social and environmental dimensions than the US and Chinese economies.

Empowering companies

While the government should set the policies for addressing social and environmental externalities, there is also a role for companies. This section explores how companies can be empowered to deliver both profit and impact. Long-term oriented institutions play an important role in fostering multiple value creation.

Figure 2. Relationship between SDG and CSR ratings (2018)

Note: CSR ratings from ASSET4 Thomson Reuters and SDG ratings from Sustainable Development Report. Europe is calculated as a weighted average of the EU28 countries with GDP as weight. Country CSR ratings are calculated as a weighted average of a country's companies with market value as weight.
Source: Bruegel.

Table 3. SDG and CSR ratings (2018)

Rating	Market (USA)	Impact (EU)	State (China)
SDG rating	73.0	78.1	70.1
CSR rating			
- Overall rating	69.0	78.8	53.0
- Social rating	65.2	83.5	52.0
- Environmental rating	70.8	88.2	59.5

Note: CSR ratings from ASSET4 Thomson Reuters and SDG ratings from Sustainable Development Report. EU figures are calculated as a weighted average of the EU28 countries with GDP as weight. Country CSR ratings are calculated as a weighted average of a country's companies with market value as weight.
Source: Bruegel.

Governance in a new economic model

It is the role of governments to set the sustainability goals: determine where we need to go and what transitions are needed. The UN SDGs provide the global strategy (UN, 2015), which needs to be further specified at the national and subnational level.

Governments should also set regulations and taxation to address social and environmental externalities. This includes determining at what level of administration the steps need to be taken. For example, carbon pricing is probably best tackled at the EU (or even global) level, while traffic congestion pricing is better done at the city level.

There is also a role for governments to engage the corporate and financial sectors in the earliest stages of development of technologies and business models. In those early stages the private risk-return trade-off might not work properly, while the societal risk-return does work.

The long-term viability of transition initiatives can then be assessed, with a potential need for short or intermediate-term concessional finance. These early stages are the hardest, where government help and vision are needed (Mazzucato, 2018).

The required government help is not only financial through co-funding or other incentives, but also coordination through developing a system vision and using its convening power by bringing parties together.

However, social and environmental externalities are not perfectly separable from production decisions (Hart and Zingales, 2017). This means that it is more expensive to undo the consequences of, for example, water pollution by a manufacturing firm than to prevent it in the first place.

Moreover, asymmetric information between company insiders and outsiders means that externalities cannot perfectly be addressed in advance by external rules and taxes. Shapira and Zingales (2017) showed how a respected company, such as DuPont, knowingly caused environmental damage when disposing of a toxic chemical used in the making of Teflon in its West Virginia Plant.

This case was recently turned into a legal thriller film called *Dark Waters*. The harmful pollution was a rational decision: under reasonable probabilities of detection, polluting was *ex-ante* optimal from the company's perspective, albeit a very harmful decision from a societal perspective.

Shapira and Zingales (2017) examined why different mechanisms of control – legal liability, regulation and reputation – all failed to deter socially harmful behaviour. One common reason for the failures of deterrence mechanisms is that the company controls most of the information and its release.

Another reason why externalities cannot be fully addressed is unforeseen circumstances, which are difficult to contract or regulate in advance (Grossman and Hart, 1986)[3]. If externalities are not perfectly addressed in advance by rules and taxes, there is ample space for economic actors to exert pressure on the regulatory, judicial and political system to avoid enforcement or to shape enforcement in their own interest (Zingales, 2017).

Finally, globalisation makes regulation of externalities caused by multinational companies more difficult (Benabou and Tirole, 2010).

Companies that manage well their material sustainability issues, are more likely to adapt their business models, protect their competitive positions and grow their intangible assets (Schoenmaker and Schramade, 2019). The better their strategy anticipates the importance of sustainability issues, the more likely they are to be successful both in long-term value creation and in making the transition to a more sustainable economy.

The move to sustainable business models requires companies not only to take care of the financial viability of their business model, but also to define and measure social benefits and environmental regeneration. They have to manage the company's integrated value, which integrates financial, social and environmental value.

Even more fundamentally, the purpose of the firm comes into question. As a company moves from simply maximising financial value to maximising integrated value, serious questions need to be asked on what the company wants to achieve, and where and how it can achieve the most.

Corporate governance

In the governance of an impact economy, there is an important role for institutions that foster the common good and multiple value creation. How can the government empower companies to behave responsibly?

While finance textbooks suggest that companies are profit-maximising entities, leading business scholars, including Colin Mayer (2018) and Alex Edmans (2020), have argued that successful companies deliver purpose and profit.

The basic idea is that successful companies are driven by purpose, which is the desire to serve a societal need. In the process of serving society, companies also generate profits for investors, salaries for employees and payments to suppliers.

Profits are thus derived from purpose rather than fundamental in their own right.

Emerging evidence shows that sustainable companies are more long-term oriented and have better financial performance (Eccles *et al.* 2014; Mayer, 2018; Schoenmaker and Schramade, 2019; Edmans, 2020).

Nevertheless, there is also evidence that shareholders have historically over-discounted future dividends by 5 to 10 percent, indicating short-termism (Davies *et al.* 2014). Box 1 provides an example of a telecoms operator pursuing long-term value creation.

This company sets long-term goals for all its stakeholders and balances these long-term goals to provide a solid footing for its business. The telecom operator's purpose, from which the long-term goals are derived, inspires all stakeholders to the common goal of connecting people through advanced technology.

It is crucial to anchor the purpose of companies in corporate law (Mayer, 2018). That allows companies to state their purpose and to establish their commitments to different parties. These commitments could go beyond the traditional groups of shareholders and directors and extend to employees, customers and communities.

Corporate law could grant these parties access to information about the performance of the company regarding their interests and rights of representation in relevant decision-making processes. Further detail can be specified in corporate governance codes.

Recent updates of the Dutch and UK corporate governance codes, for example, require companies to develop a view on long-term value creation by the company and to formulate a strategy in line with this.

It is left to companies to organise themselves and promote entrepreneurship for achieving profit and positive impact (Edmans, 2020). This also means decentralised organisation, where information on, and competition for, new impact ideas (ie. innovation) emerges bottom-up in the economy.

Companies are emerging that want to balance profit and impact. These companies enshrine financial and impact goals in their business charters and articles of incorporation. They form the framework the managing board has to operate within.

Examples of such companies are the newly emerging benefit corporations. Benefit corporations have to state their social and private purposes and are obliged to report on how they contribute to their social and private purposes.

Defining the purpose or mission of the company is the starting point. To deliver on the stated purpose, the company's governance, strategy, business model, accounting system and financial reporting must be aligned with this purpose. On corporate governance, selection and appointment criteria for non-executive and executive directors should include a sustainability track record, competencies and mindset (de Reus, 2018).

Executive pay should also be based on delivering on the company's societal key performance indicators. Executives can empower the company by centring decision-making throughout the company – from strategy, business model, accounting system to reporting – on the concept of integrated value, which combines financial, social and environmental value in a balanced way (Schoenmaker and Schramade, 2019).

A major institutional advance would be to require integrated reporting by companies. Integrated reporting is about understanding how organisations create integrated value and how its activities affect the financial, social and natural capitals it relies upon for this.

A promising development is the establishment of the IFRS Foundation working party on sustainability reporting. These sustainability standards would complement the international financial reporting standards (IFRS), which are issued by the International Accounting Standards Board.

The calculation of the integrated value makes a company's value visible to its stakeholders – shareholders, employees, customers, suppliers, society and environment. Some companies have started to report on financial, social and natural capitals in integrated reports (see, for example, KPN in Box 1), but that is still on a voluntary basis with non-harmonised standards.

Enhancing stewardship

As the financier of the corporate sector, the financial sector can fulfil a stewardship role to steer companies

Box 1. Long-term value creation at KPN

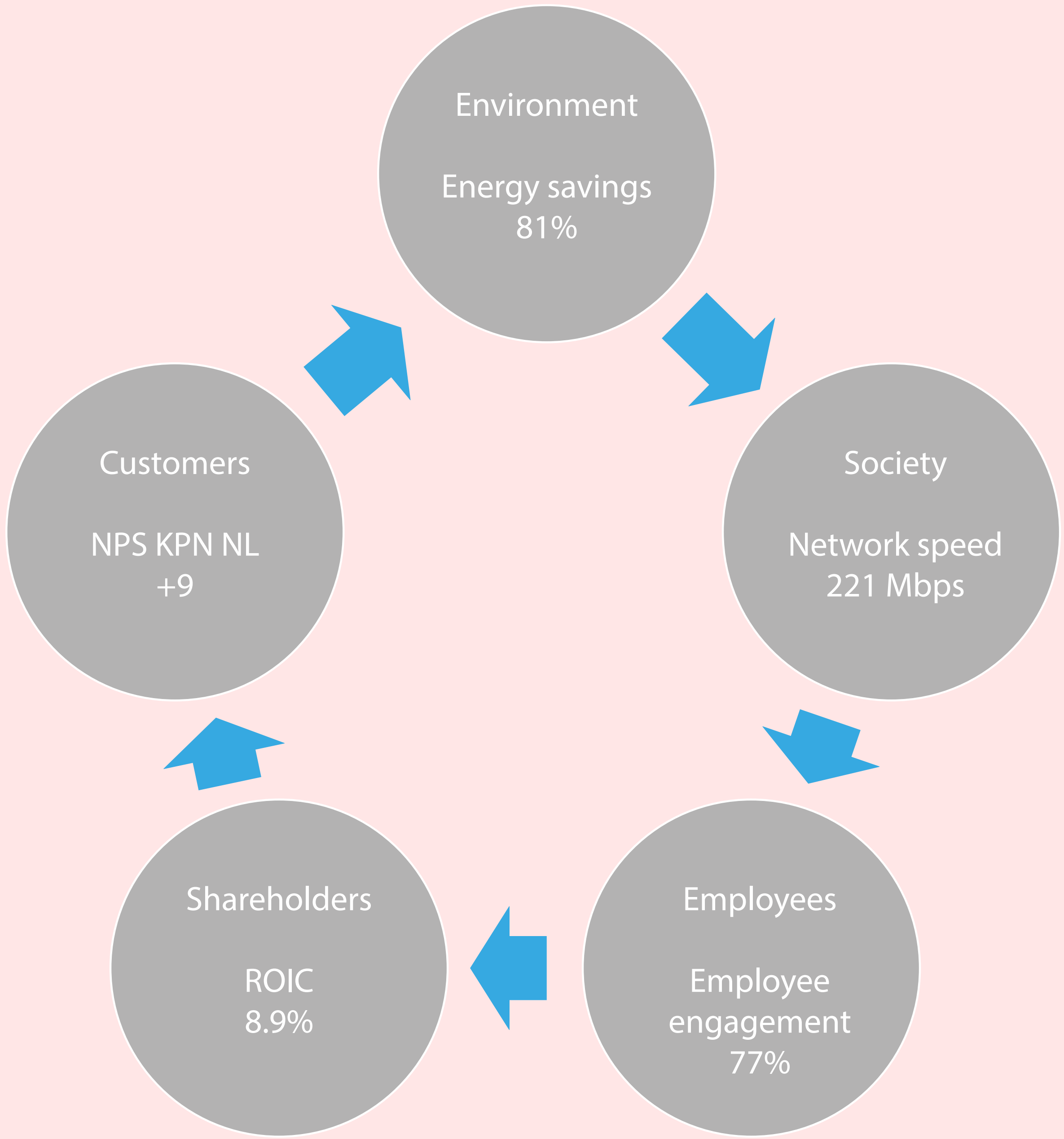
Dutch telecom operator KPN could maximise short-run return on invested capital (ROIC) by cutting operating costs (eg. marketing costs for new customers) and capital investments (eg. large investments in new network technology), which would look great for short-term minded shareholders.

