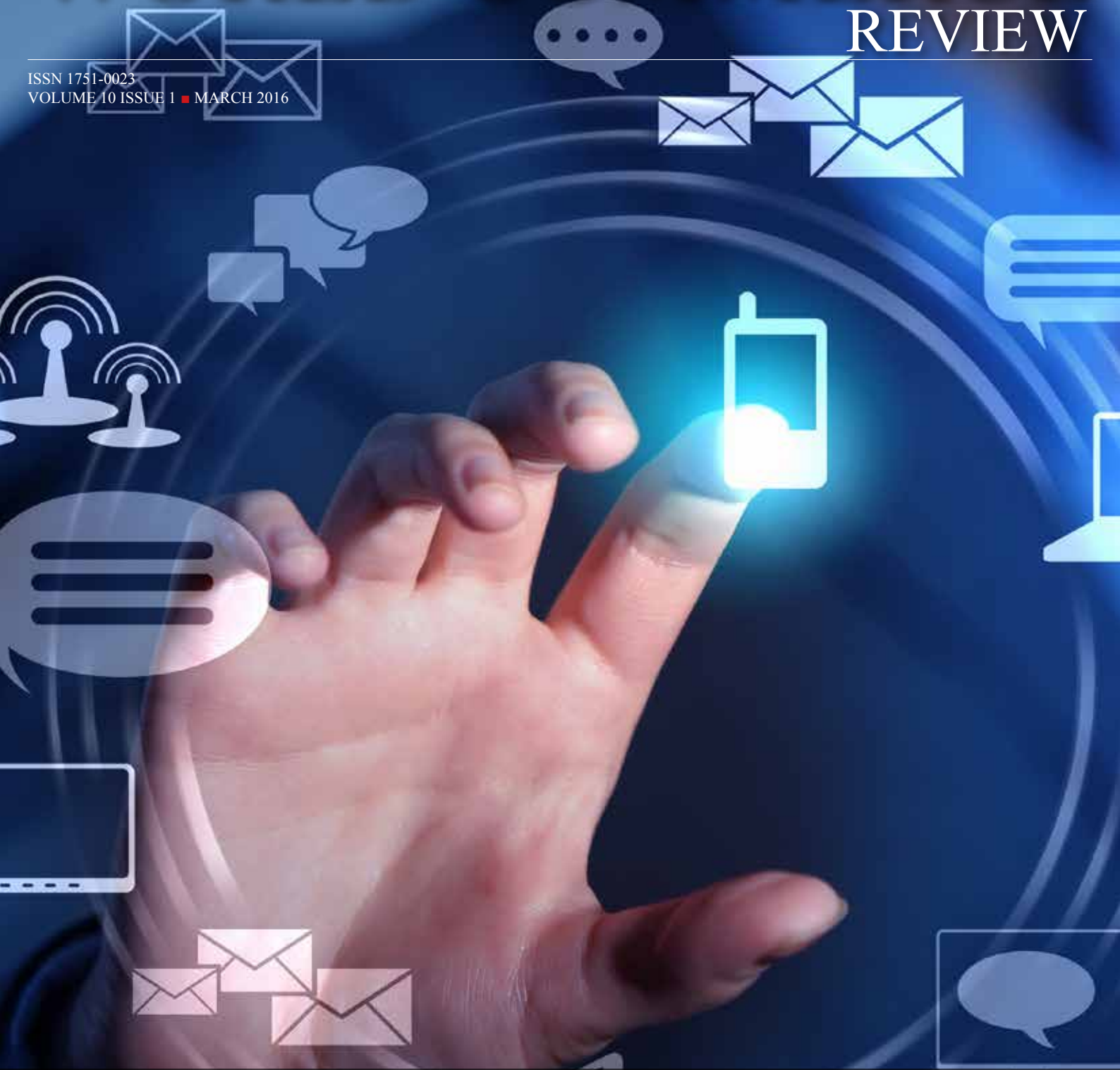


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EUROPE NEEDS A TRUE DIGITAL TRANSFORMATION TO REGAIN COMPETITIVENESS AND DELIVER GROWTH AND JOBS, **MARKUS BEYRER** WRITES

DANIEL DĂIANU EXAMINES THE IMMEDIATE AND LONG-TERM CHALLENGES TO THE EUROPEAN UNION

FRASER CAMERON CONSIDERS THE REASONS FOR JAPAN'S MORE ACTIVE GLOBAL ROLE AND ASSESSES THE IMPLICATIONS FOR EU-JAPAN RELATIONS

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The time for excuses is over

The global economy is growing and most multinationals are doing reasonably as well. But many business leaders are reluctant to commit to making the substantial investments needed for faster future growth. They look instead for potential roadblocks to the global economy. They look for excuses to do nothing.

For a long time the eurozone was blamed. Then came the upheaval in the Middle East and the drop in oil prices. Then it was turmoil in the financial markets. Recently it has been the slowdown in China. The possibility of Brexit and President Trump are future worries. In other words, executives are not confident enough to do anything.

Confidence is the key. Everything hinges on it. Without it the economy is stuck in inertia. If people think the glass is half full they will take optimistic, confident decisions that will drive the economy forward, creating the platform for further growth.

Alternatively, if they think the glass is half empty, as they have since the start of the financial crisis, they will stick their heads in the sand and do nothing. This is why the global recovery has been so slow and intermittent.

What is needed is investment to create a broad-based recovery that is not totally reliant on consumer spending. Future technologies need to be invested in and the disruptive changes understood. We take a look at Industry 4.0 in this issue of *World Commerce Review*, and the feeling is that we must act now to prepare our economies and societies for the inevitable disruption ahead.

The question is whether current executives, suffering from a lack of confidence in their own corporations' ability to reinvest earnings, will act sooner rather than later to take advantage of future opportunities. With executive share options decreasing in value with market turmoil they are increasingly reluctant to invest in the future of their companies.

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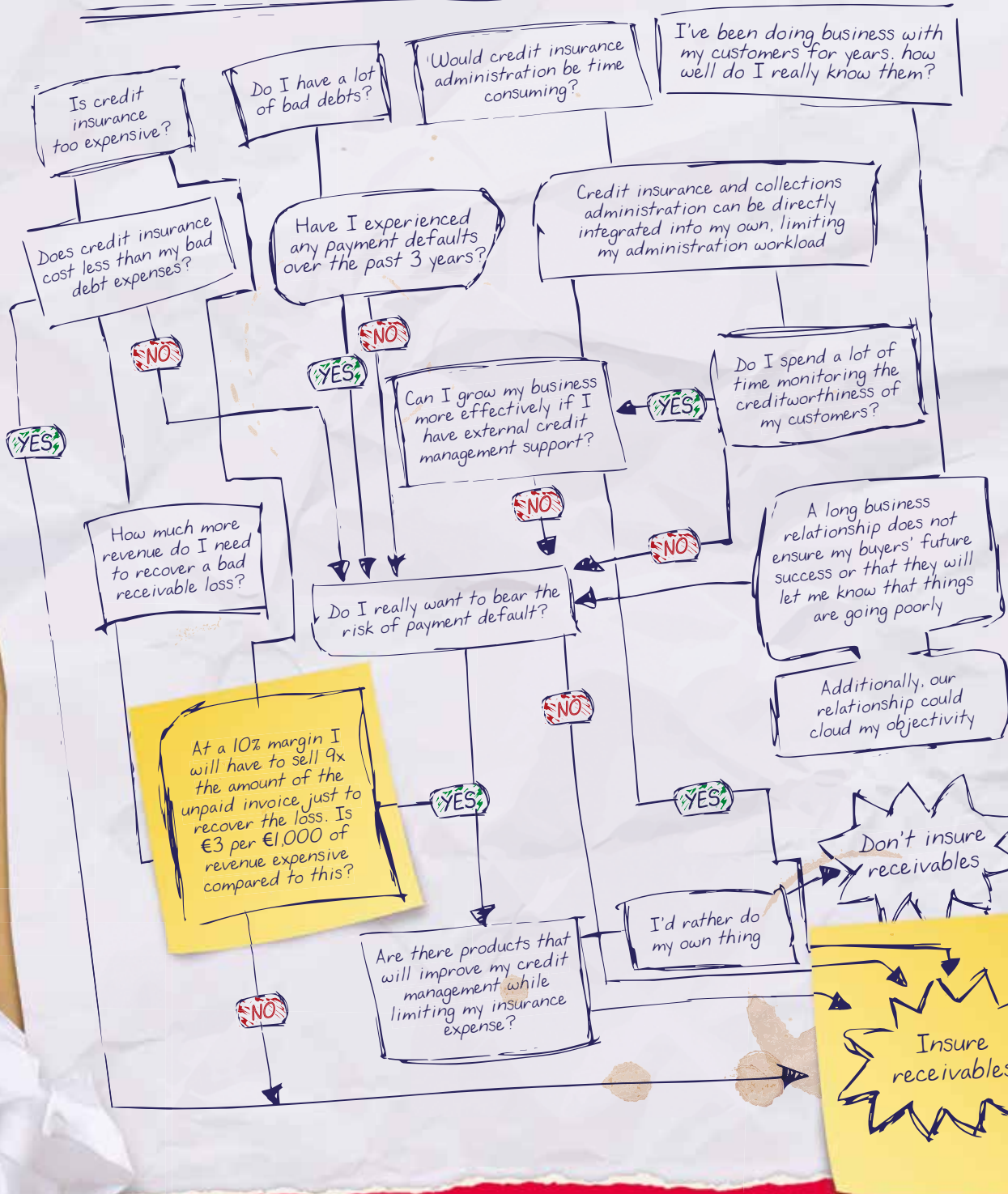
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SHOULD I INSURE MY RECEIVABLES?





Recommendations for a successful digital transformation in Europe

Markus J Beyrer is Director General of **BUSINESSEUROPE**

The ongoing fourth industrial revolution is radically modifying the global economy, particularly manufacturing and industry-related services. Europe needs a true digital transformation to regain competitiveness and deliver growth and jobs. If we succeed, Europe could see an added gross value worth €1.25 trillion by 2025 in manufacturing alone. With a fully functioning Digital Single Market (DSM), Europe will gain an estimated 4% of GDP by 2020. But if not, the potential losses can be up to €600 billion by 2025 – ie. losing over 10% of Europe's industrial base¹, meaning that the EU's stated aim of increasing manufacturing's share of European GDP to 20% by 2020 will be out of reach.

In order to tap into the full advantage of digital transformation, the EU must swiftly complete its DSM, ensuring free movement of goods, people, services, capital and data. Digital technologies are already delivering cross-sectoral efficiencies to business. The market for the Internet of Things (IoT) is also a reality: it has grown 160% in 2013 and 2014, and is still expected to grow more than 30% in the next ten years.

Digital is also supporting and advancing the increasingly integrated services elements throughout the industrial value chains. For most modern industrial companies, the manufacturing and services elements are so highly intertwined that categorising them into different sectors is not possible anymore.

In order to allow businesses and citizens to take full advantage of digitalisation, policy-makers not only must address the challenges appropriately, but also encode digitalisation in EU policy and in the European economic DNA. We need the right conditions for innovation, accompanying change and avoiding focusing primarily on possible risks. The gap between Europe and other regions (eg. USA and Asia) in crucial aspects like technology and innovation investment, as well as in the proliferation to regulation, has to be narrowed.

Legislators also need to consider the digital economy's global nature and the consequent increase European business' global integration. This requires more global convergence of rules and standards.

Key challenges ahead

Europe is a world first class manufacturer, but is less advanced in ICT and business services. The EU is the only major economy where investment in broadband has declined. Only eight of the world's top 100 high-tech companies have their headquarters in Europe and we are still lagging behind our

major competitors in R&D investments; the EU's target to reach 3% R&D investments is hardly on track.

It is key that Europe encourages digitisation and develops a comprehensive and holistic strategy. To ensure the best opportunities for growth, jobs and innovation, such a strategy has to be well coordinated between member states and at European level. While national best practices should be looked at, avoiding fragmented national approaches is essential to ensure compatibility internationally.

Turning industry digital is not only about technology investment. Companies need to rethink their value chains and way of doing business. This process will need massive knowledge input particularly for SMEs. Business services, universities and research centres will have a fundamental role in providing this critical knowledge to manufacturing companies.

Statistics show that only a very limited number of companies have developed a comprehensive investment strategy to grasp the potential of digitalisation, with as few as 1.7% of EU enterprises making full use of it, and 41% not at all. Digitalisation is still insufficient in particular in the case of SMEs and in the less technologically advanced regions of Europe. Increased digitalisation could actually result in a more inclusive environment, in which SMEs can benefit from huge growth opportunities, regardless of their location.

Approach to data, labour markets and skills

Digitalisation of industry is mainly based on connectivity, collection and analysis of data, not only personal data, but also non-personal/industrial data, for example data produced by machines. Currently, there is legal uncertainty in this field. Clarity in roles and liabilities for the treatment of these data is crucial.

The European legislative framework must allow European companies to compete globally. It is important to analyse the current legal situation identifying where the gaps are. However, policy-makers must refrain from rushing into legislation, but rather carefully assess if and where intervention at European level is needed.

Digitalisation offers opportunities both for companies as well as for workers, with more flexibility and possibilities to improve work-life balance, and more learning and work opportunities. Some existing jobs and areas of activity will evolve; some will disappear, but new activities will appear, leading to overall



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“It is key that Europe encourages digitisation and develops a comprehensive and holistic strategy”

employment gains. Using the example of Germany, the Boston Consulting Group² forecasts that by 2025 the introduction of digital industrial technologies will lead to a 5% net increase of jobs.

One of the key challenges is to adapt EU and national skills policies to better meet the rapidly evolving labour market needs generated by the digital economy. BUSINESSEUROPE and the other EU social partners agreed to work on digital skills as part of the EU social dialogue work programme 2015-2017.

Business recommendations to enable digital transformation

Our regulatory framework, in particular concerning collection, use and analysis of personal and non-personal data, must empower the digitalisation process. Legislation must enable data-driven innovation, with appropriate rules striking the right balance between protecting EU citizens’ rights and

facilitating the free flow of data in the single market. New rules should also ensure clarity between the role of data controllers and processors.

While companies should freely decide where their data is stored, there should not be forced data localisation policies, as free flow of data within the EU is crucial to their functioning. While openness is essential for the digital economy’s development, it is also important to consider negative developments potentially resulting from unlimited third-party access to data.