However, it would also effectively kill its business, as ROIC would soon enough drop sharply as market share and product margins would fall. To restore market share, KPN would have to spend more than the initial costs and investments needed to pursue its long-term strategic goals.

The company therefore manages on the basis of five goals: shareholders, customers, employees, society and environment. It has key performance indicators on all five and reports on each one, which should give a much better understanding of long-term value drivers than the old reporting system based on financial indicators.

In particular, the Net Promoter Score (NPS) for customers is found to be very powerful. Figure 3 shows the importance of balancing the goals. This balanced approach puts KPN's business on a more solid and less volatile footing.

Figure 3. Delivering value for all stakeholders



Note: Environment is measured as energy savings by customers; society as download speed of broad band fixed at mega-bits per second (Mbps); employees as employee engagement; shareholders as return on invested capital (ROIC); and customers as net promoter score (NPS).
Source: KPN Integrated Annual Report 2018.

towards sustainable business practices. The financial sector can do this through its allocation and monitoring roles (Schoenmaker and Schramade, 2019). The allocation of funding to its most productive use is a key role of finance.

Finance is therefore well positioned to assist in selecting companies that pursue long-term value creation. Finance plays this role at different levels. Banks, for example, define their lending strategies in terms of which sectors and projects are eligible for lending and which are not. Similarly, investment funds set their investment strategies, which direct in which assets the fund invests and in which assets it does not.

The financial sector can thus play a leading role in the transition to an impact economy, based on inclusiveness and environmental preservation. If the financial sector chooses to finance sustainable companies and projects, they can accelerate the transition.

In terms of monitoring their investments, investors can also influence the companies in which they invest. Investors thus have a powerful role in controlling and directing corporate boards. The governance role also involves balancing the many interests of a corporation's stakeholders.

A rising trend in sustainable investment is engagement to steer companies towards sustainable business practices. Large institutional investors, including investment funds, pension funds and insurers, are well placed to fulfil this stewardship role. Table 4 indicates that traditional institutional investors have jointly an equity stake of 58 percent in companies.

Emerging empirical evidence on proxy voting and engagement shows that the large US investment funds are more narrowly 'money conscious', voting with management and under-investing in engagement and stewardship. By contrast, large US and Canadian pension funds support a more social-environmental orientation of companies and vote typically in favour of social and environmental resolutions at annual general meetings (Bolton *et al.* 2020).

For Europe, evidence indicates that institutional investors, in particular pension funds and investment funds, are active in coordinated engagements to influence firms on environmental and social issues. Investors form a syndicate with a lead investor and supporting investors, whereby the lead investor typically has a higher stake in the company and comes from the same country as the target company.

Coordinated engagements appear effective in successfully achieving the stated engagement goals and subsequently improving target performance (Dimson *et al.* 2019). The large US investment funds, which also have a large presence in Europe, are absent in these coordinated engagements.

While some large investors, such as pension funds, thus take a broader societal view, Ferreras (2017) and Rodrik (2020) argue that firms should be democratised. They propose that shareholders and workers should both be represented on equal terms. However, this would still leave the environmental pillar (ie. future generations) unrepresented.

Effective corporate governance must include all three pillars. As discussed earlier, integrated reporting helps to make the societal value, including its financial, social and environmental components, visible to all interested parties.

Government policies could enhance the stewardship role of the financial sector. The EU's Action Plan on Sustainable Finance (European Commission, 2018) contains legal proposals to strengthen this stewardship role. The disclosure regulation[4] requires clarifying the fiduciary duty of institutional investors and their asset managers.

Fiduciary duty sets out the responsibilities that financial institutions owe to their beneficiaries and clients. Clarified duties encompass key investment activities, including investment strategy, risk management, asset allocation, governance and stewardship.

The clarified duty also requires that all participants in the investment chain pro-actively seek to understand the sustainability interests and preferences of their clients, members or beneficiaries (as applicable) and to provide clear disclosure of the effects, including the potential risks and benefits, of incorporating them into investment mandates and strategies.

Table 4. Share of institutional investors in equity

Type of institutional investor	Amount (in US$ trillion)	Share in equity markets
Investment funds	24.0	41.1%
Investment funds (excl. pension funds/insurers)	11.2	19.1%
Pension funds and insurance companies	22.9	39.1%
Traditional institutional investors	34.1	58.2%
Sovereign wealth funds	3.3	5.6%
Hedge funds	0.9	1.6%
Alternative institutional investors	4.2	7.2%
Total institutional investors	38.3	65.4%

Note: Pension funds and insurers invest directly in equity and indirectly via investment funds. This indirect investment is deducted from the equity managed by investment funds to avoid double counting. As only data for institutional investors in developed countries is available, the share is calculated as a percentage of developed equity markets.
Source: Schoenmaker and Schramade (2019) based on OECD (2017) and SIFMA (2017).

These sustainability disclosures enable a dialogue between institutional investors and end-investors. Some large pension funds are already conducting surveys among their beneficiaries to learn about their sustainability preferences. By the same token, a beneficiary can raise sustainability concerns with the relevant institutional investor that is managing its investments.

Conclusions

This paper provides a high-level overview of the main economic systems for the production of public and private goods. In the market economy, the government is exclusively responsible for public goods, while companies are producing private goods. The market economy is capable of delivering economic growth and profits, but at the expense of social inequality and economic degradation.

By contrast, the state is ultimately responsible for producing public and private goods in the state economy. This comes at the cost of efficiency and individual development. The impact economy takes the middle ground.

While the government produces the classical public goods, the government and companies care jointly about the common good of sustainable development. They do so by balancing profit and impact. Lima de Miranda and Snower (2020) also promote a balanced dashboard of economic, social and environmental indicators to evaluate current and future wellbeing.

It appears that the impact economy model is well-positioned to find that balance with appropriate achievements across all three pillars: economic, social and environmental. This is translated into higher SDG scores at country level and higher CSR scores at firm level. The market and state economy models achieve economic growth, but at the expense of far lower scores on the social and environmental pillars.

The challenge is to stay away from perceived trade-offs, for example, between growth and environmental protection or social inclusion (Kallis, 2018). The idea is that the growth/profit, social and environmental dimensions should all three become focal points and be properly balanced by governments and companies in the pursuit of long-term sustainable development.

In the impact economy model, the steering of the economy moves from stimulating GDP to enhancing broad welfare, which includes wellbeing and sustainability. Companies transform from profit- maximising entities into purpose-driven organisations. Decision-making by governments and companies is no longer based on economic and financial factors only, but also on social and environmental factors.

The defining criterion of the impact economy is taking a broad approach in government policy-making and in corporate decision-making covering all three pillars. Institutional innovations, such as putting purpose into corporate law, requiring integrated reporting and stimulating engagement by the financial sector, can encourage companies to adopt sustainable business practices.

A transition to the impact economy model requires a change of mind set and new skills to understand the social and environmental pillars. Responsible education can help to build people's capacities to overcome motivational challenges for sustainable action.

Responsible economics, business and finance education aims to develop the capabilities of students to be future generators of sustainable value for society and business. Responsible education is also relevant for professionals who are already working in government and business.

Since the Industrial Revolution, economic and financial capital have been accumulated building on social and natural capital, bringing us (material) prosperity at the expense of rising social inequality and environmental degradation. It is now time to put economic and financial capital at the service of social and natural capital in order to deliver lasting prosperity for all. ■

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Endnotes

1. This is not an argument for degrowth (see, for example, Kallis et al, 2018). Our proposal is that all three pillars (growth/profit, social and environmental) should become focal points and properly balanced by governments and companies.

2. Surveying the literature, Darvas and Wolff (2016) found, for example, that the empirical evidence for the impact of inequality on economic growth is inconclusive. Several papers have found that inequality reduces growth (eg. Knowles, 2005; Ostry et al. 2014), while many others have concluded that inequality increases growth (eg. Forbes, 2000; Halter et al. 2014).

3. One solution to unforeseen circumstances is public ownership, whereby the government has residual control rights. However, Besley and Ghatak (2001) argued that there are efficiency trade-offs between public and private ownership of public goods.

4. Regulation EU/2019/2088 on sustainability-related disclosures in the financial services sector.

5. CSR reporting by companies is still in its infancy. Moreover, rating agencies use different concepts of CSR performance.

Nevertheless, Berg et al. (2019) showed that differences between the CSR ratings of the five major rating agencies are decreasing. They found a correlation of 61 percent between their ratings.

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Appendix

Source and composition CSR ratings

Several sustainability data providers measure corporate social responsibility (CSR) ratings, which are also called environmental, social and governance (ESG) ratings. The main datasets to assess CSR performance of companies are

Table A1. Composition of CSR ratings

Pillar	Number of measures	Weight
Environmental		
Resource use	19	11%
Emissions	22	12%
Innovation	20	11%
Social		
Workforce	29	16%
Human Rights	8	4.5%
Community	14	8%
Product responsibility	12	7%
Governance		
Management	34	19%
Shareholders	12	7%
CSR strategy	8	4.5%

Source: ASSET4 from Thomson Reuters.

MSCI, Thomson Reuters' ASSET4 and Vigeo[5]. We choose the ASSET4 database because of its broad country coverage. Within the ASSET4 database, we use the ASSET4 integrated ratings, which includes three pillars – environmental, social, and governance. These integrated CSR ratings are aggregated across 10 indicators, which have various weights in the full rating. Table A1 shows the composition and weighting scheme of the integrated CSR ratings.

SDG and CSR ratings

The SDG index aggregates performance across the 17 SDGs (United Nations, 2015). The data is taken from the Sustainable Development Report (Sachs et al. 2019). The CSR ratings are from Thomson Reuters' ASSET4. Country CSR ratings are calculated as a weighted average of country's companies with market value as weight. Only countries with more than 10 company observations are included. Our dataset in Table A2 (see below) contains 40 countries. The figures for Europe are calculated as a weighted average of the available EU countries with GDP as weight.

Table A2. SDG and CSR ratings at country level (2018 figures)

Country	SDG rating	CSR rating		
		Integrated	Social	Environmental
India	59.1	63.2	75.4	78.2
Qatar	60.8	28.9	18.0	15.5
South Africa	60.8	61.2	68.9	69.7
Indonesia	62.8	66.1	81.6	72.6
Saudi Arabia	62.9	53.7	60.0	58.0
Philippines	65.0	61.5	67.7	75.0
Mexico	65.2	64.9	81.2	77.5
Turkey	66.0	66.5	79.0	81.2
Peru	68.4	43.8	30.9	34.7
Russia	68.9	65.7	76.8	71.2
United Arab Emirates	69.2	55.2	66.5	56.6
Thailand	69.2	65.1	85.9	77.7
Brazil	69.7	67.5	83.0	78.9
Malaysia	70.0	61.1	79.0	78.0
China	70.1	53.0	52.0	59.5
Argentina	70.3	57.5	56.2	58.7
Singapore	71.3	62.5	79.1	71.1
Israel	71.8	55.7	61.3	54.7
Chile	72.8	60.9	74.8	67.9
Australia	72.9	71.7	76.1	73.6

Country	SDG rating	CSR rating		
		Integrated	Social	Environmental
United States	73.0	69.0	65.2	70.7
Poland	73.7	60.0	73.6	76.0
Italy	74.2	76.4	87.6	86.3
Spain	75.4	77.1	90.3	90.2
Luxembourg	76.1	65.6	73.8	68.4
Canada	76.8	66.7	70.0	72.8
Ireland	77.5	71.2	83.5	83.0
New Zealand	77.9	52.6	48.4	54.3
Europe	78.1	78.8	83.5	88.2
Japan	78.5	64.5	74.9	80.9
United Kingdom	78.7	83.0	83.1	90.0
Belgium	79.0	62.9	72.8	83.4
Netherlands	79.5	71.6	82.2	88.0
Austria	80.0	68.4	78.6	78.6
Switzerland	80.1	77.6	85.1	89.5
Norway	81.2	74.7	80.0	78.2
France	81.2	75.8	89.1	91.2
Germany	82.3	76.5	84.8	87.1
Finland	83.0	74.3	85.6	92.3
Denmark	84.6	68.9	81.4	83.9
Sweden	85.0	69.6	77.0	80.8

Source: See Figure 1.

Is the market prepared?

The SCA deadline is nearing. Marius Galdikas says the need to adapt will be a watershed moment for businesses

Digital payment providers and vendors in the European Union are facing the fast-approaching deadline to implement Strong Customer Authentication (SCA). The EU legislation was slated to come into force on September 14, 2019. But instead, the new requirements were deemed too complex and pushed back to a rolling deadline. Still, for multiple businesses, the changes will come into force on December 31, 2020, and extend a bit into 2021 for exceptional circumstances. The need to adapt will be a watershed moment for businesses.

What are SCA requirements?

SCA requirements are a part of the EU-wide Payment Service Directive 2 (PSD2), which aim for a unified, smoother euro area payment system. The crux of SCA is the legal requirement and technical application of extra steps in the payment process.

Usually, authentication of this type combines a form of secret knowledge, such as a PIN or password, with a physical object - a chip, card, registered SIM card and phone, or another authentication device. Those requirements must be unrolled to all online transactions and contactless payments made within the EU, and the clock is ticking on rolling out solutions that unite vendors and payment providers in ways both compliant with the law and technically sound.

The changes affect a long list of activities and crucial points for both payment providers and various vendors. Without proper understanding and implementation of the new types of authentication, immediate problems arise. Vendors should act now on SCA, to prevent confusing shoppers, declined payments or abandoned shopping carts. Furthermore, implementing the changes on time will improve the credibility of vendors, as well as the entire payment provider industry.

At the moment, the current behavior of market players suggests that the SCA rules are either confusing, or the business is uncertain about their implications.

However, a wait-and-see stance is not an option, as when the deadline arrives, companies will have no choice but to sort out its compliance to resume business as usual. Although posing certain challenges, the new regulation may, in fact, be key to nurturing further market development - once the initial hurdles are overcome.

Growing market calls to strengthen security measures

The EU has tracked the challenges of the PSP business over the years, suggesting key areas of improvement, especially in combating fraud and scams.

it is crucial for vendors to seek out sound PSP partners that would help ensure their business is equipped with the right technical solutions and capable to accommodate the necessary forms of authentication

For now, a lot of responsibility falls on national legislation, but also on the PSP companies. Detecting fraud is a matter of tracking potentially unauthorised transactions. Scams, on the other hand, are defined as misleading schemes which end up redirecting funds.

The EU has set some requirements and goals to solve the payment process in a way that prevents unwanted transactions and can keep detailed records to increase the possibility for cross-border consumer protection.

The EU map of e-commerce and payment systems is highly varied, with both leaders and laggers. But this map also has room for growth due to increasing complexities of cross-border transactions. The current common euro area payment system built a network between banks, but the connections between vendors and payment providers are not any less complex, and also face challenges hindering growth.

Notably, Eurostat also discovered a growing e-commerce connectivity between EU countries. In 2019, 35% of purchases were made across borders and sourced from an EU country. This compares to 29% of the total purchases back in 2014. Until April 2020, most e-commerce covered physical goods and travel, with most vendors using their proprietary apps or other points of sale.

The looming deadline of the SCA challenges both payment processors and vendors that are struggling with the pressure of the COVID-19 pandemic. The new regulations arrive at a time when the online payment business has already worked hard on security and stricter KYC requirements. Now, the challenge is both legal and technical, as it calls to test and apply even more efficient, secure tools for user authentication.

Boom of e-commerce heightens fraud risk

With the growth of e-commerce and cross-border transactions, there has been a noticeable increase in online-related revenue. But this growth correlates with increased pressure from fraud attempts. As more users moved online for any activities from basic shopping to purchasing content, this extended the trend of busy online trade.

By April 2020, e-commerce had grown globally by 209% year-on-year. This trend coincided with a 13% increase of online fraud in April, compared to the same time period for 2019.

That said, not all vendors saw only net positives from increased online spending during lockdown. For some vendors, the past few months were a struggle with day-to-day expenses, and some are still seeking to raise revenues.

Thus, the new SCA regulations may come off as a bigger challenge for some businesses due to unfortunate timing. As their transactions will now need to follow a more complex format, some analysts have described the enforcement of SCA as *"kicking retailers while they're down."*

While the EU is aiming to be hospitable to digital modes of payment, its financial rules remain strict to ensure safety and compliance. The current mode of transactions is less secure, differentiated from the usual PIN and chip of bank cards. The SCA aims to change that by bringing businesses to apply a form of multi-factor authentication, thus preventing account theft and unauthorized transactions.

Racing to meet the deadline

Not all businesses and PSPs are on the path to becoming 'SCA-ready' as some are still battling pandemic-related strain on their resources, making it difficult to migrate to the new framework.

In addition, a number of businesses, mostly SMBs, are still unaware of the SCA's true impact on their activities.

Although SCA compliance should be at the top of everyone's mind, it was overshadowed by the current global events. However, if market players want to meet the deadline, the new implementation should become a top-list priority for vendors, and they should also start looking for partners already implementing robust forms of verification in accordance with the newly proposed rules.

Also, what should not be overlooked is that SCA encompasses not just 2FA, but much more, including dynamic linking and proper messaging to the customer about operations being authorised.

An everyday challenge to e-commerce vendors will be facilitating a bulk-payment approach, where each payment order has a unique ID and requires distinct PIN codes for verification. However, generating many PINs – and fast – becomes tricky, especially for banks still running on legacy systems, which are not up to speed to SCA requirements.

That said, vendors could fill in the gaps with a reliable PSP, which has already taken care of all the intricacies concerning the new law.

In our case, we became an early adopter of SCA regulations: reacting to the growing transaction volume, we released an App, which covers multi-factor authentication and one-tap approvals for payments. It will also be the basis for numerous innovations we have planned to implement in the near future.

The time to act is now

The EU has been lenient so far, and there is still time for businesses to face the SCA requirements. Even with the challenges ahead, both PSP and retailers can benefit from a clear, unified set of rules.

Estimates place card fraud at €1.3 billion per year. It is unknown how this number will float in the coming months, and with the growth of online payments.

However, if implemented, SCA will prevent more cases of fraud while completing the growing interrelated network of vendors and payment providers within the EU.

At this point, resources and knowledge are already available, along with clear EU guidelines. To meet the nearing deadline, it is crucial for vendors to seek out sound PSP partners that would help ensure their business is equipped with the right technical solutions and capable to accommodate the necessary forms of authentication.

Overall, the SCA implementation will put up more barriers against fraud, raising the importance that PSPs and vendors prioritize the December 2020 deadline. Even though there is a set of challenges to be considered, meeting SCA requirements can be still achieved without affecting the day-to-day business - it all comes down to what steps the company is willing to take next. ■

Marius Galdikas is CEO at ConnectPay

The global and Asian economic outlook

Tao Zhang considers the economic consequences of the COVID-19 pandemic, and says we need to work together to ensure a green and sustainable future

We are now halfway through 2020. In the first half of the year, the COVID-19 pandemic has been at the forefront of global discussion. Indeed, for many of us, 2020 is unquestionably a year like no other we have seen in our lifetime. On the one hand, the pandemic has affected the entire world. On the other hand, we also see that countries are working hard on the health front to contain the spread of the virus and to save lives. At the same time, on the economic front, countries are also using policy measures to stabilize their economies and safeguard people's livelihoods.

I would like to talk about three things. First, the global and Asian economic outlook and financial developments. Since the beginning of the year, and especially over the past 5 months, the COVID-19 pandemic coupled with governments' necessary responses to save lives, including isolation, social distancing and home quarantine, have triggered the worst downturn since the Great Depression in the 1930s.

Though still affected by the pandemic, several countries have started to reopen their economies and are making efforts to resume work and production. However, in the absence of a medical solution (for example, the development, production, and use of effective medicines and vaccines), the strength of the recovery remains highly uncertain.