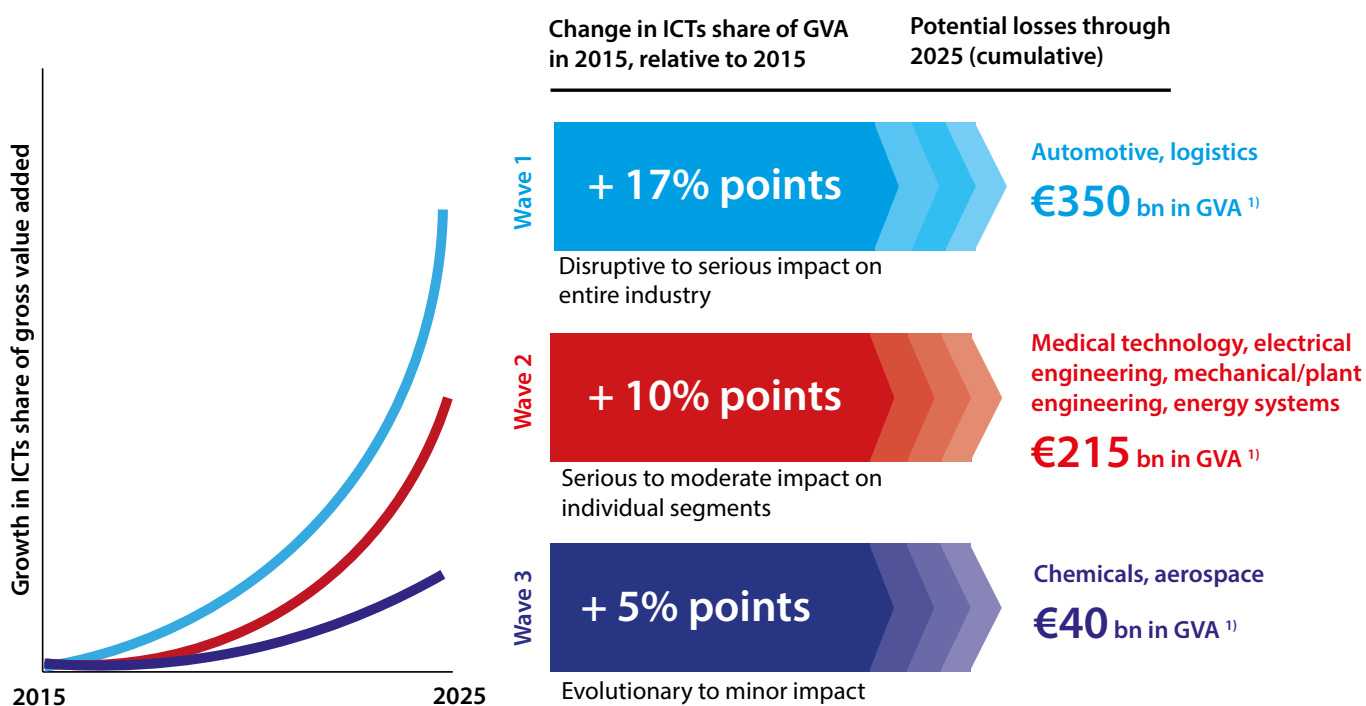
Standards, investment and digital infrastructure

Standards are extremely important to enable digital industrial processes, as well as the integration into worldwide information and communication networks. Interoperability is therefore key. The ability of connected machines to work together is absolutely critical to unleash the potential of digitalisation; without it, 40% of potential benefits of Internet of Things cannot be realised³.

To be competitive, digital products and processes should be supported by globally relevant standards. In addition, regulators should not set technical standards or mandate specific technologies. Involvement by authorities should be exceptional rather than routine. A bottom-up approach to digital standardisation is needed to keep up with the pace of technology.

Figure 1. If Europe misses out on the digital transformation it could forfeit €605 billion in lost value added

Potential losses arising from a shift in the shares of value added



1) Gross value added foregone by the EU-17 countries if the increase in ICTs share of GVA is lost to international competitors

Source: Roland Berger

Figure 2. Horizon 2020 is giving rise to important ICT research



Source: websites (Horizon 2020, FP7, CIP, EIT, EIT ICT Labs), news reports, AT Kearney analysis

A robust infrastructure is the backbone of the digital economy. Ensuring the right incentives for private investment is a fundamental prerequisite to EU industry’s digitalisation. The upcoming review of the EU telecom rules will be an opportunity to achieve these objectives.

Competition and strong incentives for continued investment in the EU on broadband infrastructure will be essential to meet the exponential connectivity and quality demands of digitalisation with particular attention to industrial areas located outside urban areas. As foreseen in Commission President Juncker’s investment plan, investments must be particularly directed towards the development of high speed networks and the adoption of digital technologies by SMEs.

Greater harmonisation in spectrum allocation is also important to meet the increasing demand for connectivity. The application of various national policies across the EU creates fragmentation hindering the completion of the single market for wireless broadband communications. Greater coordination and consistency would also enhance the predictability of the network investment environment.

At the same time, implementation of the recent net neutrality rules must ensure the best effort principle and guaranteed quality classes. Ensuring open and accessible internet to all is crucial to sustain further growth and increased usage.

Cybersecurity and privacy

In a connected world, machines and units of organised supply chains will exchange data. In order to ensure the reliability of these systems and to protect data, a high degree of cybersecurity is indispensable.

With regard to privacy issues in particular, the announcement of an agreement between the EU and the USA on a revised framework for international data flows (the ‘EU-US Privacy

Shield’) at the beginning of February 2016 was of utmost importance for businesses and citizens in Europe and the USA.

Since the invalidation of the Safe Harbour framework by the European Court of Justice (ECJ) on 6 October 2015, the ability for companies to transfer data from the EU to the USA has been undermined.

The new framework should benefit innovation, job-creation, and economic growth in both regions. In a letter to European Commission President Juncker and to USA President Obama, BUSINESSEUROPE, together with US Chamber, DIGITALEUROPE and ITI, stressed the urgent need for a reliable framework for international data transfers. It is now important to swiftly finalise the details of the newly reached agreement, granting companies, especially SMEs, a reasonable transition period to adapt.

BUSINESSEUROPE called on national authorities to contribute constructively to the functioning of the new arrangement and ensure a consistent European approach to transatlantic data transfers. This will help to have common rules in place in the DSM to the benefit of Europe’s economy.

Opportunities of digitalisation at the workplace

Europe also needs to assess how best to adapt labour markets and work organisation to fully benefit from the digital transformation. A process of adaptation to the increased work flexibility required by digital industries is essential. Working time and employment regulations should be sufficiently flexible and support EU businesses competitiveness in the digital age. This will increasingly depend on the ability to react quickly and flexibly to customer requirements and to supply ‘on demand’.

Ensuring people have appropriate skills to come to grips with the complexity of the digitalised industry is also crucial. Skills



needed for SME entrepreneurs deserve special focus, to enable them to digitalise and grow their business online. According to the European Commission, 40% of EU citizens only have a basic level of digital skills. Simultaneously, the need for digital skills is becoming increasingly pronounced - by 2025 90% of jobs are predicted to require some level of digital skills. The EU must ensure that education and training systems are adapted to the ever evolving labour market needs, focusing in particular on STEM skills and digital literacy.

The upcoming European Commission 2016 European skills strategy must strongly emphasise digital skills. The development of e-apprenticeships could also help to better meet the new labour market needs.

Training and re-training workers and jobseekers is also essential to help them keep pace with technology advancements and develop their employability, which is particularly challenging for an ageing workforce. This calls for inter-generational approaches and a coherent EU strategy for digital learning and open educational resources to be mainstreamed across all education and training sectors.

Encourage investment, support R&D and raise awareness

Facilitating financing and investment in the productive sectors and their digital transformation is crucial. In many cases the digital transformation must be carried out in parallel with ongoing routine operation of companies. This implies an

increased complexity and a need for funding. With this in mind, financial instruments should not only allow tech companies to develop new products but also allow the productive sectors to test and refine them prior to their adoption.

The imperative of digital transformation does not only concern infrastructure and hardware – support to digital content, e-commerce and services is also key, especially in relation to early adopters, thus ensuring that the new technologies’ lifecycle accelerates and achieves critical mass.

It is also essential to generate fertile ground for transferring technology to the market, something which remains challenging in Europe. In addition to encouraging private and public R&D, research institutes and universities should regard the needs of the productive sectors as one of their priorities in industrial research. The use of existing financial instruments, eg. Horizon 2020⁴ and the Juncker Plan, should ensure that this objective can be achieved.

Finally, awareness-raising actions should target financial institutions to make them more responsive to the potential return on investment in Europe’s digital transformation and more inclined to finance the material and immaterial investments needed. Also, companies - especially SMEs - should be offered information and guidance at national and EU level to enable them to embrace digitalisation. ■

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Launching the fourth industrial revolution

Eva Paunova MEP is the Vice President of the European Movement International, where she chairs the Political Committee on Jobs, Competitiveness and Sustainable Growth



Ever since it was first mentioned in a German government paper in 2011, the term 'Industry 4.0' has been widely used by analysts to indicate the ongoing profound transformations in manufacturing. Also referred to as the fourth industrial revolution, Industry 4.0 is a collective term for the change in production patterns enabled by the convergence of the physical and digital worlds.

We are already witnessing the integration of so-called cyber-physical systems in some manufacturers, whereby all automatic machines along the production line are in constant communication and interaction with one another. Very soon this smart environment will spread beyond the mere production line to processes such as marketing, distribution, consumption, etc.

As has happened with previous industrial revolutions this will lead to disruptive changes, not only in the manufacturing process, but also throughout the entire economy, society and culture. In order to reap the benefits and minimise the risks, we must act strategically now in order to prepare our economies and societies, putting the focus on three key areas – education, entrepreneurship and connectivity.

Acknowledging the need for decisive action, the European Commission adopted the Digital Single Market strategy in May 2015. The document envisages 16 concrete initiatives for the establishment of a single EU market for digital services. The European Parliament is currently debating the Commission's first two legislative proposals on the subject - cross-border portability of online content services and contracts for online sales, paving the way for Europe to march at the forefront of the fourth industrial revolution.

Preparing for the change from an early age

One of the most profound effects of Industry 4.0 will be on the types of jobs people have and on the skills they will need to succeed. The labour market of the post-Industry 4.0 world would require considerable digital skills and understanding of how the smart environment functions. Managing one's digital identity, backing up to the cloud, basic digital media editing, online shopping and banking are only a handful of examples.

These skills would be so crucial for one's chances of getting hired that acknowledging their value in the curriculum should come at as early an age as possible. Students must be encouraged to use digital devices, to express themselves

through digital means and thus get used to the convergence of the physical and digital environments.

Considering how many countries are moving towards digitising the traditional services they provide, so-called e-government, it is not difficult to imagine that in the near future digital literacy will be necessary to effectively communicate and interact with public authorities.

It's true that the fourth industrial revolution is just kicking off and we are only seeing some of its early signs. However, it is happening at a faster pace and across a wider area compared



to the third one, ie. the digital revolution and the proliferation of computers. The shift is bound to happen over the next 20 years, just within the timespan of a single generation, rather than three or four as with past industrial revolutions. That is why, if we want to maximise its benefits, we should already attempt to understand and manage its nature and causes. We must take advantage of the unique opportunity that we have to discuss and analyse the changes while they are actually happening, allowing us to shape them and mitigate the risks.

Industry 4.0 in our hands

Crucial to understanding this revolution is the fact that it is not happening for its own sake. Innovation and technology are not developed simply because they are exciting and dazzling: new technologies result in new, safer and more functional products, as well as more efficient manufacturing. The reduction of production, transportation and communication costs will enable global competition based on the quality and customisation of products rather than on prices. This will open new markets and boost economic growth. In other words, this is a major opportunity to shape the technology that will improve people's lives.

In this regard the fourth industrial revolution must be seen as a source for unlimited business opportunities. Entrepreneurship will be easier than ever because any impediments to the implementation of ambitious ideas will be easily overcome by new technology. The 'internet of things', 3D printing, and Big data are all powerful tools that just need to be harnessed by a creative mind to bring benefits to us all. That is why people should be encouraged to think big - and beyond the restrictions of current manufacturing and computing limitations.



“The most crucial question regarding the fourth industrial revolution then is ... how we can steer it in such a way that it brings the anticipated meaningful positive change to everyone”

The very word 'revolution', or synonyms such as 'waves', imply an irrepressible, external force that is beyond our control and must simply be faced and adapted to. Strategic dedicated actions like this year's World Economic Forum in Davos, for example, are needed to emphasise the fact that Industry 4.0 as a phenomenon is actually driven by none other than ourselves.

Creating the inclusive revolution

According to a study by the United Nations Specialised Agency for Information and Communication Technologies (ICT) more than 4 billion people still don't have internet access. The dataflow from billions of connected smart devices will provide us with new ways to analyse and understand patterns in the physical world. It is obvious that if more than half of the global population remains excluded from the fourth industrial revolution, its impact will be seriously undermined and the benefits will be minimised even for its early adopters.

However, data from the same study show that mobile broadband subscriptions are three times as numerous as fixed ones, which suggests that there are conditions for Industry 4.0 to emerge at the same time as the third, digital revolution. Securing easy access to broadband internet for as large a part of the global population as possible will ensure that the fourth industrial revolution spreads more widely than its predecessors. This will allow even those who haven't yet fully benefited from digitalisation to improve their living standards significantly because of what is known as a technology 'leapfrog'.

Overcoming challenges to maximise benefit

Preparing for a phenomenon with so many uncertainties around is a twofold process. In addition to analysing how to take advantage of all the opportunities for economic, social and personal development the fourth industrial revolution will provide, it is also our duty to limit the inevitable risks that come along.

3D printing and genetic engineering can boost customised production and make lives easier, but they can also be used for building weapons or to genetically modify organisms in an environmentally threatening way. Income inequalities might worsen both between countries and within societies unless we cultivate new norms and ethical principles that provide more opportunities for inclusive growth.

The most crucial question regarding the fourth industrial revolution then is not whether it has already begun or how long it would take, but rather how we can steer it in such a way that it brings the anticipated meaningful positive change to everyone. ■

Digital revolution needs offline help to realize its potential

More people around the world have access to mobile phones today than to electricity or water. Does this mean the digital revolution has truly dawned?

The answer to that question is no, not yet, says the World Bank's 2016 World Development Report on the internet, *Digital Dividends*¹.

The spread of digital technologies over the last two decades has been rapid and generated a lot of excitement about the possibilities of the digital age. But the hoped-for benefits — greater productivity, more opportunity for the poor and middle class, more accountable governments and companies — have not spread as far and wide as anticipated, says the report.

"Clearly, the potential is massive," says Deepak Mishra, a World Bank economist and one of the co-directors of the report, a flagship publication of the World Bank.

"We share the optimism of Silicon Valley when it comes to the transformative potential of digital technologies. But not the expedient view that the benefits are both assured and automatic," Mishra said. *"We think translating digital investments into*

dividends is much more difficult than many experts have reported before."

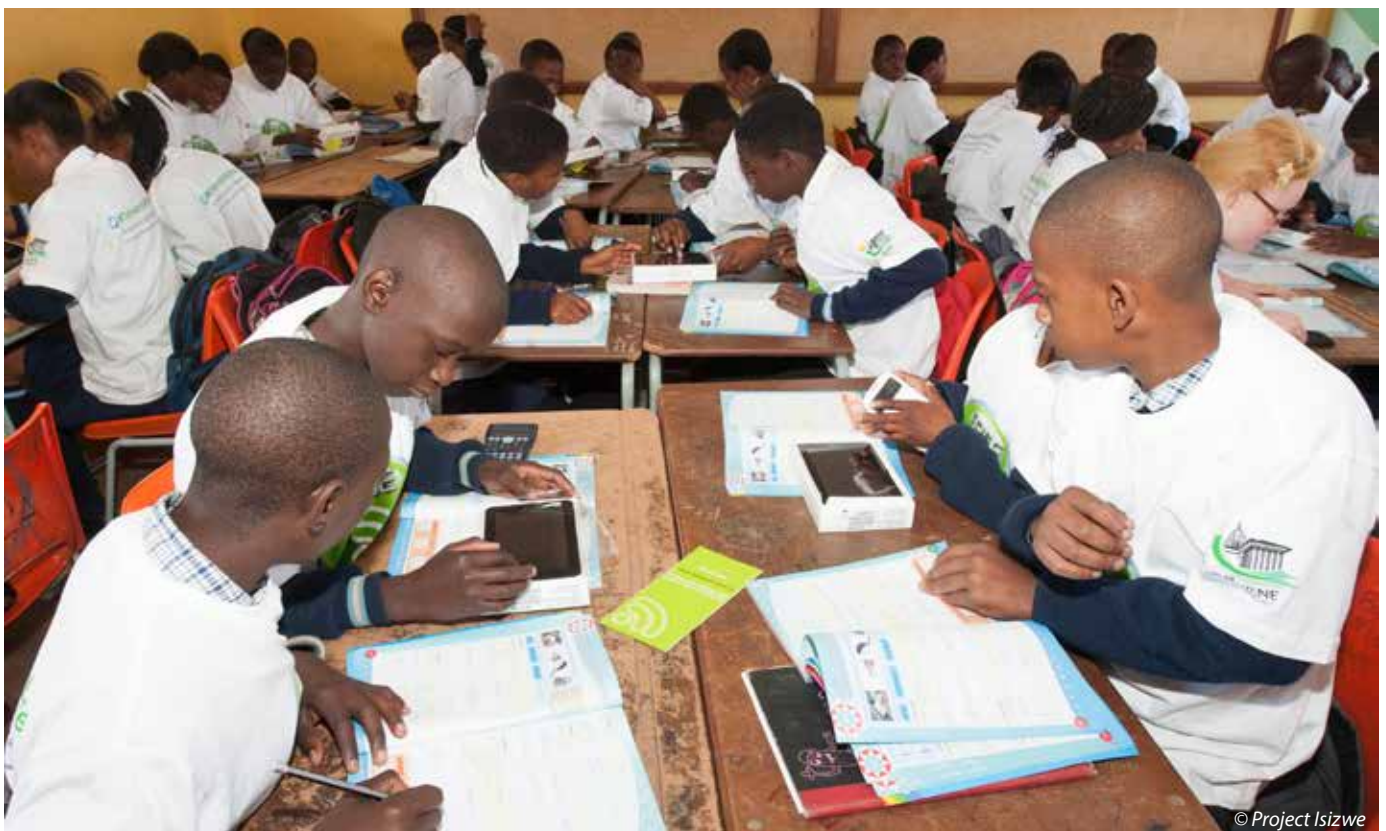
Digital Dividends, a survey of the latest research, data, and literature on the digital economy, says greater efforts must be made to connect more people to the internet and to create an environment that unleashes the benefits of digital technologies for everyone.

While internet users have tripled in a decade to an estimated 3.2 billion, nearly 60% of people globally — some 4 billion people — are still offline, says the report.

And despite the rapid adoption of mobile phones, nearly 2 billion people do not use one. Almost half a billion people live outside areas with a mobile signal.

People without access to digital technology and the education and skills to adapt will be increasingly left behind as the rest of the world advances, warns the report.

"Connecting everyone is a priority," says Uwe Deichmann, the other *Digital Dividends* co-director.



“We must ensure that the benefits of new technologies are shared widely, particularly for the poor”

Jim Yong Kim
World Bank Group President

Digital technologies, however, are not a shortcut to development, though they can accelerate it if used in the right way, Deichmann adds.

“We see a lot of disappointment and wasted investments. It’s actually quite shocking how many e-government projects fail,” says Deichmann.

“While technology can be extremely helpful in many ways, it’s not going to help us circumvent the failures of development over the last couple of decades. You still have to get the basics right: education, business climate, and accountability in government.”

The report covers the internet’s role in promoting development, including growth, jobs², and delivering services. It also examines the risks of the digital age — the growing concentration of the industry, increasing inequality as some types of jobs get automated and disappear, and the threat that the internet will be used to control information instead of sharing it.

A key message is that ‘analog,’ or non-digital, factors such as policies and regulations are needed to ensure the digital market is competitive and the Internet expands access to information, lowers the cost of information, and promotes more inclusive, efficient, and innovative societies.

Digital technologies amplify the impact of good and bad policies, so any failure to reform means falling farther behind those who do reform, says the report.

“If regulations don’t promote competition, markets will become concentrated, and you’ll have digital monopolies, and divergence of fortunes across countries,” says Mishra.

Likewise, *“If people have the right skills, digital technology will help them become more efficient and productive, but if the right skills are lacking, you’ll end up with a polarized labor market and more inequality.”*

In developed countries and several large middle-income countries, technology is automating routine jobs, such as factory work, and some white-collar jobs. While some workers benefit, a large share of workers get pushed down to lower-paying jobs that cannot be automated, says Deichmann.

“What we’re seeing is not so much a destruction of jobs but a reshuffling of jobs, what economists have been calling a hollowing out of the labor market. You see the share of mid-level jobs shrinking and lower-end jobs increasing,” he said.

Improving and rethinking education³ will be critical to prepare people for future job markets, says the report.

The report says it is important to keep in mind that job displacement from technological change is part of economic progress and that fears of ‘technological unemployment’ go back to the industrial revolution.

While the information and communication technology⁴ sector is still a fairly modest part of the global economy (about 7% of GDP in the United States, home to eight of the world’s 14 largest technology companies by revenue, but much less in developing countries), it has produced some extraordinary benefits in the rest of the economy.

Access to digital technologies has provided opportunities that were previously out of reach to the poor. Some 8 million entrepreneurs in China use e-commerce to sell goods, one-third of whom are women. Digital identification in India has reduced corruption and increased access to services. And simple SMS messages remind people living with HIV in Africa to take their medications.

4

billion

Digital technologies are spreading across the globe, but 4 billion people still do not have access to the internet.

“The world’s greatest digital revolution is transforming businesses and governments, but the benefits are neither automatic nor assured,” said World Bank Group President Jim Yong Kim. *“We must ensure that the benefits of new technologies are shared widely, particularly for the poor. Evidence suggests that we can do this by improving competition among businesses, investing in people – starting with pregnant mothers, to ensure that all children have the cognitive ability to later connect to the digital revolution.”* ■

ABOUT THE AUTHOR

Donna Barne is a Communications Officer at the World Bank

1. <http://www.worldbank.org/en/publication/wdr2016>
2. <http://www.worldbank.org/en/topic/jobsanddevelopment>
3. <http://www.worldbank.org/en/topic/education>
4. <http://www.worldbank.org/en/topic/ict>



Putting innovation to work: global challenges and Industry 4.0

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

Given how often it is being cited, you might be forgiven for thinking that we are all clear about what is meant when we refer to 'Industry 4.0'. But scratch beneath the surface and it appears to be much less clear. Is it a description of a technological revolution across all of our industrial sectors, defined chiefly by the new technologies emerging in information and communications, big data, life sciences, artificial intelligence and robotics? Or, slightly more ambitiously, is it plan for how to exploit and further develop these technologies to achieve 'smart' economic growth?

In fact, if it is to mean anything, it should be the heart of a new industrial strategy that delivers 'green' and 'inclusive', as well as 'smart' growth. It could and should be an exemplar of a wider economic strategy aiming at 'high road' competitiveness¹, addressing the profound social, economic and environmental challenges facing modern European societies in a truly systemic and integrated fashion.

This is not as big a leap to make as all that, in fact. As was evident at both the annual meeting of the World Economic Forum in Davos this January, and last year's European Business Summit, the challenges and opportunities presented by the latest industrial revolution are clearly front of mind for the world's policy, business and NGO leaders, and many worried about the possible social consequences. The digital revolution and its fusing with related advances in robotics or life sciences clearly has a technological dimension, but rather than primarily fret about the potential negative implication, we should consider how these advances can be harnessed and scaled to meet urgent global challenges where a much wider 'socio-technical' innovation is essential².

Take the transition the fossil-fuel free economy that world leaders agreed on at COP 21 in Paris last December. Decarbonisation of our economies is one of the biggest challenges we face. Only deep, rapid and probably disruptive innovation will enable us to hold global average temperature increases well below 2°C while enabling the European economy to remain competitive. Indeed, by focusing on 'breakthrough technologies', the launch of *Mission Innovation*³, and its private sector counterpart led by Bill Gates, is missing this wider point, however welcome their endeavour is as a signal that the time to act is now.

By harnessing the technological innovation promised by Industry 4.0 to the grand challenges faced by society, such as climate change, resource scarcity and the dangers to social cohesion threatened by changes to advanced economies, we have the potential to deliver not only long-term competitive

advantage, but also economic, social and environmental resilience and flexibility. But for the industrial technological revolution to have social benefit on the scale required, we need to consider how systemic innovation can be successfully fostered at the same time.

Innovation is happening in Europe

Innovation is, of course, constantly underway in Europe, across all industrial value chains, and even in parts of the economy that are the most mature and resistant to change.

Take the construction value chain. Here, there is enormous potential offered by the industrialisation of the manufacture of prefabricated building elements for the renovation market⁴. The digital revolution plays an essential role, coupled with other innovations: robotics, 3D scans and simulations allow existing buildings to be accurately measured, allowing the customisation of prefabricated elements – bringing dramatic cost reductions to the deep energy retrofits needed to meet long-term climate goals.



One Dutch initiative, *Energiesprong*, demonstrates how this innovation can serve both competitiveness and decarbonisation objectives. The initiative was born out of the willingness of the Dutch government to seek cost-effective solutions to make up to 6 million homes energy neutral. While retrofitting one's home brings obvious gains in the medium term (delivering up to 60-90% energy savings), the upfront costs and the disruption caused currently deter uptake.

To solve this issue, the *Energiesprong* initiative combines a revolutionary business model with an innovative industrial process. Housing associations invest €40-70,000 per property, at no cost to the tenant, who continues to make the same rent and energy payments. However, the benefits of the dramatically lower energy costs are passed on to the housing association to repay the investment. The initiative is based upon collaboration between manufacturers, installers and housing associations, whereby the renovation is tailored to each building using software, components are manufactured off-site, and are installed in only 10 days per building, minimising the inconvenience for the tenant.

While this innovation can have significant climate benefits, its economic potential is also substantial. Research undertaken by the Buildings Performance Institute Europe estimates the potential value-add from prefabricated renovation modules at around €200 billion/year in Europe, creating up to 2 million construction sector jobs plus a ripple effect of 5 million additional jobs in the wider economy.

The potential for transforming the construction value chain is immense, and deep retrofits are only a small part of it. Innovation in how buildings are integrated with modern,

“We need a much bolder strategy for how such broad, deep and rapid innovation sits at the heart of our approach to modern industrial policy, and to Industry 4.0”

distributed low-carbon energy systems, or how developments in building automation and advanced insulation materials are applied, hold the promise of driving economic growth and competitiveness.

Second, in the automotive value chain, the electrification of vehicle powertrains, if combined with clean energy sources, could be one of the most significant contributors to lowering transport CO₂, air pollution and noise. Transport accounts for almost a third of EU carbon dioxide emissions, and is also a significant source of health-damaging air pollutants.

The sector is predominantly powered by oil, almost all of which is imported from overseas. For each €100 spent on fuelling the average vehicle, €43 leaves the European economy to pay petroleum suppliers⁵. By helping Europe shift from imported oil to domestically produced electricity, the EU's energy trade balance and economic resilience would be improved.

However, the transition is not simple: it requires a shift to an entirely new mobility ecosystem, creating risks for incumbents and opportunities for new entrants. In particular, new openings are created for companies that are outside the automotive



sector and specialise in integration with related sectors, such as electricity; the infrastructure to distribute it; and the ICT to ensure it is smartly managed. The electronics industry is key to this opportunity.

European car manufacturers are well placed to profit from this transition due to their competences in vehicle production and engineering and their skilled workforces. BMW and the Renault-Nissan alliance are at the forefront. But in addition to the car-makers, automotive component suppliers, which generate 75% of the value in a car, stand to benefit from innovation in this area.

Companies such as Valeo and Bosch are already competing strongly on hybrid systems. Beyond manufacturers, opportunities for innovation are emerging – and are being seized – in e-mobility infrastructure, shared mobility, connected vehicles and lightweight materials.

However, these examples, while promising, do not mean that current levels of innovation are equal to the challenges facing society, and that the market should be left to its own devices.

Industrialising innovation should be a political priority

Quite the opposite. What these examples show is that innovation need to be nurtured and accelerated if its potential is to be tapped. This is particularly the case at the deployment phase. Indeed, while there are a lot of technologies available already, it is their market uptake that is most problematic: help is needed to get them across the so-called ‘valley of death’.

There are still many barriers hampering the uptake of innovative technologies: financial risks for businesses, regulatory hurdles, immature or non-existent markets etc. Strong political will and action are needed to overcome them.

It is wrong to consider oppose innovation capacity and regulation in opposition. They are not necessarily incompatible and, indeed, regulation can drive innovation, even if businesses are not so keen to acknowledge it. For example, the introduction by the EU of the GSM digital mobile telephony standard in the late 1980s helped stimulate disruptive technology development in Europe.

There is growing recognition among EU member states and within EU institutions that a re-imagined approach to industrial policy is needed to deliver and direct this next wave of industrial innovation. For example, Germany has adopted the term ‘Industry 4.0’ for its new industrial policy, which has echoes in France’s ‘Future of Industry’ policy plan.

Yet, these plans are not necessarily the right ones or sufficient on their own. They don’t amount to a vision and strategy. This is where the EU has to come in. It needs to give a sense of direction and show that industrial innovation is a priority.

Recognizing today’s industrial realities

An effective strategy to unlock low-carbon industrial innovation requires starting with a firm recognition of a number of new realities, which the latest policy thinking is not consistently clear about. For example, industry is no longer primarily about heavy manufacturing but also about services.

Not only have advanced economies pivoted from manufacturing to services, those manufacturing sectors that have prospered are increasingly ‘servitised’ – that is, integrated

with the service sector, using technology and automation to respond more dynamically to customer demand.

And encouraging innovation is not just about technology but also about mindsets, business models and processes. Advances in technology may underpin business model innovations such as servitisation and the sharing economy, but they are as much about new approaches to conducting business.

And encouraging innovation is also the key factor in longer-term competitive advantage in a modern industrial economy; indeed, innovation is the single largest driver of competitiveness, accounting for at least 30 to 40 percent of competitiveness.

The need for a systemic European industrial strategy fostering innovation

So, how then should today’s leaders seek to broaden their understanding of what a modern industrial innovation strategy can deliver beyond the many ‘4.0’ initiatives? A modern industrial strategy that fosters innovation should meet some of the following requirements:

- **Innovation needs to be a means to an end – the end being public interest**

The ultimate objective of innovation policy is not to pick winning technologies, but to tackle societal ‘grand’ challenges. This should be the role of public authorities, be it at local, national or European levels. Decarbonisation is perhaps the most pressing such societal challenge, but inequality and immigration are also at the front of mind for voters and policymakers.