Since the outbreak of the COVID-19 pandemic, the IMF has issued its *World Economic Outlook* (WEO) and its *Global Financial Stability Report* (GFSR) twice, in April and again in June. In the April WEO report, our projection of global output in 2020 was brought down substantially to -3.0 percent from 3.3 percent. In our June report, the projection was further revised downward by 1.9 percent to -4.9 percent. In other words, we believe the impact of the pandemic on world output is much bigger than we thought two or three months ago.

Almost all our member countries are seeing their growth forecasts this year revised downward, and most into negative territory. A synchronized deep downturn in 2020 is taking place, in both advanced economies (-8 percent) and emerging market and developing economies (-3 percent; -5 percent if we exclude China). Over 95 percent of countries are projected to have negative per capita income growth in 2020, with export-dependent economies particularly affected.

Given that the pandemic is still developing across the globe and many countries have yet to bring it under control, there remains tremendous uncertainty surrounding our 2020 annual growth forecast. On the upside, better understanding of the virus and more progress on vaccines and effective medicines could substantially bolster

... we are facing a complex situation, with major tasks and serious challenges ahead. Only by working together can we ensure that the global economy continues to move toward a greener, smarter, and fairer path of recovery

confidence that we will overcome the pandemic sooner. Larger, more forceful economic and financial policy support could also lead to faster and more complete recovery.

On the downside, further waves of infections, a rapid tightening of financial conditions, declining trade, and rising geopolitical tensions, among other factors, could further erode confidence with respect to consumption and investment, leading to deeper downturns or slower growth. Global trade is projected to collapse by nearly 12 percent in 2020.

Next, what can we say about the economic and financial outlook in Asia? With the exception of China, most Asian economies have had to ramp up their containment measures since the release of our April WEO report. The current picture of virus cases differs across the region. Some countries are experiencing rapidly rising cases each week.

Others are trying to flatten their curves. And yet others have been relatively successful in getting the virus under control. The main impact of lockdowns on the real economy is in the second quarter of 2020 for most Asian economies excluding China.

About our GDP forecast, for the first time in recent memory, Asia's output is expected to contract by 1.6 percent—a further downgrade from our April projection of zero growth. Asia's economic growth in the first quarter of 2020 was, in fact, better than projected in April—partly owing to early stabilization of the virus in some countries.

But, according to our June report, projections for 2020 have been revised downward for most of the countries in the region on account of weaker global conditions and more protracted containment measures in several emerging economies.

We are projecting that only a very small number of economies in Asia and the Pacific will actually grow this year, including China by 1.0 percent. Most economies in the region are expected to contract in 2020, and some quite sharply—Korea by around 2 percent, India by 4.5 percent, Japan by 5.8 percent, and some other economies by even more, given their dependence on remittances, tourism, and/or commodities.

It is also important to note that across Asia, on the demand side the only spending that is growing in 2020 is government consumption and investment, in emerging as well as advanced economies. In other words, economies are relying heavily on government stimulus.

Second, it will take longer for the global and Asian economies to recover. We believe that the recovery will start in 2021, and our projection of global output in 2021 is 5.4 percent. This may sound good, but it is 0.4 percent lower than our April forecast of 5.8 percent, and combined with the sharp contraction in 2020, it implies a cumulative loss to the global economy over two years (2020–21) of over USD 12 trillion from this crisis. Hotels, tourism, the travel industry, among others, will be particularly impacted.

As for Asia, in 2021 we project a pick-up of 6.6 percent, with China growing at 8.2 percent. This too has been revised downward from our April forecast (by 1 percent), leaving the level of Asia’s real GDP 5 percent lower in 2021 compared to pre-crisis projections.

In other words, we expect output losses in Asia from the pandemic to be persistent. And, unfortunately, some of this will be permanent. We are assuming a recovery of the private sector in 2021, but the pace is slower than previously expected. Moreover, the assumptions regarding this private-sector–led recovery may turn out to be somewhat too optimistic.

Why are we expecting this kind of slow and partial recovery? Here I wish to emphasize the following reasons.

First, the scope and duration of lockdown have been more substantial than expected, and we are already seeing some permanent negative effects, despite policy stimulus. A recent study, which was conducted by IMF staff and covers 57 economies, shows that lockdowns have led to a contraction in industrial production of about 12 percent a month.

Even when lockdown measures are fully relaxed, economic activity is not likely to return to full capacity, on account of social distancing and other containment measures. There may be a negative impact on productivity, as surviving businesses enhance workplace safety and hygiene standards. Also, many Asian economies depend on tourism, remittances, and in-person contact services, which will take a lot longer to recover.

Second, trade growth has slowed down. Global trade contracted by 3.5 percent in the first quarter relative to the same period last year. For Asian economies, the overall picture that they heavily depend on global supply chains has not changed, so that they cannot grow by themselves while the whole world is suffering.

Fundamentally reorienting the growth model towards domestic demand and away from heavy reliance on exports is a process that has already started, but it is clear that the region still depends on demand from other parts of the world. Given the sharp recession in advanced economies outside Asia, it is expected that the overall exports of Asia will contract quite significantly in 2020.

Third, domestic inequality was already rising fast in Asia and our recent research shows that past pandemics added to this inequality, especially hurting the employment prospects of those with limited education. Not only is inequality widening, but the adverse impacts of the COVID-19 shock are made even worse in Asia, which has a high proportion of informal workers. This can leave deeper economic scars, make the recovery more protracted, and pose greater challenges to social protection and health care systems.

Fourth, high debt levels will be a common problem in the global economy and Asia. Weakened household and corporate balance sheets in many Asian countries can weigh on investor sentiment and affect the pace of the recovery, amplifying the scarring effects.

And finally, should the private-sector-led recovery not occur as we are currently forecasting, policymakers in Asia will not have the space to provide much economic and financial policy support as they have been able to do in 2020 so far.

Third, how to support the recovery with effective and strong policy measures? For policymakers across the globe, the severe downturn and slow recovery mean that we are not out of the woods yet. There is a need for careful attention and great prudence as policymakers prepare their policy response.

Let's first look at short-term policies for the pandemic and the recovery from it. On the positive side, the recovery is benefitting from tremendous policy support—particularly in advanced economies—and to a lesser extent in emerging market and developing economies.

Global fiscal support now stands at over $10 trillion. In addition, major central banks have provided substantial additional stimulus via interest rate cuts, liquidity injections, and asset purchases, which has eased financial conditions. In many countries, these measures have succeeded in supporting people and preventing large-scale bankruptcies, thus helping to reduce lasting scars and aiding the recovery.

Although the real economic outlook is still not positive in many countries, the exceptional policy support, particularly by major central banks, has driven a strong recovery in financial conditions. Equity prices have rebounded and credit spreads have narrowed. Portfolio flows to emerging market and developing economies have stabilized. And currencies that sharply depreciated have strengthened.

By preventing a financial crisis, policy support has helped us avoid even worse outcomes. Yet at the same time, the disconnect between real and financial markets raises concerns of excessive risk taking and is a significant vulnerability.

Currently, some countries have begun to reopen their economy and resume work and production. The focus of their policy support will need to move toward encouraging people to return to work, as well as to helping reallocate workers to sectors with growing demand and away from shrinking sectors.

Support for a recovery should also include actions to repair balance sheets and address debt overhangs. This will require strong insolvency frameworks and mechanisms for restructuring and disposing of distressed debt.

As for Asia, fiscal and monetary policy support has been substantial—on an unprecedented level—and especially so in Japan, Australia, Singapore, and New Zealand. Support in Asian emerging markets has been mainly in the form of guarantees, loans, and quasifiscal activities, on account of a lack of fiscal space in government budgets. These helped to provide support to firms facing liquidity constraints.

Do we see the need for more support in Asian countries in the future? It depends on whether there are second waves of infection. In some cases, where government support is temporary, the authorities will need to look at whether they renew or revise measures to avoid creating serious fiscal pressures. Some low-income developing countries and small island states will need to actively seek additional budget support from development partners.

There are some specific challenges facing Asian countries. Let me discuss two of these. The first challenge, as mentioned before, is the worsening inequality and high levels of informality, which make it difficult to implement policy support, and which may exacerbate the scarring left by the crisis. The second challenge is capital flow volatility. If financial-market jitters return, then we may see the use of capital flow measures.

The international community has a responsibility to ensure that developing economies can finance critical spending by providing concessional financing, debt relief, and grants. At the same time, emerging market and developing economies must also have access to international liquidity.

As there are a large number of emerging economies in Asia, ensuring financial market stability, making available central bank swap lines, and deployment of a global financial safety net, will all be imperative.

As for the medium and longer term, besides fighting the pandemic and promoting recovery, policymakers in Asia will also have to focus on the structural challenges in the region. In fact, these challenges have already been in existence before COVID-19, and the pandemic has highlighted the importance of addressing them.

The first such challenge is population aging, which we at the IMF have written a great deal about. One important finding is that demographic trends could subtract ½ to 1 percentage point from annual GDP growth over the next three decades in countries like Japan where the aging problem is quite severe. Therefore, policies should incentivise greater labour-force participation by women and others to offset the impact of population aging.

Slowing productivity growth is a second major challenge. Policies should foster greater corporate dynamism by promoting the healthy entry and exit of firms, helping firms to address their debt overhang, and encouraging business innovation, so as to promote productivity growth.

In some Asian countries for example, 5-10 percent of the total corporate capital stock is tied up in so-called 'zombie' firms. If this problem can be solved, resources can be redirected to more competitive, innovative, and productive uses.

The third challenge is to promote trade openness. For decades, Asian economies used to benefit from rapid trade growth. But in recent years, they have also felt the impact from slowing trade on their economy. We notice that countries are making strong efforts to resolve trade and technology disputes, and that they are still promoting regional integration and improving the multilateral rules-based trading system.

Our modeling suggests that further trade liberalization and regional integration could, over time, lead to a new equilibrium in which Asia's GDP would be higher by more than 10 percent.

The fourth challenge relates to new technologies. Digitalization and automation offer huge opportunities to Asia and to the world. Two-thirds of the world's industrial robots are used in the region, and the share of retail sales taking place online is 1½ times larger in Asia than in Western Europe or the United States.

In the current COVID-19 crisis, the digital economy has played a key role, in terms of enabling working from home, improving business flexibility, and enhancing the efficiency of resource allocation. But these new technologies also bring challenges, such as the need to combat growing inequality (including the digital divide) and to support those displaced by new technologies.