The redevelopment of HafenCity, in Hamburg, is a case in point. A former port area, measuring 157 hectares, is being transformed into a city district with living, working and leisure space, in a challenge-led process that clearly set out strong sustainability goals, but which allowed for flexibility and innovation in how they were met.

- **Cooperation as the key to innovation**

Innovation does not happen in a vacuum. Neither the private or public sectors alone hold the key to make systemic innovation happen. For that we need cooperation between public and private actors, and in the context of industrial ecosystems. Silicon Valley is not the only ecosystem that can give birth to industrial innovation.

In Europe we already see good examples. For instance, the development of the Autolib shared electric car scheme in Paris was driven by a clear mission, launched by the city of Paris, and tendered to industrial groups such as Bolloré.

- **Manage the implications of these innovations for workers**

Innovation, and the disruption it brings, has losers as well as winners. Jobs will be destroyed. Skills will become obsolete. It is one of the roles of government to support those whose ability to earn a livelihood is eroded by new technologies and business models, particularly with retraining, but also by ensuring the maintenance of social safety nets.

Germany’s experience with the Ruhr is a case in point: economic diversification away from coal mining and steel was managed by regional and federal governments

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working together, assisted by an industrial relations culture which emphasised workers' participation.

Scaling solutions to tackle the societal challenges we face, such as climate change, will require changes in business models and processes, and citizen-consumer and public institutional behaviour, which a focus on technology alone misses.

If we want the European industrial economy to be able to reap the benefits in terms of international competitiveness, domestic employment and economic value-add, we need a much bolder strategy for how such broad, deep and rapid innovation sits at the heart of our approach to modern industrial policy, and to Industry 4.0. ■

1. See Aiginger, K. *A Strategy Change for Europe: Old Myths Versus New Roads*. *Intereconomics* 51, 28–33 (2016).
2. See Fred Steward, *Building an EU Industrial focused on Innovation* http://www.i24c.eu/steward_eu_policy_industrial_innovation
3. <http://mission-innovation.net/>
4. http://i2-4c.eu/wp-content/uploads/2016/01/I24C_CVCmemo_final.pdf & <http://bpie.eu/wp-content/uploads/2016/02/Deep-dive-1-Prefab-systems.pdf>
5. *Fuelling Europe's Future: How auto innovation leads to EU jobs* – Cambridge Econometrics 2013

Principles to support innovation and meet global challenges

ICC issues principles to support innovation as a key driver of economic growth, job creation and broad-based opportunity

The social, environmental and economic challenges that we face today require innovative responses. Business has a key role to play in helping society meet these challenges but can only do so in an environment that supports innovation.

With this in mind, the International Chamber of Commerce has issued a set of principles to support innovation as a key driver of economic growth, job creation and broad-based opportunity. They respond, in part, to the challenge of the United Nations' new Sustainable Development Goals which emphasize the role

of innovation in tackling global challenges such as extreme poverty and climate change.

The *ICC Innovation Principles* aim to support the development of policy frameworks that enable innovation, especially in high-technology industries, and to provide the foundation for a wider discussion on technological innovation between business and policymakers.

To take just one example, governments must do all they can to create an environment in which all sectors are incentivized

and encouraged to innovate in order to meet climate change challenges. ICC has emphasized the need for governments to support innovation to reduce carbon emissions and build resilience to changing weather patterns-both as part of last year's historic climate change agreement and through other policy measures.

But it's important to recognize that investment and innovation to meet these challenges will depend not only on the global climate agreement but as much on what happens outside the new treaty. In this context, it's vital that robust and balanced IP frameworks are maintained both in those international institutions that have expertise in IP protection, such as the World Intellectual Property Organization and the World Trade Organization as well as at national level.

The ICC Principles were launched at a roundtable in Geneva co-hosted at the Permanent Mission to Canada and attended by senior business executives and ambassadors representing a range of countries.

The new ICC paper expands upon four central principles, necessary for the creation of a supportive policy environment for innovation, urging policymakers to:

Build investor confidence by encouraging dialogue between stakeholders, providing stability and good governance, investing in infrastructure and ensuring that regulatory frameworks are predictable, transparent, robust and up to date.

Train skilled workers in a climate that promotes knowledge exchange. To achieve this, the principles highlight the need for collaboration across sectors, along with investment in educational infrastructure and public-private research programmes.

“The ICC Innovation Principles aim to support the development of policy frameworks that enable innovation, especially in high-technology industries, and to provide the foundation for a wider discussion on technological innovation between business and policymakers”

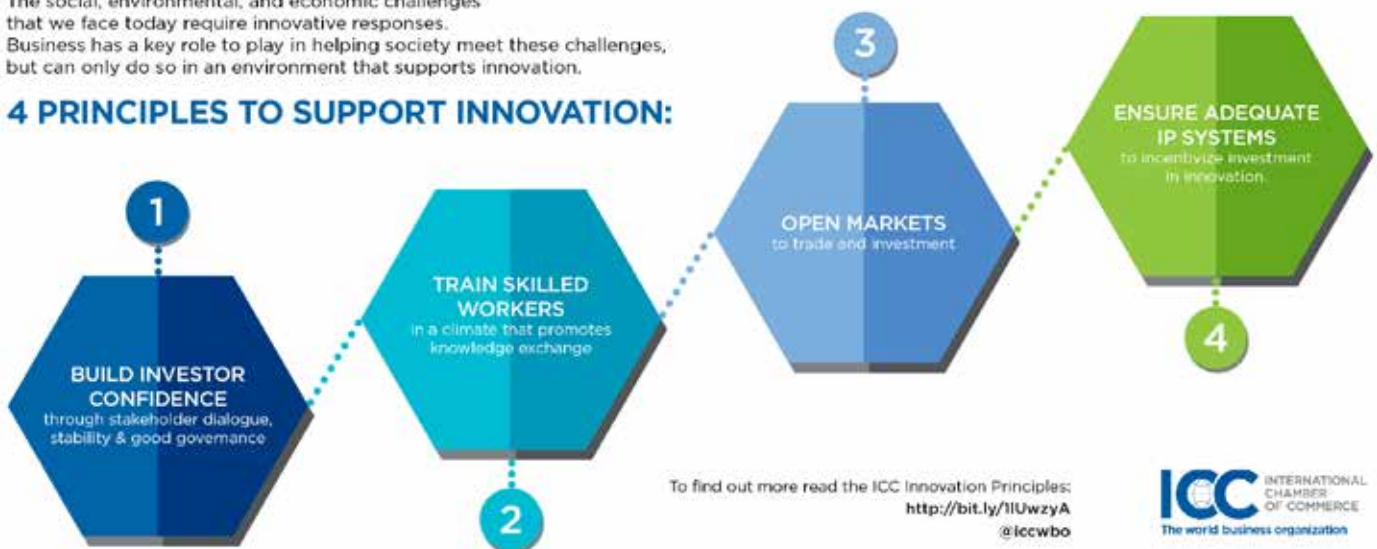
Open markets to trade and investment, noting that innovation is a global endeavour that transcends borders. The principles state that national trade and competition laws should not discriminate between domestic and foreign companies, and that national systems aimed at attracting investment should conform to international norms and take into account global competition to attract investment capital.

Ensure adequate intellectual property (IP) systems to incentivize investment in innovation. The paper explains that effective and predictable intellectual property systems assist businesses to obtain financing for innovation, provide certainty that businesses can recoup their investments in R&D, and enable innovative ideas to be commercialized and scaled. They also help to provide security for sharing know-how between businesses and other entities in the context of collaborative innovation. ■

WHAT FOSTERS INNOVATION?

The social, environmental, and economic challenges that we face today require innovative responses. Business has a key role to play in helping society meet these challenges, but can only do so in an environment that supports innovation.

4 PRINCIPLES TO SUPPORT INNOVATION:





The digital storm is here – are you ready?

Jonathan Sharp is Sales & Marketing Director at Britannic Technologies

The digital revolution is not about to arrive and hit the workplace – it has arrived, and is here to stay. Businesses must react to this paradigm shift to not only remain competitive but also to survive.

Technology and consumer demand have helped propel the catalyst for change, and technology now dominates our personal lives, yet the same level of use and the latest technology is not always available in the workplace. This is ironic because this is the place where it can make the most difference in terms of improving productivity, communications, flexibility and boosting customer service.

There is an element of fear of the unknown on the part of businesses that are slow to implement a digital transformation strategy because they know they need to do it, but are not sure where to start and how. They are aware that it is a massive undertaking that no longer just means deploying new technology but that marks an essential change in the way the company does business. It tends to come with a complete overhaul of management structures, processes and company-wide culture. It is not an ad-hoc project; it is a multi-stage evolving working process that requires support from the CEO and the senior management team.

This kind of business transformation is not for the fainthearted, which is why it is advisable to work with a trusted and experienced third party solutions provider.

Millennials re-defining the workplace

Technology is the lifeblood of millennials and by 2020 they will make up 75% (*Forbes* 2013) of the global workforce. With their dependency on technology and the fact that they don't know any different, naturally they expect these tools to be available in the workplace. A total of 59% of graduates confirm that state-of-the-art technology is important to them when considering a job. And 78% of them say that access to the technology they like to use makes them more effective at work. Companies therefore need to have infrastructures in place that will incorporate their own devices into the network.

Unfortunately, many businesses appear to be stuck in the old way of doing things and not utilising this generation to learn from them. A recent IBM survey stated that more than two in five millennials said they felt their use of technology was not clearly understood and they were held back by out of date and rigid work styles.

This generation wants to work for companies that are ethical and transparent, a place where there are no barriers between

workers of different levels, and where everyone knows what is going on in the business so they can learn from each other. Given the transparency and immediacy of knowledge exchange in the world of social media, it is clear that these sentiments largely derive from the norms of the digital world that millennials have been brought up in.

Additionally, the demand for flexible working has increased as employees want to work from anywhere and on any device they choose. 95% of millennials stated that work life balance was important to them and 19% saw it as a benefit. Consequently, businesses also need to be prepared for the increase of freelancers and the rise of portfolio working.

The technology explosion

There is an abundance of technology in the market for businesses to deploy and benefit from. Unified communications ranges from video and audio conferencing, to working from home solutions, multi-media contact centers, and the ability to access all features and functionality that employees have on their desk phones from their mobiles. Full mobile and collaboration solutions such as Microsoft Skype for Business, Mitel UCA and Avaya One-X, facilitate voice calls, video calls, instant messaging, screen share, and joint remote collaboration on documents.

Unified communications improve productivity and efficiencies by enabling employees to communicate easily and collaborate more effectively. This technology can be hosted on-premise or in the cloud, or a combination of the two allowing cost savings to be made and margin increased.

Workforces are increasingly becoming more mobile and more employees want to work flexibly and have the ability to work from anywhere. Forrester estimates that, by 2020, mobility will account for \$252 billion so companies do not have a choice but to maximise mobility. Integrating business phone systems into employees' mobile devices makes working from anywhere possible and deploying working at home solutions enables businesses to save on real estate. It also widens the recruitment pool to any location. Essentially, location is no longer a criterion of business!

So, how do businesses know what technology to choose? What is best for their operation and how will it help them? This is a quandary that many businesses face as the list is endless and here lies the problem: the market is saturated with technology.

People are so busy with their day jobs that they often miss out on going back to basics to identify objectives and devise

a strategy that will help to achieve these. They simply have too much to do! Consequently, businesses will then just rush and deploy technology because they feel they have to get on the digital bandwagon but they never utilise it for defined business purposes.

Businesses need to look at their technology operations in a strategic manner, and realise that going back to basics is often fundamental to success or failure.

The power of the solution provider

The answer to the challenges of today's modern workplace lies in the deployment of the correct technology and utilising it accordingly to benefit your employees and your business. It is important to realise that just implementing the latest technology will not automatically generate the results required, business and IT leaders also have to embrace and hone a culture of change alongside it.

Taking all of this into account is a massive undertaking for any business and it is advisable to recruit a trusted solutions and managed services provider, that is both able to advise you what technology you require to meet your objectives and adept at guiding you through the change management process.

When deploying a digital transformation strategy many businesses will require new or improved IT systems. Forrester research has found that 62% of senior business decision makers agree they would require improvements to their IT systems. And 95% say they need to recruit a third party with 53% stating they would use a full managed service provider.

External providers will work very closely with businesses holding discovery workshops, conducting individual meetings and focus groups with different departments to ensure that technology is part of the main fabric of the business and



“To have a successful digital transformation process in place companies must work together to achieve the business’s and individual’s results and goals”

aligned to the business’s objectives and strategy. They will discover what technology is needed, how to align business services with operations, and how to embed the technology into its processes.

Digital culture shock – view with new lenses

With such a plethora of external and internal influences senior management teams should look at existing management structures and cultures, and adapt them to the ‘brave new workplace’.

This tide of change requires companies to look at their existing business and processes with a new set of eyes, and it is essential that they let go of their rigid views and be prepared to bend and flex.

Digital transformation is not just about deploying technology for the sake of technology, it is about deploying technology that will help businesses meet objectives. It will transform processes, improve customer service and make employees’ lives easier. It is about putting the users and customers first to find out how it will make their roles and experiences easier and more effective.

Utilising the digital skills of millennials to help this transformation along is a good starting point as Forrester Research shows that 57% of organisations lack digital skills. This highlights a gap that is likely to shrink as more millennials join the workplace but whose current effects on a business’s market differentiation and competitiveness are very real until its operation is reorganised to deliver a better digital experience.

The digital strategy also needs to have owners, as lack of ownership of a new technology can otherwise lead to internal politics and disgruntled employees where no one knows what they are doing. The same research also states that 52% disagree on ownership and 51% identified organisational inertia as a further barrier to digital transformation. Also lack of training is evident in businesses; the user experience is essential when implementing new technology.

The solution needs to be easy to use and make the employee’s job easier, otherwise they won’t use it. Many businesses and organisations think that once they have deployed the technology the job is done, but ownership of a project needs to be announced from the start. Training requirements also need to be put in place to ensure that everyone understands how to use the technology. Aiding user adoption through training will ensure that new systems or applications won’t just be a fad but will be continued to be used on a daily basis.

It is undoubtedly hard to change people’s views but it is vital to embrace change. The CEO and senior management team need to champion a digital transformation strategy and open the



lines of communication between departments to knock down the silos, so everyone is aware of the objectives, strategy and plans and working in a transparent organisation.

Through creating a transparent environment a flatter management structure will occur organically. And a more 'grassroots bottom-up' approach will exist where directors and managers get more involved with different departments, and the silos between the departments start to dissolve.

This environment will naturally produce more fluidity within job roles where people will potentially be less pigeonholed into specific roles, and will start to become more involved in different departments and roles. This will benefit the business, as employees will still have specialist job function skills that will be utilised across the business, and with the open environment they should be encouraged to share ideas and feedback. As a result, the business will flourish with more ideas and valuable feedback available. Employees will become more commercially rounded rather than focused on a single task.

Intelligent customers

Customer experience is no longer just the responsibility of the contact centre or a marketing department, and it is essential that the senior management team take the onus and champion customer experience through the business in order for it to succeed.

Customer experience has never before been so huge; CEOs and members of the Board are now owning the 'customer experience' space, in contrast to it once being a job that lay on the fringes of marketing. It is no longer just about communicating customer experience in marketing material; it is about the entire company being focused on owning the customers' experience and incorporating it into its culture.

Technology can help to improve the customer journey by implementing a multimedia contact centre and presenting different options for customers to contact the agents, including social media.

Businesses need to change their technology roadmap not just for employees but to ensure that they are retaining and attracting customers. They need to be prepared to offer customers multi-channel communication from text and email through to phone calls and social media. Customers need to have the choice on how they communicate with you, and they expect a slick, consistent experience where the communication method is straightforward, and intuitive to create the ultimate seamless experience.

Working together to achieve results

To have a successful digital transformation process in place companies must work together to achieve the business's and individual's results and goals. It is crucial that departments no longer work in silos and start collaborating – to maximise each other's skills, and learn from one another.

Ultimately, technology can only benefit businesses if it is aligned with the business's objectives, strategy and operations, and correctly embedded into its processes. The success is dependent upon the silos that need to be broken down, ownerships that need to be established and the lines of communications opened. This will create an open and collaborative working culture where everyone is united and working towards the same goals.

The rules of the game are changing and will continue to do so, stay ahead of the game and embrace the digital world that is here now and here to stay. ■

WORLD COMMERCE REVIEW

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World Commerce Review is pleased to announce that Hermes Executive Aviation has been awarded the Best Corporate Aviation Provider 2016.

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Solutions to the digital trade imbalance

Susan Ariel Aaronson is Research Professor and Cross-Disciplinary Fellow at the Elliott School of International Affairs, George Washington University

Cross-border information flows are the fastest growing component of global trade. But countries have struggled to develop a system of trade rules to govern these flows. This column discusses how governments use trade agreements and policies to address cross-border internet issues and to limit digital protectionism. It also provides recommendations on how to build coherent regulation in the near future.

The information superhighway is not limited to any one country. Thus, when we use messaging apps such as WeChat or Kik, download movies from Netflix, or seek a new friend at Ashley Madison or Tinder, our information travels from servers based in one country to computers or mobile devices located in another. Although money may never change hands in such transactions, we have participated in trade by moving information across borders.

Growing cross-border information flows

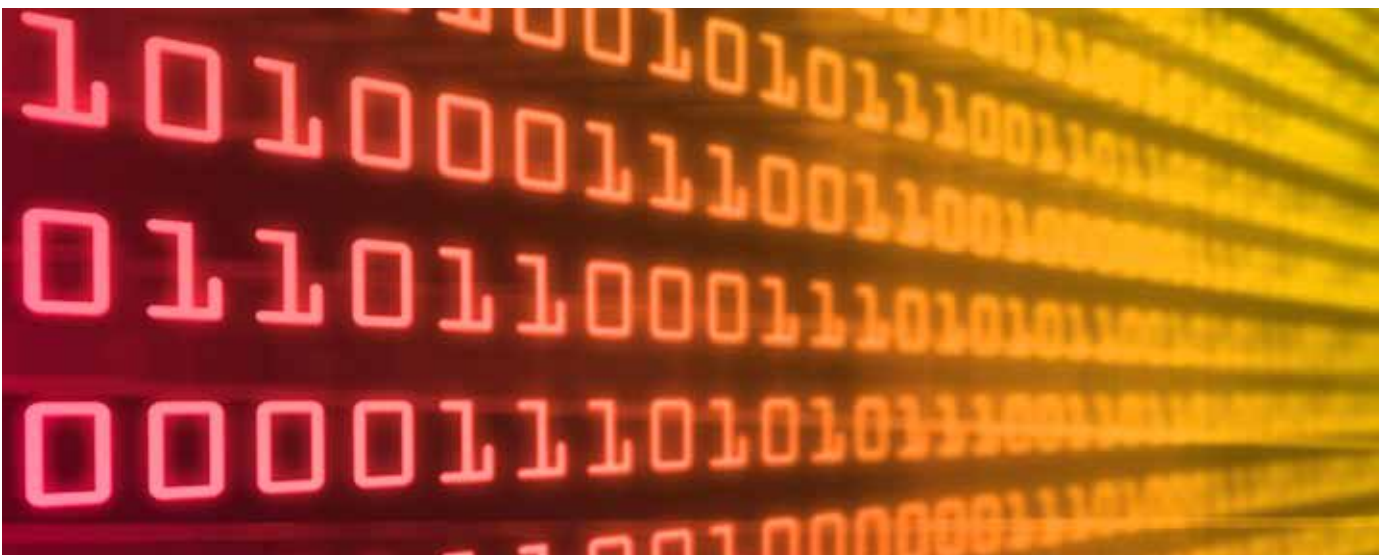
In fact, cross-border information flows are the fastest growing component of global trade. Using IMF data from 2008 to 2012, economist Michael Mandel¹ found that such flows increased 49%, while trade in goods and services grew some 2.4%. Clearly digital trade (commerce in products and services delivered via the internet through cross-border information flows) is booming. Growth in global markets for digital technologies is likely to continue because some 61% of the world's population has yet to go online².

Digital trade has become increasingly important to the US. The US International Trade Commission (USITC) estimates that digital trade in certain digitally intensive industries resulted in a 3.4% to 4.8% increase in US GDP in 2011-2013, while online sales of products and services in 'digitally intensive' sectors were about \$935.2 billion—or 6.3% of US GDP—in 2012. USITC also asserts that the expansion of digital trade caused real wages to increase by 4.5 to 5.0% and increased US aggregate employment by up to 1.8% while reducing trade costs by some 26% on average³.

Although many countries are gaining expertise and market share, the US continues to dominate both the global digital economy and digital trade. The US is home to 11 of the world's 15 largest internet business (China is home to the other four). Companies such as Facebook, Google, Yahoo, and Twitter dominate much of the web. Not surprisingly, the US is the key force behind efforts to develop a system of trade rules to govern cross-border information flows⁴.

What rules can govern cross-border information flows?

But the US has long struggled to find common ground on these rules. Almost every country has adopted policies to encourage the development of digital technologies and firms, as well as steps to protect privacy, enforce intellectual property rights, protect national security, or thwart cyber-theft, hacking or spam. At times, these policies may discriminate against foreign market actors, and in so doing, distort trade.



In May 2015 alone, France, Germany, and the UK asked Twitter, Facebook, and Google to pre-emptively remove content considered extremist⁵. That same month, the Chinese Ministry of Industry and Information Technology (MIIT) announced that domain name registrars in China would be forbidden from selling domain names in top-level domains (TLDs) not approved by the Chinese government⁶. Each of these governments would likely argue that such policies are legitimate and necessary.

Given the stakes, many US executives and policymakers label other governments' efforts to restrict information flows or to enhance local digital prowess as 'digital protectionism'. The US International Trade Commission (USITC) defines digital protectionism as barriers or impediments to digital trade, including censorship, filtering, localisation measures, and regulations to protect privacy. The US has made efforts to limit digital protection central to its trade policy efforts and even its national security strategy⁷.

Until recently, the US (as well as Canada and the EU) included non-binding language in trade agreements designed to ensure that information moves seamlessly across borders. However, in October 2015 after seven years of negotiation, the US and its 11 negotiating partners found common ground on binding language in the Trans-Pacific Partnership (TPP)⁸.

The TPP states that *"each party shall allow the cross-border transfer of information by electronic means."* In so doing, the TPP nations have made the free flow of information a default. However, the agreement also includes exceptions to the free flow of information. The parties may impose conditions or restrictions on the cross-border transfer of information as required to achieve public policy objectives, provided those measures are not discriminatory or a disguised restriction on trade. As a result, one TPP party could use the agreement to challenge censorship or filtering in nations that might do so in a discriminatory manner⁹.

Because of this binding language, should TPP go into effect, it will set an important precedent for cross-border information flows. The agreement will cover almost one-quarter of current internet users and will affect the internet in 12 significant trading nations. TPP parties have a population of some 800 million people, or 11.4% of the earth's total. Vietnam, Colombia, Indonesia, the Philippines, South Korea, Taiwan, and Thailand have expressed interest in joining TPP should it come into effect¹⁰.

Moreover, if TPP is approved, it could have significant spillover effects upon how other governments deal with cross-border information flows. They will have to comply with TPP rules when they exchange information with TPP parties. At a minimum, the US will want to use TPP as a guidepost for other trade agreements including TTIP and TISA under negotiation. Meanwhile, other governments too will need to consider this language and what it means for their firms' cross-border flows¹¹.

Policies to limit digital protectionism: new research

In a recent paper for the Global Commission on Internet Governance¹², I examined how governments use trade agreements and policies to address cross-border internet issues and to limit digital protectionism¹³. The 'digital trade imbalance' of the title refers to the imbalance between the US' enthusiasm for and its major trade partners' resistance to the creation of a system of trade rules to govern cross-border information flows. The imbalance also speaks to the divide

"Governments have not figured out how to coordinate policies to promote cross-border information flows with national security and digital rights policies"

over what is 'protectionist' and what comprises legitimate national policies.

I note that although policymakers have succeeded at binding language, they should carefully weigh the pros and cons of trade agreements as a strategy for regulating these flows.

- On one hand, trade agreements could help clarify how and when governments can limit information flows, and could have positive implications for global internet governance.

As noted above, TPP will provide an impetus to the development of globally coordinated policies on a wide range of global issues from privacy to cyber security. A system of shared rules could build greater trust and could reduce costs for firms and individuals who must deal with different rules about how and where data can be collected and stored; when and under what conditions data can be transferred to other organisations; and what types of user authorisations are needed for collection, storage, and transfer.

- On the other hand, trade agreements might not be the best venue for governing cross-border information flows.

Trade agreements regulate the behaviour of states, not of individuals or firms; thus, companies and citizens have no direct way to influence trade agreement bodies. Moreover, trade agreements are negotiated in secret by governments; these negotiations move slowly and the public is not directly involved. In contrast, the internet is governed in a more ad hoc, bottom-up and transparent manner.

Stakeholders from civil society, business, government, academia, and national and international organisations make internet governance rules in a timely, open and collaborative manner without a central governing body. Many internet activists would not take kindly such a dramatic change to internet governance. Moreover, many internet issues that involve information flows, such as privacy or the security of data, are not market-access issues — although they are regulatory issues, and finding common ground on cross-border regulations has become an important rationale for 21st century trade agreements.

Trade agreements are sometimes perceived as favouring US interests and actors. Government officials probably do not want to use trade policy to perpetuate US digital dominance and are likely to balk at US demands unless the US can come up with other arguments as to why such language in trade agreements could be in their interest as well. Finally, trade agreements are not explicitly designed

to facilitate interoperability or universal standards, which is how internet policies have traditionally been designed.

- Trade agreements do not include clear language regarding human rights yet will have direct effects on human rights.

Human rights are a key element of the rule of law online and thus must be coordinated with international efforts to regulate cross-border information flows. As information flows across borders, it can simultaneously enhance and undermine specific human rights.

These effects are complex and constantly changing, and governments are just learning to protect and respect such rights online. However, most trade agreements do not contain language that links government obligations to protect, respect, and remedy violations of human rights to government obligations for trade. Policymakers must clarify the relationship of trade obligations to human rights obligations delineated in other agreements.

Recommendations towards policymakers

In light of these findings, I recommend that policymakers should:

- Encourage interoperability and the rule of law.

Governments negotiating binding provisions to encourage cross-border information flows should also include language related to the regulatory context in which the internet functions (for example, provisions to encourage interoperability, free expression, fair use, the rule of law and due process). By including such language, policymakers can argue that these rules enhance human welfare and internet operability. Hence, they will be better

positioned to argue that trade agreements are appropriate avenues for mediating tensions between national law and cross-border flows of information.

- Define and challenge barriers to digital trade by using the WTO—the most broad-based trade agreement.

A WTO member should ask the WTO Secretariat to analyse if domestic policies that restrict information (short of exceptions for national security and public morals) are also barriers to cross-border information flows that could be challenged in a trade dispute.

Moreover, policymakers should develop strategies to quantify how such information restrictions might affect trade flows. Finally, they should use the WTO (and, if the TPP goes into force, the TPP) to test these provisions in a trade dispute. In so doing, they can reduce the digital trade imbalance.

- Do a better job of linking trade and other internet policies.

Although many countries have taken steps to advance digital rights globally, these governments have not figured out how to coordinate policies to promote cross-border information flows with national security and digital rights policies. Nor have these governments developed clear and compelling arguments as to how these agreements will benefit netizens.

The US should connect these arguments in order to build public support among their publics and to convince citizens and policymakers from other nations (including those that heavily censor the internet) to adhere to digital trade agreements. ■

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40 YEARS OF OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES



Winand Quaadvlieg is Chair of the BIAC Committee on Investment and Responsible Business Conduct, and Hanni Rosenbaum is Senior Director of Policy and Strategic Planning at BIAC, the Business and Industry Advisory Committee to the OECD

A unique and comprehensive instrument for responsible business conduct

Business has long recognized the importance of responsible business conduct in a globalized world. Today, many companies have integrated responsible business conduct into their overall business strategy to manage their activities in a responsible way. Out of the range of international instruments that are in place to guide business in this effort, the *OECD Guidelines for Multinational Enterprises (MNE Guidelines)* are the most comprehensive international instrument for responsible business conduct. Adhering countries have committed to promote the *Guidelines* in a global context.

The *MNE Guidelines* cover all major areas of business ethics and include recommendations in the areas of disclosure, human rights, employment and industrial relations, environment, bribery, consumer interests, science and technology, competition, taxation, as well as general policies related to supply chains, due diligence and stakeholder engagement.

In 1976, the OECD adopted the Declaration on International Investment and Multinational Enterprises. It aims to balance the public policy of OECD governments to promote an open international investment climate with a business commitment to make responsible use of the opportunities an open investment climate provides. The *MNE Guidelines* are an integral part of the OECD Declaration, together with a national treatment instrument, the commitment to minimize conflicting requirements, and the commitment to cooperate in the field of international investment incentives and disincentives.

Together, they form the foundation on which the actual international investment regime rests. And in a world in profound transformation, their relevance is as big and fresh as 40 years ago. Equally, the *MNE Guidelines*, which have been substantially updated and revised several times, are more than ever a key international reference document for responsible business conduct for companies around the world.

Why should business be aware of the MNE Guidelines?

First of all, the *MNE Guidelines* provide a comprehensive framework for responsible business conduct. It is based on a consensus view from adhering governments, which was forged in an intensive negotiation process in 2011 with close involvement of business, labour and civil society. Adhering governments have committed to promote the *MNE Guidelines* within the OECD area and globally. The *Guidelines* are

deliberately not legally enforceable as they are intended to stimulate responsible behaviour, not to trigger legal disputes. However, MNEs are expected to fulfil the recommendations set out in the *Guidelines* and to have a policy in place that is consistent with these recommendations.