Finally, policies should promote both mitigation and adaptation to climate change, and this will require global cooperation. Where conditions permit, countries should undertake green public investment to accelerate the recovery and support longer-term climate goals.

We will need to work together and make concerted efforts to develop mechanisms for carbon pricing and to promote investment in resilient infrastructure.

Conclusion

Global cooperation is vital to deal with both this truly global crisis and the more structural challenges that will remain with us in the medium to long term. The crisis has emphatically illustrated how necessary and beneficial our global linkages are. The virus knows no borders, and the only way to conquer it is to work together.

For Asia, which is highly integrated in the global value chain, external demand is especially important. The strength of its recovery will likely depend on the openness and innovation capability of Asia and other parts of the world, as well as on forging stronger links within the region and enhancing regional/sub-regional cooperation and integration.

The IMF will continue to do all it can to ensure adequate international liquidity, provide emergency financing, support the G20 Debt Service Suspension Initiative, and furnish advice and support to countries during this unprecedented crisis.

Globally, we have provided substantial lending support to our member countries. In the Asia-Pacific region, we are constantly engaging with our members. In terms of lending, so far for the Asia Pacific region we have agreed on four emergency funding programs and one IMF debt-relief arrangement. In terms of capacity development, despite connectivity challenges, our work has continued virtually on topics like cash management, supervisory responses to the crisis, and actions to safeguard tax compliance after the crisis.

In short, we are facing a complex situation, with major tasks and serious challenges ahead. Only by working together can we ensure that the global economy continues to move toward a greener, smarter, and fairer path of recovery. The IMF stands ready to provide all possible assistance to its membership. ■

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Deeper recession, wider divergences

Maarten Verwey and Björn Döhring consider the Commission's Summer 2020 interim forecast, and argue that a rapid response at the EU level is needed to minimise hysteresis

Forecasters agree that the economic fallout from COVID-19 has caused the sharpest drop in economic activity in Europe and globally since WWII. Just how deep the drop of activity was in the second quarter, which sectors were most strongly affected by containment measures, and how swift the rebound will be as they are gradually lifted is still very uncertain.

This column describes how the European Commission's Summer 2020 interim European Economic Forecast now estimates a deeper drop of output in the second quarter of the current year than was anticipated earlier. The recovery is also now expected to be less swift than was projected in Spring, with differences across member states set to be more pronounced.

Minimising hysteresis and avoiding persistent economic divergences within the EU and euro area requires the rapid agreement and deployment of common support measures at the EU level. The risk otherwise is of significant distortions to the internal market and of even deeper divergences between countries that could ultimately threaten the smooth functioning of the monetary union.

The economic impact of the COVID-19 pandemic spread around the globe extremely swiftly. In 2007-2008, it took more than a year from the appearance of cracks in the US subprime mortgage market to the collapse of Lehman Brothers in September 2008, and the trough of the ensuing recession was reached in both the US and the euro area in the second quarter of 2009 (NBER, CEPR).

In 2019-2020, it took 3½ months from the first reports on a novel virus in Wuhan to the imposition of lockdowns around the world in late March, and the trough of output in Europe is likely to have been reached in the course of the second quarter.

The recovery will be more drawn out than anticipated

In an environment that is so fast-moving, standard monthly or quarterly macroeconomic indicators are of limited use. Moreover, they are often released with substantial lags – for example, the preliminary flash estimates for second-quarter GDP will become available at the end of July.

Faced with the fast pace of events as well as vast uncertainty about the dynamics of the pandemic and the economic impact of containment measures, forecasters have turned to alternative data to gauge developments in quasi-real time[1].

Avoiding persistent drags from a debt overhang and unemployment hysteresis and minimising the still very large downside risks will require continued policy support

- *Medical indicators* depict a peak of new COVID-19 infections in the EU in the first half of April and a stabilisation at low levels since the second half of May. At the same time, the global number of new infections continues to be on the rise, with no clear indication of an inflection point (Figure 1a).

- *Indicators related to containment measures* illustrate the swift imposition of severe restrictions and their gradual lifting as well as the behavioural responses to the pandemic and related containment measures, for example in mobility patterns (Figure 1b).

- *Economic activity indicators* provide an early estimate of the depth of the economic fallout, for example measures of energy use (Figure 1c) and pollution as well as financial and survey data.

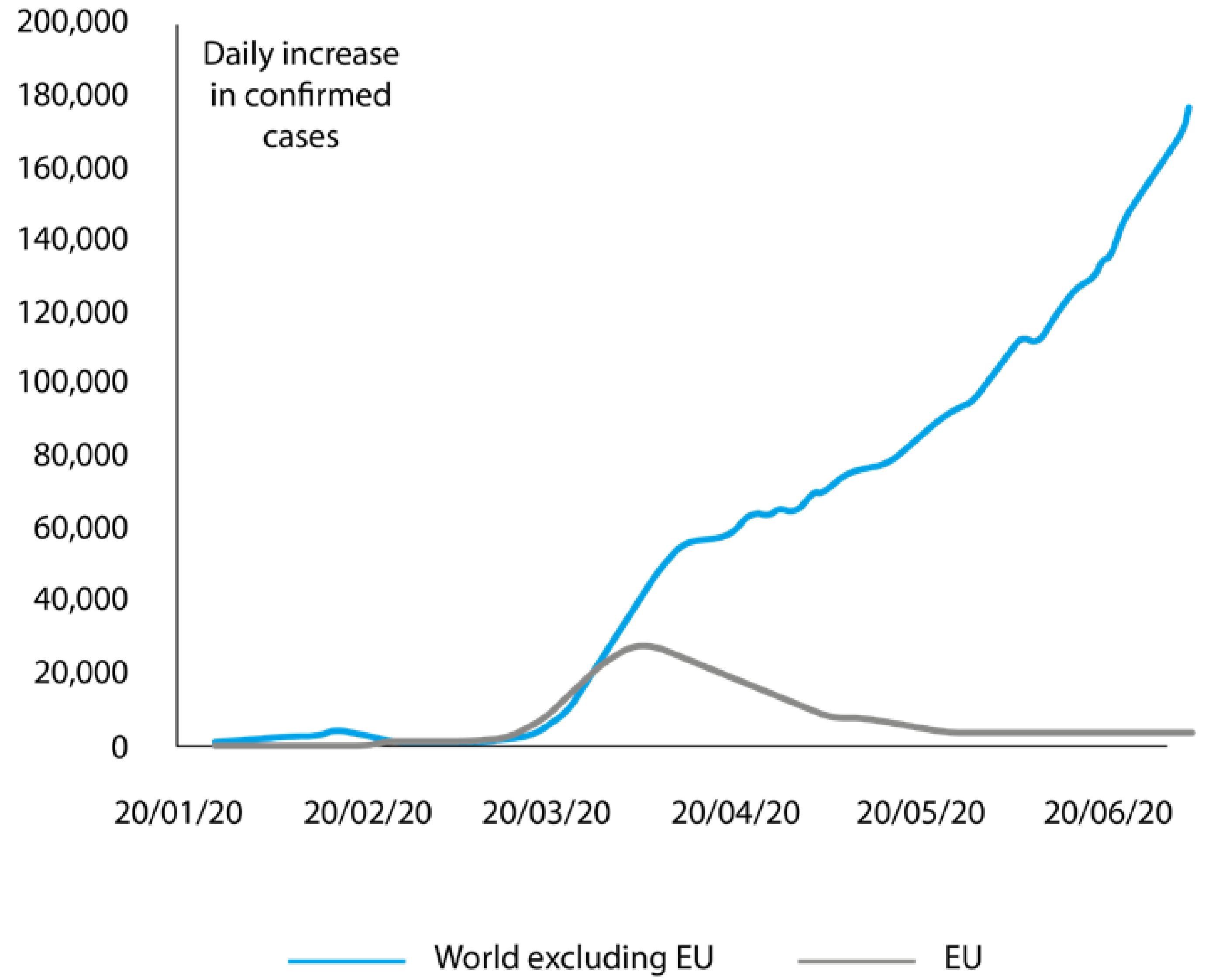
Taken together, these data suggest that economic activity in the euro area was hit harder in the second quarter than initially expected. Consequently, the Commission's summer interim forecast has revised GDP lower for this year, mostly on account of a later and more gradual lifting of containment measures than anticipated earlier. Other international institutions and private-sector forecasters have also revised their projections for 2020 lower in their latest forecasts (Figure 2).

High-frequency data now also point to a rebound of activity in the past few weeks. The Commission's business surveys for June not only confirm an increase of output expectations but also a bottoming-out of actual activity. The assessment of recent production improved strongly in industry in June and robustly in the retail sector, but only just points to a turnaround in services.

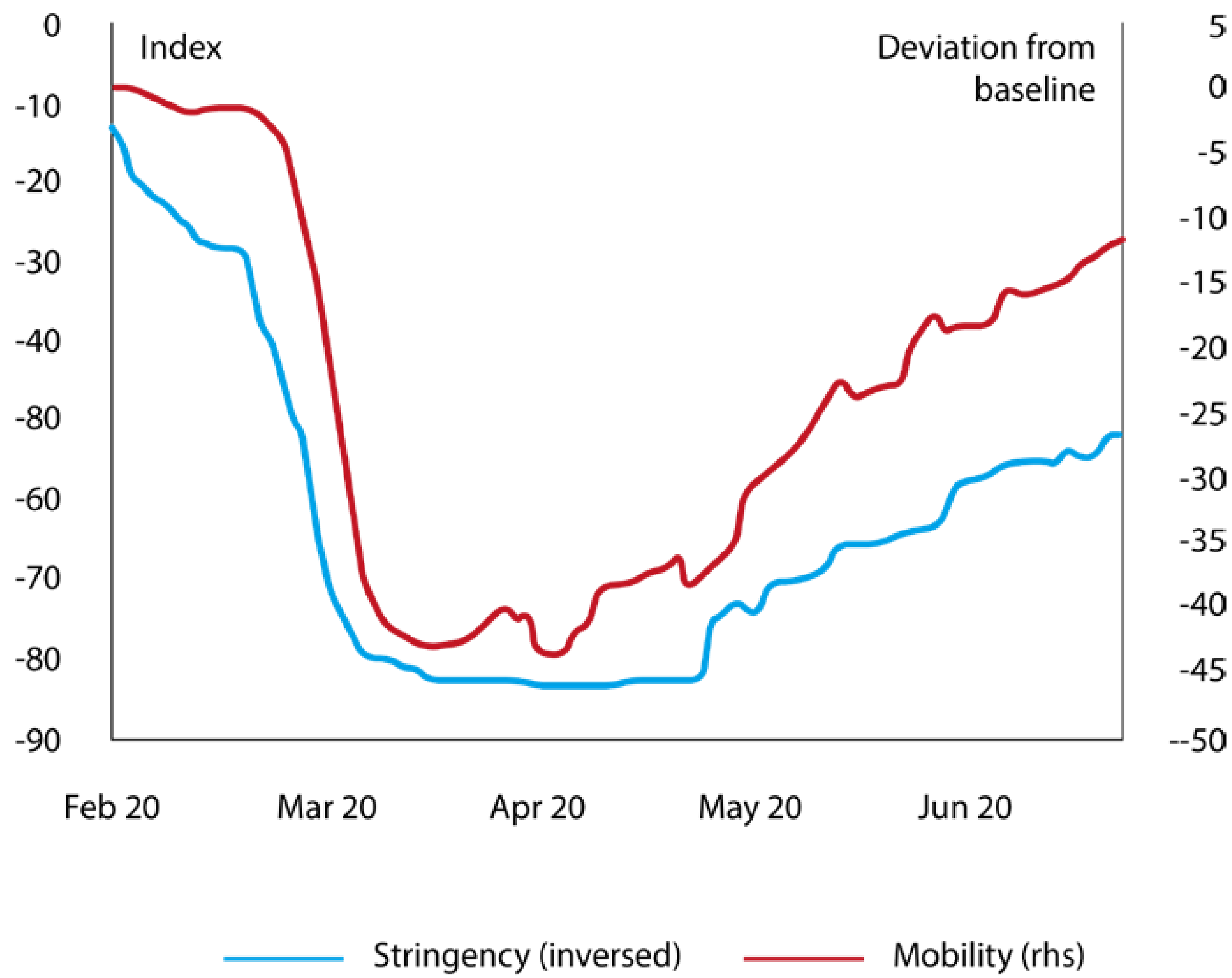
Despite some differences in the quantification of the negative impact this year and the subsequent rebound, there is broad agreement about the general outlook, and in particular that the recovery will remain incomplete by 2021.

Figure 1. Pandemic and containment measures, real-time data

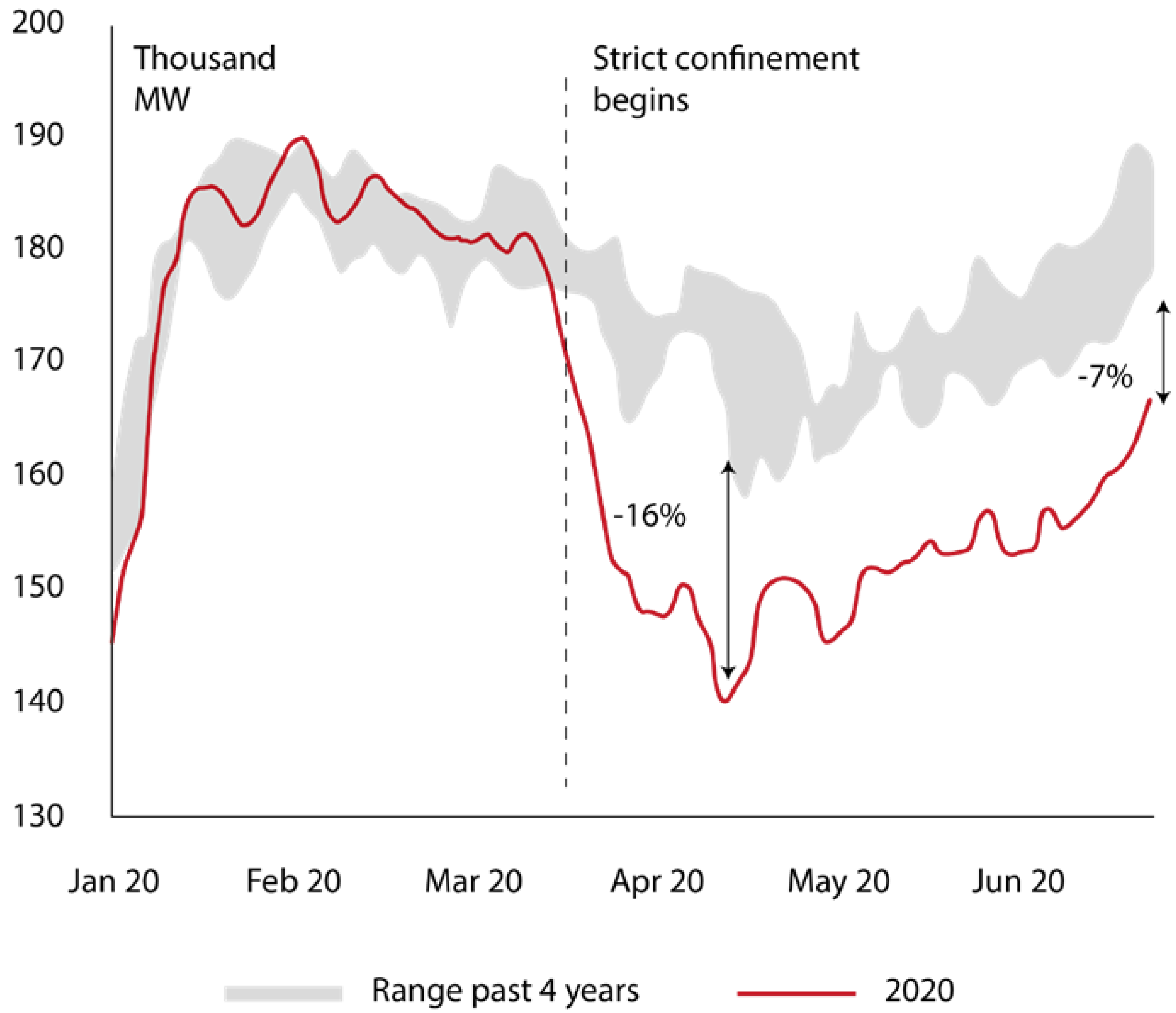
a) Daily new infections



b) Stringency of containment, mobilty, euro area



c) Electricity use



Note: Temperature adjusted 7-day rolling average.

Sources: 1a) ECDC; 1b) Oxford University, Google; 1c) ENTSO-E, NOAA

The Commission's Summer interim forecast is based on a number of assumptions regarding the pandemic and the lasting effects of the recession. In particular, the forecast baseline assumes no major second wave of infections.

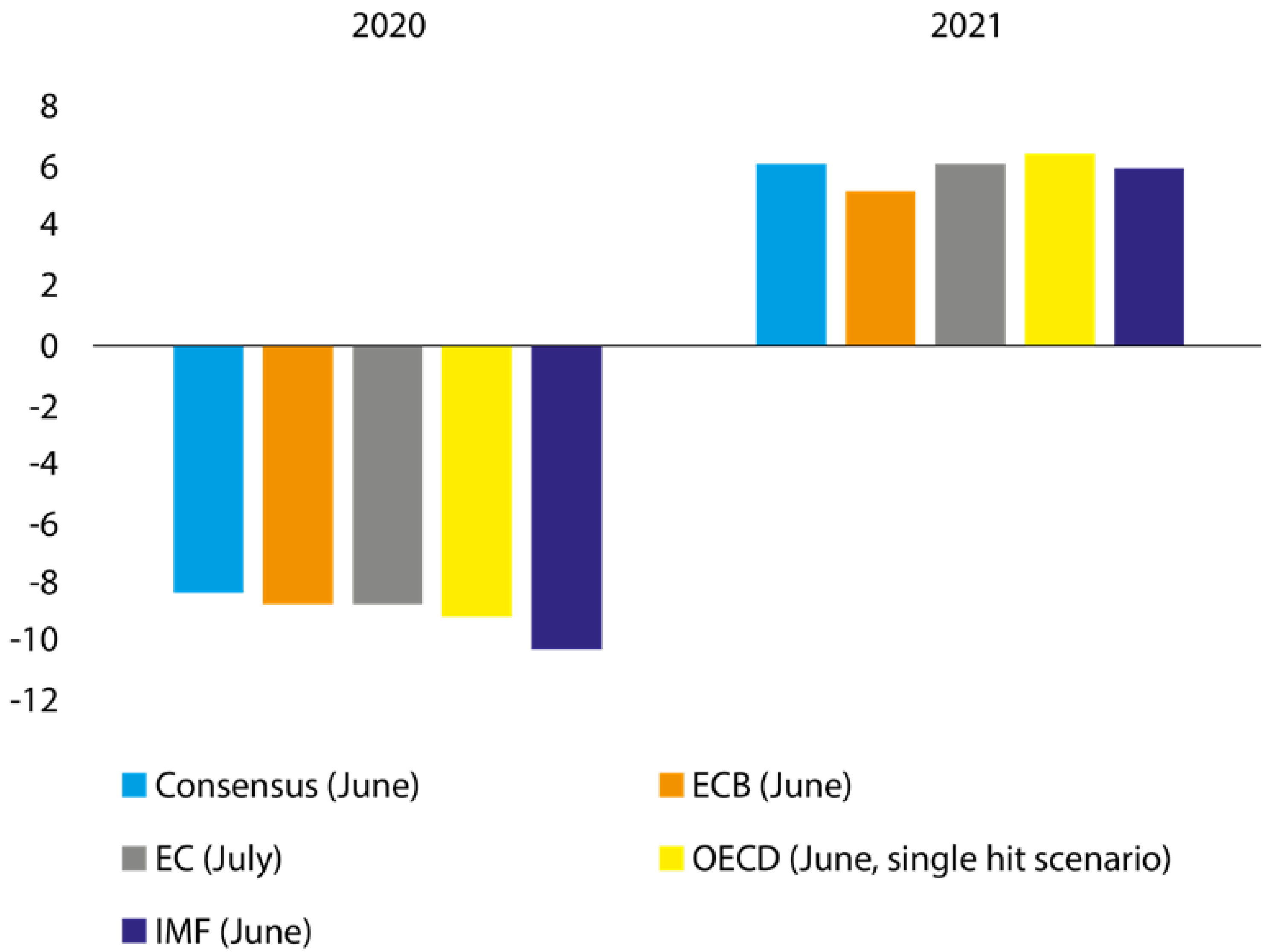
By contrast, the ongoing global spread of the virus, in particular in the US and in a number of emerging market economies, is expected to dampen the rebound of global activity and world trade. It is further assumed that containment measures in Europe will continue to be gradually eased, but that social distancing and consumers' prudence will continue to hold back the recovery in activities that involve personal contact, such as tourism and recreational activities.

The measures that have been put in place to protect jobs and shield firms from bankruptcy are assumed to be effective, without however being able to avoid unemployment increases and insolvencies altogether.