What makes the *MNE Guidelines* different from other instruments is that they are supported by a unique implementation mechanism of National Contact Points (NCPs), which are established by all adhering governments. The NCP promotes the *MNE Guidelines* and provides a non-judicial grievance mechanism that can contribute to the resolution of issues that arise in relation to the implementation of the *Guidelines*. Any interested party, in most cases NGOs and trade unions, can call upon the NCP to help resolve issues concerning the implementation of the *MNE Guidelines* by a company in a specific case. The *MNE Guidelines* are the only international corporate responsibility instrument with such a grievance mechanism in place.

In 2015, the *MNE Guidelines* and the NCPs got high-level political attention when the OECD Ministerial Council Meeting in June underlined the importance of continuing efforts to further strengthen the performance of NCPs. The critical role of the OECD *MNE Guidelines* and NCPs was further underlined at the June G7 Summit, which encouraged the OECD to promote peer reviews and peer learning on the functioning and performance of NCPs while G7 governments made a commitment to 'lead by example.'

However, the *MNE Guidelines* should not only be considered as a demand on business. They also contribute to providing a more level playing field, nationally and internationally, by setting out the standards of responsible behaviour that are expected from all MNEs. They also protect business from unrealistic expectations from stakeholders. Expectations that go clearly beyond the *Guidelines* will not easily be considered justified.

The MNE Guidelines today

In addition to the 34 OECD member countries, there are also 12 non-member countries that adhere to the *MNE Guidelines*, and discussions with additional non-member countries are underway. The *MNE Guidelines* are applicable to MNEs operating in and from adhering countries, bearing in mind that observance of the *Guidelines* by these enterprises is recommended wherever they operate, not only in adhering

countries, but also in other countries where they invest. In order to create a level playing field, the business community strongly encourages global engagement and implementation of the standards included in the *Guidelines* by non-adhering countries, including major non-member economies, such as China and India. The OECD activities in this field are highly appreciated.

Since the adoption of the OECD Declaration on International Investment and Multinational Enterprises in 1976, the *MNE Guidelines* have been updated five times. These updates reflected the need to consider the changing landscape for international investment, increasingly complex patterns of production and consumption, and the need to establish confidence in open markets.

In particular, the last update in 2011 has led to increased attention from countries and stakeholders around the world to the *MNE Guidelines*, due to a number of new provisions, such as those related to supply chains and the new human rights chapter. The human rights chapter is fully consistent with the UN Guiding Principles on Business and Human Rights, which were negotiated simultaneously with the *Guidelines*.

The grievance mechanism of the *MNE Guidelines* is increasingly being used. Over 320 'specific instances' were submitted to NCPs between 2000 and mid-2015, covering MNE operations in 90 countries from a range of different business sectors. This clearly demonstrates that companies must be aware of the *MNE Guidelines*.

Avoiding adverse impact - due diligence

The 2011 *MNE Guidelines* introduced an important new recommendation: MNEs should avoid adverse impacts of their business activities in the areas covered by the *Guidelines*. First of all, enterprises should prevent their own activities from causing an adverse impact. Enterprises should also avoid substantially contributing to any such adverse impact. Their own activities also include activities in the supply chain,

"... active engagement on responsible business conduct by companies and countries around the world is more important than ever for a global level playing field and sustainable economic growth"

however, some meaningful involvement of the MNE in the activity is then required.

In addition, MNEs should seek to prevent or mitigate adverse impacts by a business relationship, when the impact is directly related to the MNE's operations, products or services. The practical implications of this provision are still subject to a societal debate. At the same time, it should be borne in mind that the *Guidelines* are based on the principle that MNEs are responsible for their own behaviour and not for the adverse impacts purely caused by others. They are more demanding depending on how directly or substantially the enterprise is involved in the adverse impact.

To avoid adverse impacts, enterprises should carry out due diligence. This means that they should introduce a process to identify, prevent, reduce, and account for how they address actual and potential adverse impacts.

However, flexibility is also a key concept of the *MNE Guidelines*. The nature and extent of due diligence depends on the precise circumstances. The *Guidelines* recognize that the encouragement of business partners to comply with the recommendations is subject to practical limitations depending on the specific circumstances.



Business recommendations going forward

BIAC, which represents the business community at the OECD, considers responsible business conduct as promoted by the *MNE Guidelines* to be an essential part of an open investment climate and in the best interest of business. At the same time, the business community continues to work closely with the OECD to ensure that there is a level playing field and to address a number of issues related to implementation.

40 years after the adoption of the OECD Declaration, responsible business conduct and the OECD *MNE Guidelines* are receiving increased public attention. Thus, business must be aware of this important instrument and contribute to strategic discussions in a forward-looking manner. Key considerations for business include the following:

For the *MNE Guidelines* to be effectively implemented, it is important that every country fulfills its commitment to put in place an adequately functioning NCP. Countries cannot reasonably expect business to comply with the *Guidelines* if there is no adequately functioning NCP in place. At the same time, it must be ensured that there is a shared understanding of all stakeholders of the NCP procedure. The purpose of the procedure is to help parties to work constructively on the basis of facts and trust towards a common future-oriented solution to the advantage of all parties.

The OECD and NCPs should ensure that the NCP procedure is publicly presented as an offer of good offices to help parties find a solution, and not a platform for campaigning against companies. The initiation of a specific instance procedure does not automatically imply that a company has failed to observe the *MNE Guidelines*. This should be abundantly clear. NCPs, business and stakeholders will get the best result if they adopt a constructive approach

focusing on responsible business conduct and not an adversarial approach based on campaigning.

To be practical, an excessively broad interpretation of the recommendations in the *MNE Guidelines* must be avoided. There must be a clear understanding of the reasonable limitations for an MNE to change third parties' conduct in the supply chain when seeking to avoid or mitigate adverse impacts in a specific business context.

The *Guidelines* need to remain a practical and manageable tool for MNEs, which is also important to facilitate their acceptance in non-OECD-member countries. Seeking to prevent or mitigate an adverse impact to which an enterprise is only linked by a business relationship does not intend to shift the responsibility from the entity causing the adverse impact to the enterprise with which it has a business relationship.

Finally, with the shift of weight in the world economy, it is more important than ever to expand the geographical coverage of the *MNE Guidelines* and promote implementation of the standards of the *Guidelines* by non-adhering countries, including major non-member economies such as China and India. Any country that is actively involved in international investment should give serious consideration to endorsing the *Guidelines*. This will also contribute to creating a favourable investment environment for those countries and demonstrate their commitment to responsible business conduct.

As 2016 marks the 40th anniversary of the OECD *MNE Guidelines*, active engagement on responsible business conduct by companies and countries around the world is more important than ever for a global level playing field and sustainable economic growth. ■

G20 missed opportunities on trade and investment

A recently released scorecard rating G20 responsiveness to key business policy priorities has revealed that during the Turkish presidency of 2015, the G20 made progress on a number of international business priorities but missed some important opportunities to advance trade and international investment policy frameworks.

Prepared by the International Chamber of Commerce, the Scorecard examines a total of 25 business priorities developed during the 2015 Turkish B20 cycle and rates G20 responsiveness across seven policy areas. This year's score of 2.0 out of 3.0 translates to an assessment of 'Fair'.

ICC Chairman Terry McGraw said: "We publish the Scorecard to help the G20 gauge progress and identify areas that merit greater

attention. This edition finds that the G20 is making progress on the B20 (Business-20) recommendations that will lead to economic growth and job creation. It is critical that G20 leaders, with support from business, unite to exercise stronger leadership in tackling the world's economic policy challenges, particularly on trade, investment and the environment."

ICC Secretary General John Danilovich added: "The score is a slight decrease from the previous Brisbane and St. Petersburg Summits' and reflect our disappointment in G20 leadership on the trade agenda."

The Scorecard suggests that passive wording used in the Antalya Communiqué led to a missed opportunity to underscore the urgency of implementing the WTO Trade



Facilitation Agreement (TFA) which according to ICC research has a potential to add US\$1 trillion to global GDP and 18 million jobs, primarily in emerging markets.

"The G20 should have rallied endorsement for the TFA in the run-up to the WTO ministerial in Nairobi," McGraw said: "Leaders in Antalya missed an important opportunity to build momentum on the trade agenda and progress on ratification of the WTO Trade Facilitation Agreement has been disappointingly slow," he said. "We need 108 countries to ratify the TFA and we still have 10 G20 countries that haven't. We must get this done."

While the Scorecard G20 demonstrates some progress on the infrastructure investment agenda, it notes that G20 leaders have not responded to growing calls for G20 leadership on international investment governance, including business calls for a model investment framework.

Jeffrey Hardy, Director of the ICC G20 CEO Advisory Group said: *"The country-specific investment strategies endorsed by leaders in Antalya are the type of concrete actions we need to see from the G20. But we also need them to set national targets on infrastructure spending, as a percentage of GDP and to agree overarching national strategies for credible infrastructure pipelines. This was also a missed opportunity for the G20 to demonstrate leadership on rationalizing the current patchwork of bilateral and regional investment rules."*

The G20 received high marks for its commitments to SMEs, including recognition of the new World SME Forum (WSF), an initiative to unlock the potential of SMEs worldwide. Co-founded by ICC and launched during the Antalya Summit, the WSF is set to be an enduring legacy of Turkey's G20 Presidency.

While acknowledging a concrete commitment by G20 leaders to reduce the proportion of young people most at risk of being left permanently behind in the labour market, the Scorecard noted that implementation would require comprehensive reform and modernization of national and vocational education and training systems along with the creation of open and dynamic labour markets.

"It is disappointing that G20 ministers failed again under the Turkish Presidency to address key issues around bringing more people into employment," said Daniel Funes de Rioja, President

of the International Organization of Employers (IOE). *"It's not enough for the G20 employment process to take the line of least resistance; the difficult tasks need to be tackled. Business stands ready to support G20 Governments in this endeavour."*

Scores given for G20 efforts on Energy and Environment were significantly higher than the previous year – the result of increased focus on energy and climate change in the Antalya Leader's Communiqué, coupled with the first G20 Energy Ministers Meeting on 2 October 2015.

Hardy said: *"ICC is pleased that the G20 has recognized several of the business priorities outlined in 2015. The Antalya Communiqué included unprecedented strong language on climate change, stating and that it was 'one of the greatest challenges of our time'. The G20's Antalya commitments held firm and helped secure the historic global climate agreement reached in Paris in December."*

The Scorecard also reflected good G20 progress on Anti-Corruption, an acknowledgement of the on-going partnership between the B20 and the G20 anti-corruption working group and several deliverables cited in the 2015-2016 G20 Anti-Corruption Action Plan aligned to Business-20 recommendations.

"It is encouraging that the G20 continues to demonstrate leadership in denouncing corrupt practices, including the delivery and publication in Antalya of national implementation plans on beneficial ownership transparency. This is an important area of focus for the G20 and presents a significant boon to the global effort to increase transparency and deter corruption," said Danilovich. *"However, one year after Brisbane, there are still gaps between the G20's own principles and the current state of regulation in several G20 countries."*

In January, an ICC delegation led by Mr McGraw joined 400 Chinese and international business leaders and government officials for the official launch of B20 China. The meeting marked the beginning of the business policy development process in the run-up to the 2016 G20 Summit scheduled to take place in Hangzhou, China on 3-4 September 2016. ■

To learn more about ICC's G20 Scorecard visit:

www.iccwbo.org/global-influence/g20/advisory-group



The Nairobi WTO Ministerial Conference and post-Nairobi developments



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The World Trade Organization (WTO) organises Ministerial Conferences, generally once every two years, which provides a platform for trade ministers from all member countries to discuss the pressing issues affecting international trade and take decisions under the multilateral trading agreements or adopt new agreements. The WTO concluded its Tenth Ministerial Conference in Nairobi, Kenya, in December 2015.

This article aims to understand the outcome of the Nairobi Ministerial Conference and the post-Nairobi developments. At the outset, it is important to briefly understand the background of the WTO negotiations leading up to Nairobi. We will then discuss the implications of the decisions taken at Nairobi and the road ahead for the multilateral trading system.

The WTO Ministerial Conferences

At the WTO's Fourth Ministerial Conference in Doha, Qatar, in November 2001, the Doha Development Agenda (DDA) was launched which encompassed a wide-ranging work program with the aim to achieve lower trade barriers around the world and facilitate increased global trade. With development at the heart of the negotiations, the main areas included Agriculture, Non-Agricultural Market Access (NAMA), Services, Intellectual Property, Development Issues and Trade Facilitation amongst others.

Since then, progress has been slow for a variety of reasons (as discussed later). However, the WTO's Ninth Ministerial Conference, held in December 2013 in Bali, Indonesia, gave a new impetus to the multilateral trade regime with the successful conclusion of negotiations on the Trade Facilitation Agreement (TFA).

Furthermore, along with the TFA, the Bali Declaration included Decisions on other items including Understanding on Tariff Rate Quota Administration Provisions of Agricultural Products, Public Stockholding for Food Security Purposes, Export Competition, Cotton, and four issues of interest to Least Developed Countries (LDCs), namely: Preferential Rules of Origin, Preferential Treatment to Services and Service Suppliers, Duty-Free and Quota-Free Market Access, and Monitoring Mechanism on Special and Differential Treatment.

The days and months leading up to the WTO's Tenth Ministerial Conference in Nairobi were tense and over the last several years there has been an increasingly sharp divide amongst member countries, both over the content of various specific deliverables, as well as on the future course of multilateral negotiations at the WTO. There has been a sharp divide in

opinions about the future of the DDA and whether or not it remains relevant.

Going into Nairobi, Michael Froman, the United States Trade Representative, made it abundantly clear that the Doha Round was designed for a different era and in the present context it is important to reframe the agenda. Furthermore, he indicated that the United States is interested in bringing new emerging issues for discussion the WTO forum (such as electronic commerce and environment)¹.

A similar stand was advocated by Cecilia Malmström, the EU Commissioner for Trade, highlighting the need to have a flexible approach to negotiations². On the other hand, developing countries like India have remained firm that the negotiations must be carried out within the DDA and no new issues be brought unless the Doha Round issues are closed. With this backdrop we proceed to analyse the outcomes of the Nairobi Ministerial Conference.

Outcome of the Nairobi Ministerial Conference

The Tenth WTO Ministerial Conference was held in Nairobi from 15th to 19th December 2015. After five days of intense negotiations, 162 members of the WTO came to a deal to push the agenda, and crucially reassert their relevance. There were a number of significant decisions made by the member countries.

The 'Nairobi Package' contains six ministerial decisions, including three decisions pertaining to agriculture. Additionally, three decisions were adopted under the Regular Work of the General Council on electronic commerce, implementation of the WTO Agreement on Trade-Related Intellectual Property Rights (TRIPS), and a work programme for the advancement of small economies. Furthermore, members also endorsed the Declaration on the Expansion of Trade in Information Technology (ITA-II).

The first was a decision on a special safeguard mechanism (SSM) for developing country members. It recognises the right of developing country members to have recourse to a SSM. The issue of SSM would be further discussed amongst the members, and delinked from the issue of market access.