On this basis, euro area (EU) GDP is now projected to drop by 8¾% (8¼%) this year and to increase by 6% (5¾%) in 2021. The quarterly profile implies that output in the fourth quarter of 2021 will still be 2% below the level in the fourth quarter of 2019 in the euro area, and 1¾% in the EU. In the Spring forecast (European Commission 2020a), this gap was projected at ½% for both areas.

Remaining restrictions and voluntary social distancing are likely to affect sectors to which personal interaction is central more permanently than others. Estimations carried out by DG ECFIN's geographical desks confirm that the sectors hit the most in the second quarter are tourism and recreational services, and to a lesser extent manufacturing, construction and wholesale and retail trade. Accommodation and food services, as well as recreational services, are the sectors in which activity is expected to remain the most subdued also in the second half of this year.

Figure 2. Recent GDP growth forecasts for the euro area



Sources: DG ECFIN, ECB, IMF, OECD, Consensus

The increase of the unemployment rate, to 6.7% in May, has so far been remarkably mild in the EU as a whole, on the back of strong policy support for keeping workers in employment relationships during the episode of output losses.

However, some laid-off workers have not been able to actively look for jobs during the lockdowns or withdrew from the labour market to care for relatives and were therefore not counted as unemployed. The drop of hours worked by 2.6% already in the first quarter points to significantly larger shifts in the underutilisation of labour in recent months than unemployment data suggest.

Looking ahead, bankruptcies are likely to rise in the most persistently affected sectors, and some further rise of unemployment will be hard to avoid. This combination will lead to some lasting crisis impact (hysteresis), even in the relatively mild forecast baseline.

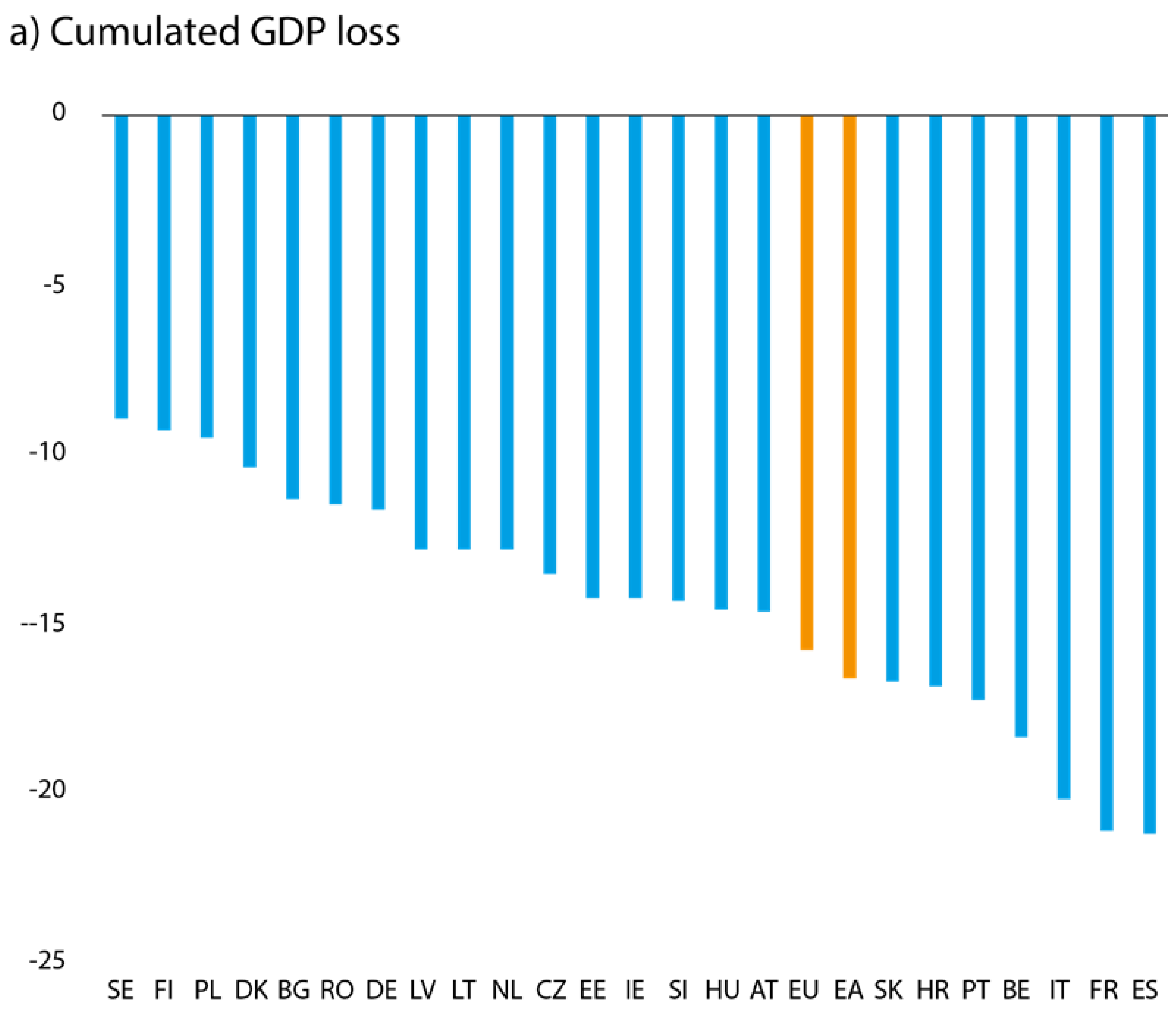
Cross-country differences will be large

The negative impact of the crisis is set to differ widely across EU member states. The pandemic has hit countries simultaneously and the nature of the shock appears to have been very similar.

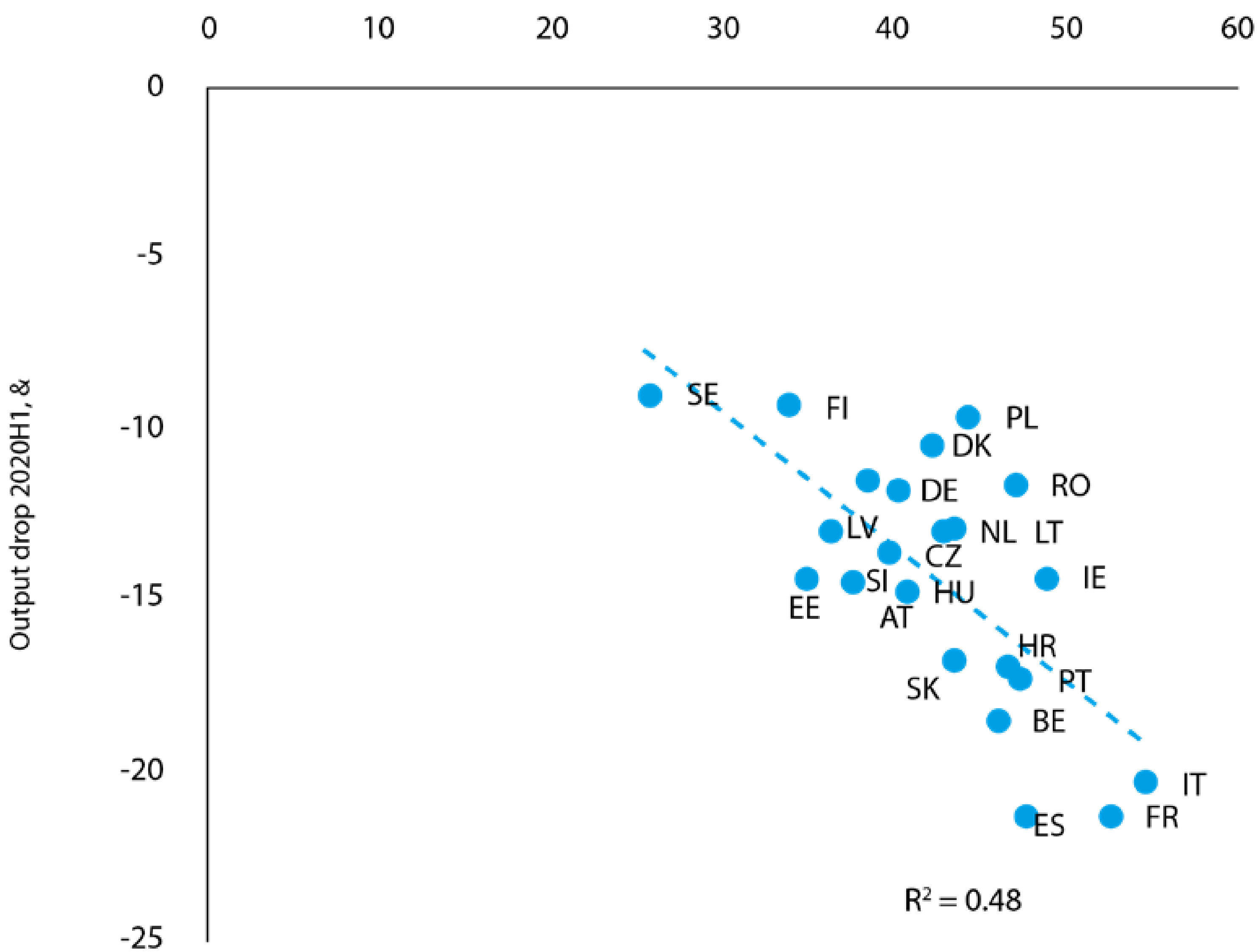
Nonetheless, the projected loss of output over the first two quarters of 2020 compared to the last quarter of 2019 ranges from less than 10% in Finland, Sweden and Poland to more than 20% in Italy, France and Spain (Figure 3a). These differences in the initial impact reflect the severity of the COVID-19 outbreak, the stringency of containment measures as well as different economic structures.

In particular, an important share of personal services such as accommodation and food services and a large dependence on tourism increased the negative impact on member states (Figures 3b and 3c)[2].