The second decision was on public stock holding for food security purposes. These negotiations will be held in the Committee on Agriculture in dedicated sessions and in an accelerated time-frame, distinct from the agriculture negotiations under the DDA. SSM and public stockholding are important issues for developing and net food importing

countries and it is significant that going forward these issues will be taken up for an early resolution. While there may not have been any binding commitment at Nairobi, but the recognition of the importance of these issues is significant.

The third decision was on export competition. Disciplines have been imposed on measures affecting export competition, including export subsidies. All member countries have to eliminate export subsidies within a given time frame, with some relaxation for developing countries to comply. While on paper the decision to eliminate export subsidies sounds remarkable, over the years most developed countries have eliminated or significantly reduced such subsidies.

Member countries also affirmed the importance of cotton to the least developed countries (LDCs). Developed country members, and developing country members declaring themselves in a position to do so, shall under their respective preferential trade agreements grant duty-free and quota-free market access for cotton produced and exported by LDCs from 1 January 2016. Further, developed countries shall eliminate cotton export subsidies immediately and developing countries do so by 1st January 2017.

Decisions were adopted in favour of the LDCs on preferential rules of origin for LDCs and on preferential treatment in favour of services and service suppliers of LDCs to increase LDC participation in services. The endeavour is to facilitate trade by the LDCs and help them increase their share in world trade. The decisions in favour of LDCs are in line with the WTO's constant effort to make the global trading order more inclusive and to help LDCs reap the benefits of trade.

Member countries also reaffirmed their commitment to the Work Programme on Small Economies. The objective of the programme, which is carried out in dedicated sessions of the Committee on Trade and Development, is to address the trade-related issues facing small economies and to help them integrate into the multilateral trading system. An important commitment was undertaken regarding e-commerce. WTO members would continue the practice of not imposing customs duties on electronic transmissions until the next session of the Ministerial Conference in 2017.

"... developing countries must raise the level of ambitions while negotiating trade and investment deals"

Further, the TRIPS Council would be asked to continue its discussions on whether non-violation disputes should apply to intellectual property, and to make recommendations to the next Ministerial Conference to be held in 2017. In the meantime, WTO members would refrain from bringing such cases to the dispute settlement system.

The Nairobi Ministerial also witnessed the endorsement of the second phase of the Information Technology Agreement (ITA-II) by 53 WTO members that calls for tariff eliminations on a large number of information technology (IT) products. As a result of these negotiations, approximately 65 per cent of tariff lines will be fully eliminated by 1st July 2016. Most of the remaining tariff lines will be completely phased out in four stages over three years and by 2019 almost all imports of the relevant products will be duty free. The elimination of high tariffs on IT products will boost global trade and expand annual global GDP by \$190 billion³. This indeed is one of the most significant outcomes of the Nairobi Ministerial Conference.

However, Nairobi fell short on a number of fronts. As discussed above, the no permanent solution was arrived at on the issues of SSM and public stockholding for food security. The impact of elimination of export subsidies is not likely to be significant either. More profoundly, member countries agreed to disagree on whether the DDA can remain the basis for ongoing negotiations. The general consensus based approach to decision making in the WTO made way for an express division in views. The Nairobi Ministerial Declaration highlighted that some countries prefer 'new approaches' to achieve results at the multilateral level⁴. Other members reiterated that the WTO negotiations must address outstanding issues within the confines of the DDA agenda.



Changing global realities

In all fairness, the results at Nairobi were perhaps the best that could be achieved given the circumstances. One of the reasons for the modest outcome is that the global realities have been changing very rapidly since the launch of the Doha Round, and even more so in the last decade. There has been economic and political turbulence across the globe.

Global realities have significantly altered in the WTO's 20-year history. Developing countries, particularly emerging economies such as Brazil, Russia, India, China, and South Africa, exercise significant influence over global trade. China, which joined the WTO in 2001, has now become the world's largest exporter⁵. Average applied tariffs, meanwhile, have significantly dropped and trade volumes have doubled. Meanwhile, electronic commerce has changed the nature of cross-border engagement.

Regional and bilateral trade deals are also on the rise, with over 600 such agreements notified to the WTO by the end of 2015, up from 267 in 1995⁶. Mega-regional pacts, such as the Trans-Pacific Partnership (TPP), have drawn particular notice for their potential commercial impacts (both for TPP members and the countries excluded from the TPP) and their forays into areas not traditionally dealt in trade agreements.

As a result of all of these developments, the WTO is said to be at a crossroad, and there is a growing voice for it to evolve. This is despite the fact that its other key pillars, trade monitoring, the work of the WTO's regular bodies, and the dispute settlement system, have been widely appreciated for their success⁷.

The road ahead

There is a need to re-assess and re-think in a realistic manner of what is achievable within the Doha framework. Clinging on to the rhetoric of DDA will not facilitate a beneficial dialogue. There is a need for all countries to adopt a more pragmatic approach. The rise of mega trade agreements and plurilateral agreements has created an avenue for countries to agree on issues with like-minded countries alone. Going forward there are many issues, both old and new, that call for deliberation and some of them are discussed below.

Services. There is a growing appreciation of services and its importance to all countries. It is worth considering if the negotiations on services is worthy of discussion in isolation. There is, thus, a need for streamlining the rules for services trade and investment and having single-window clearance to reduce transaction costs. Processes and procedures pertaining to visas and work permits should be streamlined within the scope of the General Agreement on Trade in Services (GATS).

Farm subsidies. They still remain on the WTO's agenda but because the Nairobi Ministerial outcome was ambiguous on this, we do not know if it will come up for discussion in Geneva any time soon. However, there is a need to look into the

Agreement on Agriculture and the classification of subsidies into the permissible 'green box' and the restricted 'amber box' subsidies.

As noted earlier, the developed countries have been drastically reducing the amber box subsidies, but greatly increasing direct farm subsidies (which fall in the green box). Developing countries will continue to resist reduction in agricultural tariffs in the face of high farm subsidies and to achieve any meaningful trade liberalisation the issue of subsidies must be addressed first.

New issues. WTO members decided at the 1996 Singapore Ministerial Conference to set up three new working groups: on trade and investment, on competition policy, and on transparency in government procurement. They also instructed the WTO Goods Council to look at possible ways of simplifying trade procedures (that is trade facilitation).

Of the four Singapore issues, trade facilitation was retained and wrapped up at the Bali Ministerial in 2013 and there has been some movement on the other issues. Moreover, these issues are already covered in agreements such as the TPP. Given the trend, it is likely that interested countries will push for these issues plurilaterally.

Developing countries need to assess their internal capabilities and take another look at these issues to see how they can benefit from potential multilateral agreements on them. Many developing countries like India are now not only capital importers, but also capital exporters, and it may be in their interest to be open to discussing trade and investment.

Similarly, as compared to 2001, a number of developing countries have adopted domestic competition law, which includes provisions to deal with competition-related trade issues. Further, an increasing number of member countries are joining the WTO GPA and if countries do not wish to be left behind in participating in public procurement contracts abroad, they must consider joining the GPA.

At the international level, it is clear that new issues will be discussed and agreements will be finalised, if not multilaterally, then bilaterally/regionally or plurilaterally. Instead of shying away from discussions, developing countries may engage in them and see how they can influence their trade competitiveness. This will allow them to influence the discussions since inception.

Further, developing countries must raise the level of ambitions while negotiating trade and investment deals. Numerous studies have shown that trade liberalisation helps the economy to grow and in order to reap benefits from international trade countries must be proactive, rather than defensive in negotiations. ■

1 <http://www.ft.com/intl/cms/s/0/4ccf5356-9eaa-11e5-8ce1-f6219b685d74.html#axzz40hcTcegV>

2 <http://www.politico.eu/article/we-must-have-a-trade-deal-nairobi-fair/>

3 <http://blogs.piie.com/trade/?p=536>

4 WT/MIN(15)/DEC, available at https://www.wto.org/english/thewto_e/minist_e/mc10_e/mindecision_e.htm

5 https://www.wto.org/english/res_e/statis_e/its2015_e/its2015_e.pdf, at p. 25

6 https://www.wto.org/english/tratop_e/region_e/regfac_e.htm

7 <http://www.ictsd.org/bridges-news/bridges/news/wto-ministerial-a-time-for-reflection-in-nairobi-on-the-future-of-global>

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Trade negotiations in an era of deep integration

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Introduction

In October 2013, Stephen Harper and José Manuel Barroso, then respectively the prime minister of Canada and the commission president of the European Union (EU), announced that they had reached agreement in principle on the Canada-EU Comprehensive Economic and Trade Agreement (CETA). Ten months later, in August 2014, their governments released in English the complete text of the agreement. In the months that followed, CETA underwent a “legal scrubbing” and translation into 22 languages.

Following the October 2015 federal election, newly elected Canadian prime minister Justin Trudeau identified the implementation of CETA as a top priority for his minister of international trade. Ratification of CETA on the European side might be delayed until European concerns about investor-state dispute settlement provisions can be allayed but is also likely to proceed in 2016.

One of the distinctive features of CETA is the role that subnational actors played in the negotiations. In particular, the Canadian provincial and territorial governments were involved to an unprecedented degree (Paquin 2013; DeBeer 2012, 51). Why is this so? I argue that a unique combination of political and technical factors explain this outcome.

Provinces and territories in trade negotiations: their evolving role

The provinces and territories have long been privy to trade negotiations, but in the case of CETA, they were at the negotiating table alongside their federal colleagues. The EU reportedly asked for the provinces to be present, recognizing that negotiations would touch on many issues with direct or indirect consequences for areas of provincial jurisdiction (Fafard and Leblond 2012, 10; Finbow 2013, 2) including financial services; government procurement; patent term extensions for pharmaceutical products, which could affect provincial and territorial health care provision costs; and greater access to the Canadian dairy market, especially for cheese.

“The worst that could happen for the EU is to devote time and energy to negotiating CETA with Canada only to find out that many of the provisions are not being applied or implemented by some or all of the provinces” (Fafard and Leblond 2012, 10).

Canadian provinces have always played some kind of role in trade negotiations, and sometimes a very substantial

one. Interestingly, this role has not been identical in every negotiation. There is some latitude for movement in the role that provinces and territories can and should play in any particular instance of international negotiations.

To what can one attribute this latitude? Christopher J Kukucha explains (2011, 132) that “*unlike other federal states, Canada does not have clearly defined constitutional guidelines regarding the international activity of non-central governments.*” Further, a series of court decisions and constitutional provisions create “*a level of constitutional ambiguity that grants Canadian provinces a degree of international legitimacy absent in many other federal states*” (133).

These various provisions establish roles for both the federal and provincial governments in international trade treaty-making — for the federal government, in setting the mandate, conducting negotiations and ratifying the agreement; for the provinces, in implementation. If provincial legislation must be enacted to give a trade agreement full force, the provinces can exercise genuine control by threatening not to implement required legislation (Delagran 1992, 18).

Canadian provinces and territories certainly do not function as a monolithic bloc against the federal government (Fafard and Leblond 2013). Furthermore, a number of issues on the table in trade negotiations are ‘new’ issues in the sense that they pertain to sectors that did not exist when provincial and federal jurisdictions were first delineated (DeBeer 2012). These include aspects of intellectual property and internet regulation.

The federal government’s need for sub-federal support and buy-in has led to various mechanisms of consultation and intergovernmental communication. This has evolved through work in a series of committees, the nature and degree of participation depending on the trade negotiations in focus at the time. CETA marks the first time provinces and territories were ‘at the table.’

One could argue that municipalities are as implicated in procurement decisions as the provinces. Indeed, several municipalities across Canada sought exemptions from CETA on this basis. Efforts by municipalities are noteworthy partly because they drive home the degree to which trade agreements have ramifications across multiple levels of governance. However, they also show that not all levels

exercise the same influence. While it is clear that the provinces played a crucial role in CETA, there is not much evidence to suggest that the municipalities' views were weighed heavily in negotiations, although they had flagged the agreement's relevance for them.

What changed? the evolving trading system

In the last several decades, the trading system has changed significantly. The shift from the treaty-based negotiating rounds of the GATT system to the brick-and-mortar institution of the WTO; the rise of China as a big trader; and the increasing importance of global value chains are just some of the noteworthy occurrences.

In addition, two developments have had profound consequences for the role that Canadian provinces and territories might be asked to play in trade negotiations. First, governments have shifted their focus from the multilateral trading system toward preferential agreements. Second, the substantive focus of trade agreements is evolving from the removal of tariffs and related border measures to non-tariff, behind-the-border measures, including regulatory harmonization.

As Michael Trebilcock, Robert Howse and Antonia Eliason (2013, 83) put it, *"proliferation' is the word most often used to describe the rapidly rising number of Preferential Trade Agreements (PTAs) in the international community."* Only 70 PTAs came into force between 1948 and 1990. That number had reached 300 by 2010 (ibid.). The average WTO member is party to 13 PTAs (WTO 2011, 47). Just as the number of PTAs

"Is Canada a distinctive example of multi-level politics with regard to trade negotiations? Can we expect to see greater participation by sub-federal actors in other multi-level contexts?"

has changed noticeably in recent years, so has the content of these agreements. Various terms have been used to capture this trend, including *"second-generation agreement"* (Hübner 2011, 1) and *"twenty-first century trade agreements"* (Fafard and Leblond 2012). Trebilcock, Howse and Eliason (2013) describe the phenomenon as *"deep integration."* *"Deep integration' PTAs include rules on 'behind-the border' domestic policies such as intellectual property, competition, investment, environment and labour standards. In contrast, 'shallow integration' is focused on the removal of border measures"* (Trebilcock, Howse and Eliason 2013, 86).

One measure of an agreement's deep integration is the inclusion of 'WTO+' and 'WTO-X' provisions. WTO+ issues are ones already covered by WTO agreements, but PTAs go further than the WTO in these areas. WTO-X domains are not yet covered by WTO agreements but find their way into PTAs (ibid., 87). The number of WTO+ and WTO-X areas in PTAs has increased substantially in recent decades (WTO 2011, 131).



These trends in the trade system suggest that we have entered a phase when liberalization of domains within provincial jurisdiction will be a focus. While they portend that provinces will be more fully implicated in future trade negotiations, they do not provide insight into how they will be involved. For example, these trends do not guarantee that the provinces will be given a seat at the negotiating table in all subsequent negotiations, as they had in CETA. There is no evidence to suggest that the provinces were 'at the table' in recent Trans-Pacific Partnership (TPP) talks.

What, then, determines the nature of the role that the provinces and territories will play in any negotiation? The answer will likely be a function of two factors. The first springs from the trends just described — trade agreements are increasingly, and frequently, encroaching on areas of provincial and territorial jurisdiction.

The second factor, however, acknowledges that the federal government still holds a leading position in determining trade negotiating strategy. If the federal government sees the political or strategic value of involving subnational actors directly in the negotiating process, it may choose to do so. If it does not, as appears to be the case in TPP, it might rely on provincial and territorial support at the implementation stage.