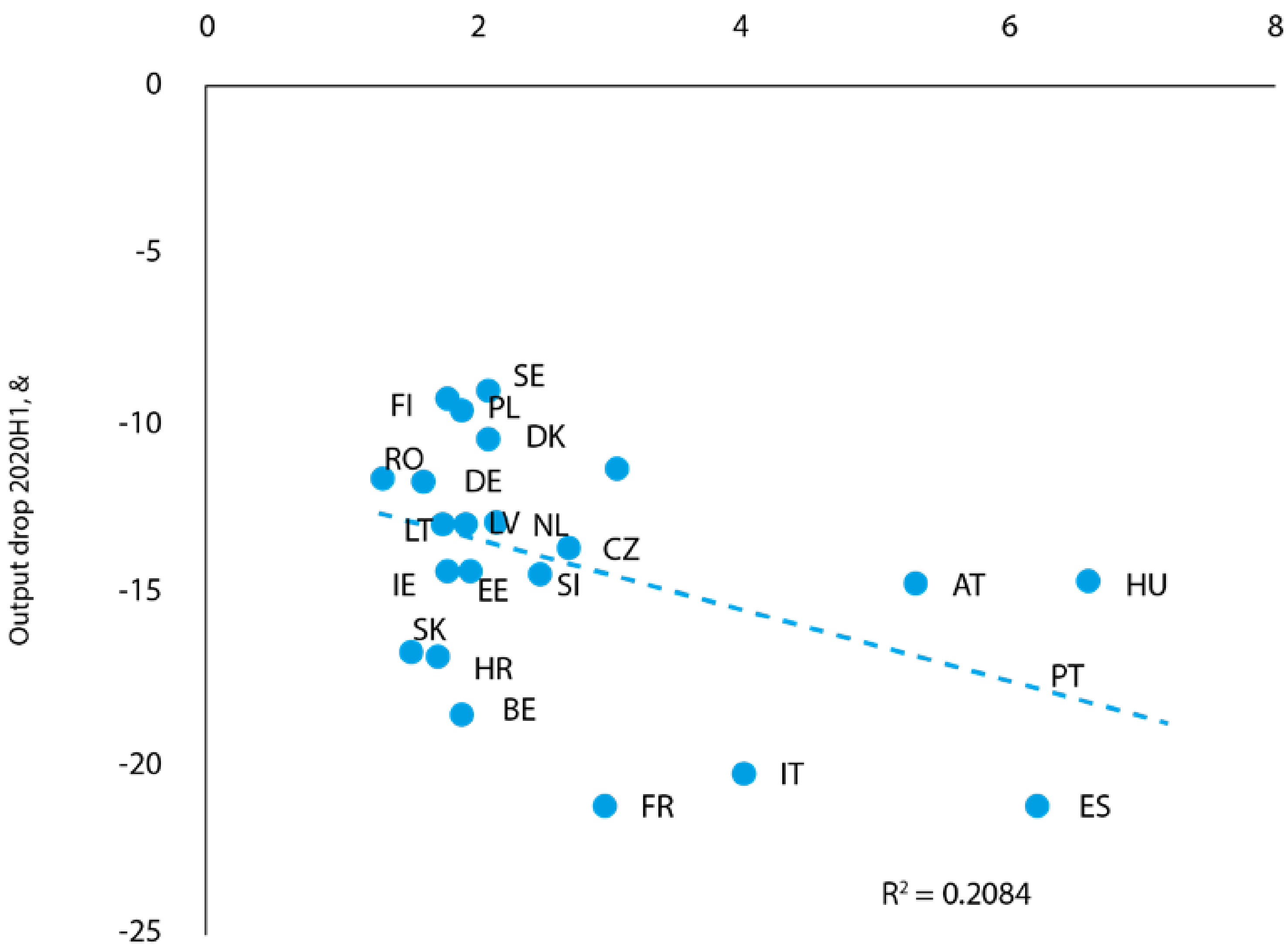
Figure 3. Cumulated loss of output by 2020Q2, drivers



b) GVA share of accommodation and food services

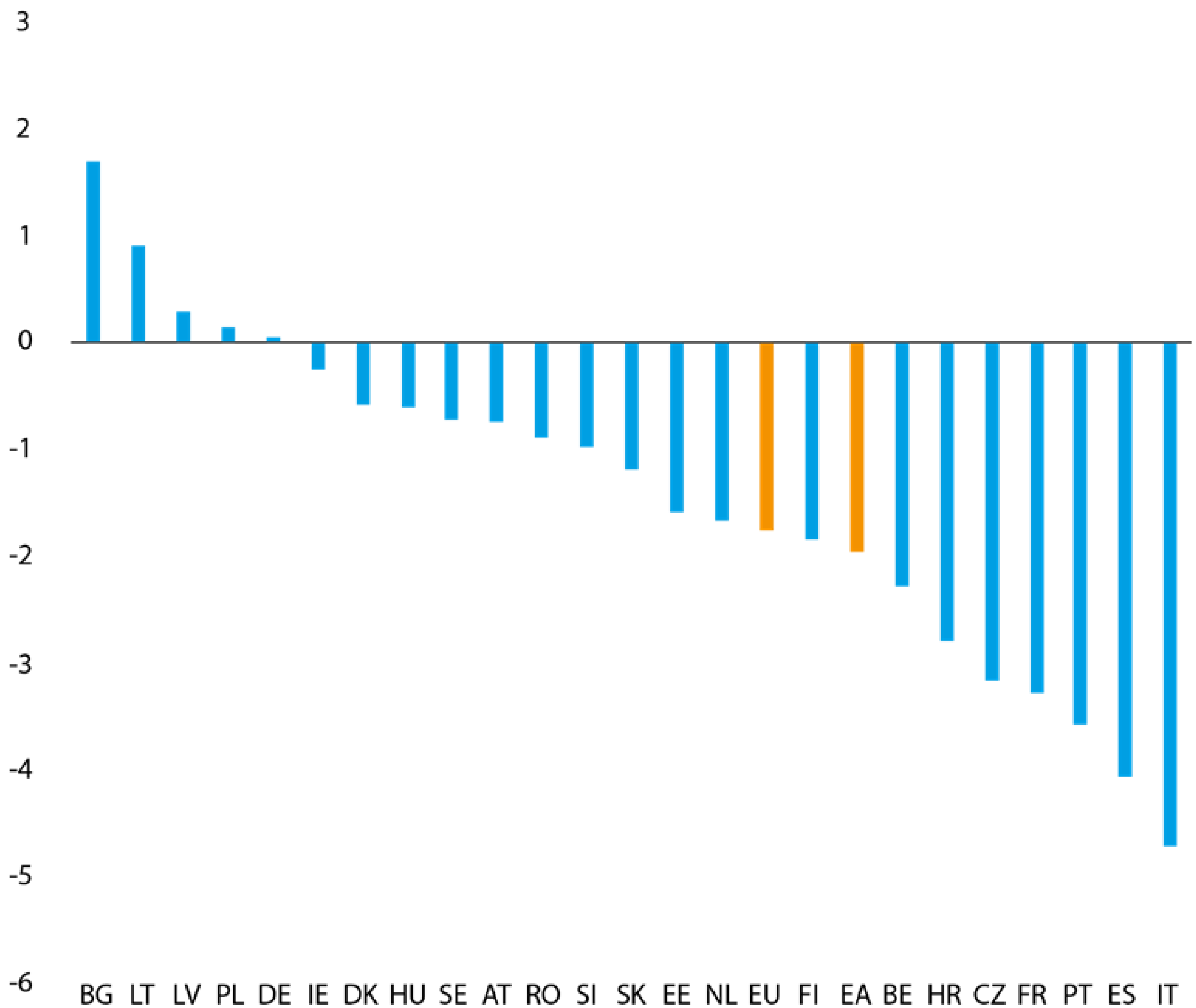


c) Stringency of containment (index average 32020H1)



Sources: 3a) DG ECFIN; 3b) DG ECFIN, Oxford University; 3c) DG ECFIN, Eurostat.

Figure 4. Cumulated change of GDP, 2019Q4 to 2021Q4



Source: DG ECFIN

These divergences are likely to persist also in the recovery. The countries hardest hit so far are expected to continue lagging behind at the end of the forecast horizon (Figure 4).

Labour market developments could amplify the divergence even further. Here, differences across member states are also pronounced, reflecting not only output losses related to the severity of the pandemic and sectoral exposure to COVID, but also institutional features such as the share of short-term contracts and the design and strength of policy responses such as partial unemployment schemes.

Differences in average firm size between member states may also play a role, with small firms being financially more constrained than larger firms. Doerr and Gambacorta (2020) construct a regional employment risk index on the basis of firm size and sectoral specialisation that shows particularly high values for Greece, Spain, Italy, Cyprus, Portugal, Slovenia and parts of France. This puts an emphasis on the need for targeted measures that reflect the geographical differences in Europe's economic fabric.

Need for a large recovery package responsive to sectoral and geographical differences

The Summer interim forecast underscores the need to accompany the recovery with a major fiscal support as outlined in the Commission's 'Next Generation EU' proposal (European Commission 2020b). The downward revisions to the outlook for GDP point to a larger investment gap, indebtedness and financing needs of the public and private sectors than estimated in May, highlighting the urgency even more.

During the past decade, external demand made a major contribution to the recovery from the Great Recession that started in 2009 and the recovery from the sovereign debt crisis since 2013. By contrast, exports are unlikely to come to the rescue this time around, as the COVID-19 pandemic is not only a truly global crisis, but it also continues to affect many of the EU's largest trading partners particularly heavily.

This is confirmed by the continued fast spread of the pandemic outside Europe's borders and ensuing downward revisions to the global growth outlook. More onus is therefore on endogenous domestic demand as a key driver of the recovery.

Large funds have been made available by member states and the EU to protect workers' incomes and prevent bankruptcies during the crisis, but this alone will not be enough to ensure a swift and complete recovery (Revoltella *et al*. 2020).

Avoiding persistent drags from a debt overhang and unemployment hysteresis and minimising the still very large downside risks will require continued policy support.

Careful targeting of this support is essential. In line with the downward revisions to GDP, the shortfall of investment in the EU in 2020 and 2021 compared to the path expected last autumn is even larger than estimated in the spring forecast (European Commission 2020a).

The outlook for economic activity in the countries and sectors most affected by the crisis has been revised down further. Often faced with limited fiscal space, they are also projected to recover more slowly than others. Left unaddressed, these divergences between member states could become persistent and lead to fragmentation within the Single Market and the monetary union.

Moreover, the recovery offers the opportunity to boost investment with an orientation towards the green and digital transitions.

With the recovery plan 'Next Generation EU', the Commission proposes to act on these differentiated financing needs through a combination of several instruments amounting in total to €750 billion over four years (European Commission 2020b, Verwey *et al*. 2020).

Political agreement on this package is needed in the coming weeks in order to implement this fiscal stimulus in a timely manner. ■

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Endnotes

1. Haldane (2020) and references therein; several recent VOX columns including: Leiva-León et al (2020); Chen et al (2020); and Deb et al (2020).

2. In a simple regression, the average stringency of containment measures in the first half of 2020 and the gross-value-added share of accommodation and food services explain more than half of the cross-country variation of output in the first half of 2020.

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