This analysis aligns with the approach of Christopher Alcantara, Jörg Broschek and Jen Nelles (2015) to multi-level politics. The starting point for these authors is the "*irrefutable (and somewhat trivial) fact that politics today is often conducted through at least two governmental tiers*" (ibid., 5). Alcantara, Broschek and Nelles (2015) usefully differentiate between a 'systems approach' and an 'instances' approach.

A systems approach understands multi-level politics in a holistic way, leaving less room to capture the movement and dynamism inherent in relations between multiple tiers of government.

An instances approach looks at "*distinct 'instances' or occurrences*" of multi-level politics (5). From an 'instances' perspective, "*each policy interaction should be evaluated on its characteristics and should not be assumed to be one type or another based solely or even primarily on the characteristics of the political system within which it occurs*" (6).

This conceptualization helps to explain why the Canadian provinces had a seat at the negotiating table in CETA, but did not enjoy the same direct involvement in TPP. Each trade negotiation constitutes a distinct instance or episode of federal-provincial relations. The role that the provinces will play is necessarily enhanced due to the changes in the trading system outlined above. But, the exact nature of the role — will they be directly involved in negotiations; will they exercise their influence at implementation? — is a function of the federal government's own political and strategic assessment.

From this standpoint, CETA becomes a bellwether only of the increased relevance of the provinces and territories to trade negotiations generally, and not of their direct involvement in international trade talks.

Future research

This survey of the changes in Canadian trade-negotiating processes on display in CETA points to at least three avenues for future research.

If actors at the subnational levels are going to enjoy greater prominence in trade negotiations, at what stage(s) in the process will they exert their influence? During agenda-setting? While drafting a negotiating mandate? During negotiations? Throughout the approval and ratification stages? At implementation? Will they merely be consulted or will they be active partners?

Is Canada a distinctive example of multi-level politics with regard to trade negotiations? Can we expect to see greater participation by sub-federal actors in other multi-level contexts? How does Canada compare with other federal and non-federal systems or with the European Union?

Is CETA a distinctive trade agreement? CETA is not the only significant trade agreement that Canada has negotiated in recent years. In January 2015, Canada's free trade agreement with the Republic of Korea was brought into force. Interestingly, the role of the provinces in this particular negotiation seems to be less prominent. Similar observations can be made about sub-federal involvement in TPP talks. In which sorts of trade agreement negotiations might sub-federal actors be more directly implicated and why? ■

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CORRUPTION-FREE TRADE – AN IMPORTANT AGENDA FOR NEW GENERATION TRADE AGREEMENTS



Susan Côté-Freeman is Head of the Business Integrity Programme, and Dr Dieter Zinnbauer is with the Research Department, at Transparency International

Global trade governance at a crossroads

Trade continues to be an important engine of economic development as global integration and interdependence are reaching unprecedented levels. World trade in goods and services has almost quadrupled over the last twenty years with world trade accounting for 30% of world GDP in 2014. Half of all trade now takes place across global value chains and the participation of developing countries in global trade has increased by 50% over the same period¹.

At the same time, globalisation is increasingly linked with a number of global challenges including climate change, food security, rising income inequality and geopolitical instability. Given these challenges, trade governance must be viewed, not as a stand-alone technocratic exercise, but as a fundamental building block for creating an inclusive and sustainable future for all stakeholders.

But trade governance is in flux. A new generation of mega-regional trade agreements is emerging, by-passing the multilateral WTO process. These mega-regionals go far beyond tariff reductions and aim at investors' rights protections, regulatory convergence and many other measures that may impact national sovereignty and national policy domains related to health, safety, the environment and consumers' protection.

Corruption – an impediment to trade

Business executives around the world increasingly recognise corruption as a major challenge for their operations. More than half of all respondents in a 2016 survey of more than 1,400 CEOs in 83 countries reported they were concerned about bribery and corruption as a threat to growth, a number that is up by more than 25% since 2013². In a similar poll, one in five CEOs said they had been asked to pay a bribe in a business situation³.

Corruption has been found to have particularly problematic implications for trade. Here are four major ways this happens.

First, corruption undermines competitiveness and entrepreneurship by reducing overall institutional quality. It distorts the allocation of credit and drives away foreign direct investment thereby placing business from countries that face high levels of corruption at a competitive disadvantage. It also reduces for many developing nations the potential gains from participating in the global economy⁴.

Second, corruption in ports and customs as well as in the broader business environment reduces trade and deters

foreign business partners from entering the market. Some 30% of compliance and legal professionals polled in a recent survey said that they have decided against doing business in a given country owing to high risk of corruption⁵. Detailed accounts of corruption in African ports describe how firms choose to re-route cargo to ports with less corruption even if it means a doubling of transportation costs simply to avoid the uncertainty that comes with more corrupt customs practices⁶.

Third, the impact of corruption goes well beyond slowing down and reducing trade. Perhaps more problematically, corruption can undermine efforts at raising global standards for economic governance. For example, where corruption undermines regulatory oversight, tainted products like conflict diamonds, poached ivory, unsustainably harvested timber and oil from terrorist-controlled territories can make their way into legitimate world markets.

Furthermore, trade that is tainted by corruption can accelerate threats to health, safety and the environment. We all remember the 2013 Rana Plaza tragedy in Bangladesh, which involved the tragic collapse of a factory producing garments for export. Corruption resulted in grave violations of safety and workplace regulations and ultimately caused the death of more than 1,000 workers who had producing clothes for some well-known Western fashion outlets⁷.

Finally, subtler forms of corruption and lack of transparency may also threaten to compromise the future architecture of global trade and its potential benefits.

Special interests can gain undue influence in the design of national trade policies and international trade agreements if conflicts of interests are not adequately addressed, political finance rules allow for undue influence and there is a lack of transparency in trade policy decision-making. This can lead to the drafting of rules and regulations – from intellectual property to consumer protection – that unfairly skew the benefits and opportunities trade provides.

Making the mega-regional trade agreements more open – a work in progress

The new generation of mega-regional trade agreements, some of which are still under negotiation, includes the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union; the Comprehensive Economic and Trade Agreement (CETA), recently concluded by Canada and the European Union; and the Trans-Pacific Partnership

(TPP) signed by 12 countries in North America, Asia and the Pacific which is still awaiting ratification.

The transparency standards for negotiations surrounding these new trade pacts have not kept pace with 21st century expectations of openness. There has been no public access to key draft texts and only selective access for the parliamentarians who will eventually be asked to ratify these far-reaching deals. Such lack of transparency is out of step in an era of increasingly open government and open data. These disclosure practices even fall short of the transparency standards of other international fora and accords such as the WTO, the Aarhus Convention or the UNFCCC, some of which predate these mega-regionals⁸.

However, there is reason for guarded optimism, following recent amendments to the draft CETA agreement between Europe and Canada which will strengthen the investment dispute settlement mechanism by creating a more permanent tribunal and include more commitments on ethics aimed at avoiding conflicts of interests. Members of the tribunal will no longer be able to work as lawyers or experts in other investment disputes⁹.

The extent of revolving doors between industry lobbyists and officials is well documented. This can result in close, personal ties between the negotiators and lobbyists representing business interests with deep pockets¹⁰. It has been estimated that 90% of recorded meetings with lobbyists by Brussels trade officials were with representatives of business, illustrating the limited the sphere of influence of consumers and that of other public interest groups¹¹ in this area.

Towards corruption-free trade

The new generation of mega-regional trade agreements is providing a great opportunity to explore and advance measures that can support corruption-free trade.

An important starting point is to think about the transparency requirements that should apply to the new trade regimes and to current and future trade negotiations. These negotiations suffer from significant transparency deficits that have even prompted the top EU negotiator to lament that *"we need to explain that trade is good, but the public doesn't trust the negotiators."*¹¹

While the EU has taken steps to enhance openness, others still seem to be dragging their feet. Observers believe that increased transparency is needed throughout the process to restore public trust. This should start at the assessment stage, which seeks to gauge the desirability and scope of new trade

"... a lot can and should be done to ensure that corruption and lack of transparency do not undermine trade governance. There is no excuse for not taking action"

agreements and continue through the negotiation process and the preparation of draft texts. These moves towards increased transparency can include setting clear and objective standards of independency for the economic consultants carrying out ex-ante trade impact assessments; publishing meeting agendas; disclosing lists of participant and detailed records of meetings; publishing the name and qualifications of the senior negotiators; and making public the submissions of all stakeholders.

Because these agreements are designed as living agreements that establish processes aimed at producing greater harmonisation, mutual recognition and dispute resolution over many years, it is important to avoid policy capture and to level the playing field. Some areas for improvement in the mega-regional trade deals could include:

- measures to avoid forum shopping and to level the playing field between foreign and domestic investors by setting sufficient thresholds for initiating arbitration proceedings;
- high transparency standards for arbitration proceedings, including public hearings, third-party submissions and disclosure of any possible third-party funding for parties to the dispute; and,
- measures to ensure the independence of arbitrators and strengthen the position of less influential stakeholders.

Finally, there is considerable interest by some negotiating parties and civil society groups to include strong anti-corruption provisions in these trade agreements as a means to present corruption in global trade relations. Some observers point out that such clauses can build on and reinforce key international anti-corruption treaties such as the United Nations Convention against Corruption and the OECD Anti-Bribery Convention, provided there is sufficient commitment for their actual enforcement.

In sum, a lot can and should be done to ensure that corruption and lack of transparency do not undermine trade governance. There is no excuse for not taking action. ■

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Japan's new international role

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For decades Japan has allowed its economy to do the talking in global affairs with its security guaranteed by the United States. But now, with a rapidly changing international environment exemplified by the rise of China, Japan is seeking to take on more responsibility for its own security and to expand its international role.

Prime Minister Shinzo Abe has put forward guidelines to allow Japan to engage in collective security within the provisions of its pacifist constitution. Japan has always been a strong supporter of global institutions and for years has lobbied for a permanent seat on the UN Security Council. It is a prominent actor in the WTO and is negotiating a raft of trade agreements with Asia-Pacific partners (TPP), with neighbours China and Korea, and with the EU. Japan is chair of the G7 this year and a key member of the G20.

Abe's foreign policy has benefited from activism – expressed in 63 overseas visits in three years – with a focus on the alliance with the US, a strengthening of ties with Australia and India, plus ASEAN and NATO. The government has also established a new national security council and publish new strategic guidelines. Later this year it will host the 6th Tokyo International Conference on African Development. This article considers the reasons for this more active global role and assesses the implications for EU-Japan relations.

A gentle trade giant

Assessments of Japan's economy often include reference to the country's heydays of the 1980s and early 1990s when books were written about Japan 'taking over the world.' Japan's economic post-war development was indeed very impressive. As depicted in the chart its GDP per head had overtaken the US GDP per capita in the 1990s.

Its share of world trade based on purchasing power parity rose from 7.8% in 1980 to 8.9% in 1990. In 2000, Japan accounted for 6.6% of world trade based on purchasing power parity and in 2014 for only 4.5%. Instead of 'taking over the world' Japan slipped into gentle stagnation with rising debt, a situation that had bedevilled Japanese policy makers for the past two decades. There are also understandable concerns in Japan about the implications of China's astonishing economic rise.

Japan's GDP to debt ratio has now grown to unsustainable levels of over 200%, the highest among all OECD countries. Many analysts blame this trend on failure to tackle long-standing structural weaknesses. Prime Minister Abe's attempts to tackle these weaknesses have been dubbed 'Abenomics.'

Abenomics has lifted Japan's economy out of deflation and recession, leading to 0.5% GDP growth in 2015. This is likely due to the first two arrows of Abenomics, fiscal stimulus and quantitative easing conducted by the Bank of Japan, which lately went as far as imposing negative interest rates. The third arrow of Abenomics, comprehensive structural reform, is yet to hit its target.

This is well illustrated by the significant gap between Japan's GNI and GDP. According to the World Bank, in 2014, Japan's Gross National Income per capita was 16% higher than its Gross Domestic Product per capita. This indicates that Japanese corporations are doing very well while they are operating abroad. What keeps them from investing at home, and thereby

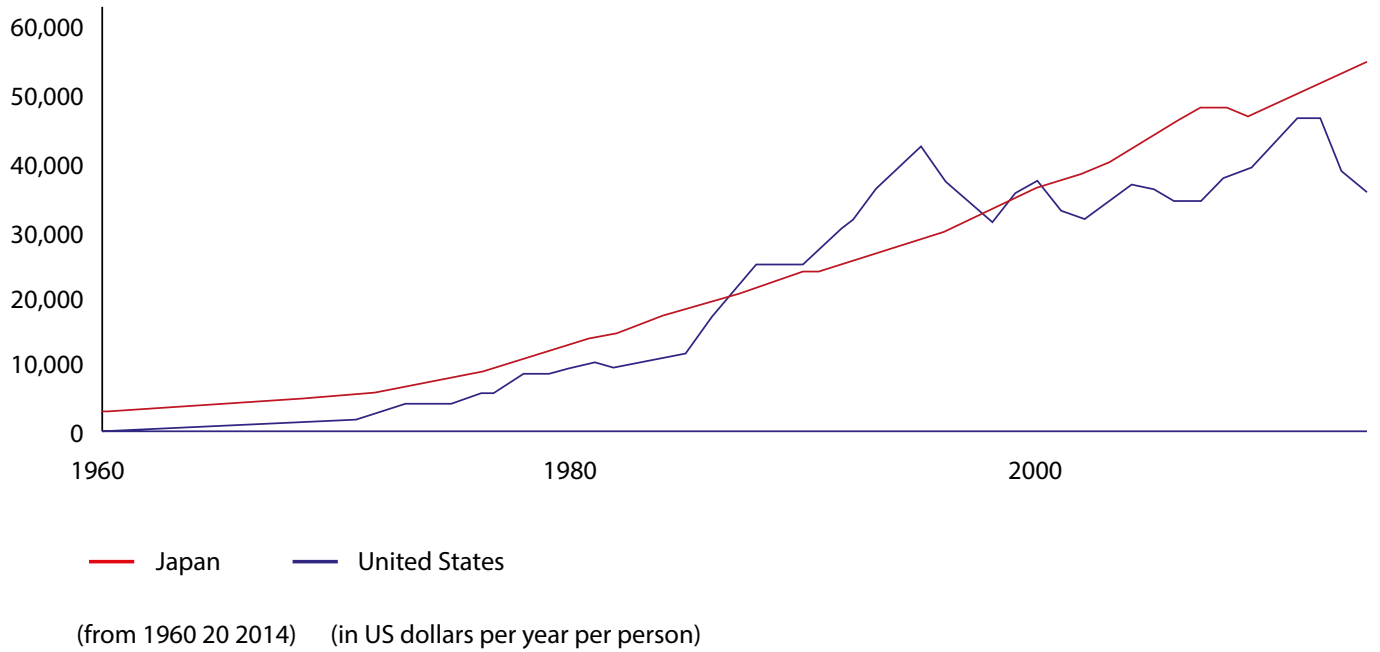
"2016 will be a very active year for Japanese diplomacy and demonstrate that under Abe, Japan is developing a new international role"

driving up wages and domestic consumption, is Japan's lack of productivity.

A recent McKinsey report holds that 'even Japan's advanced manufacturing industries, which once introduced the world to the concept of 'lean,' lag behind the comparable US and

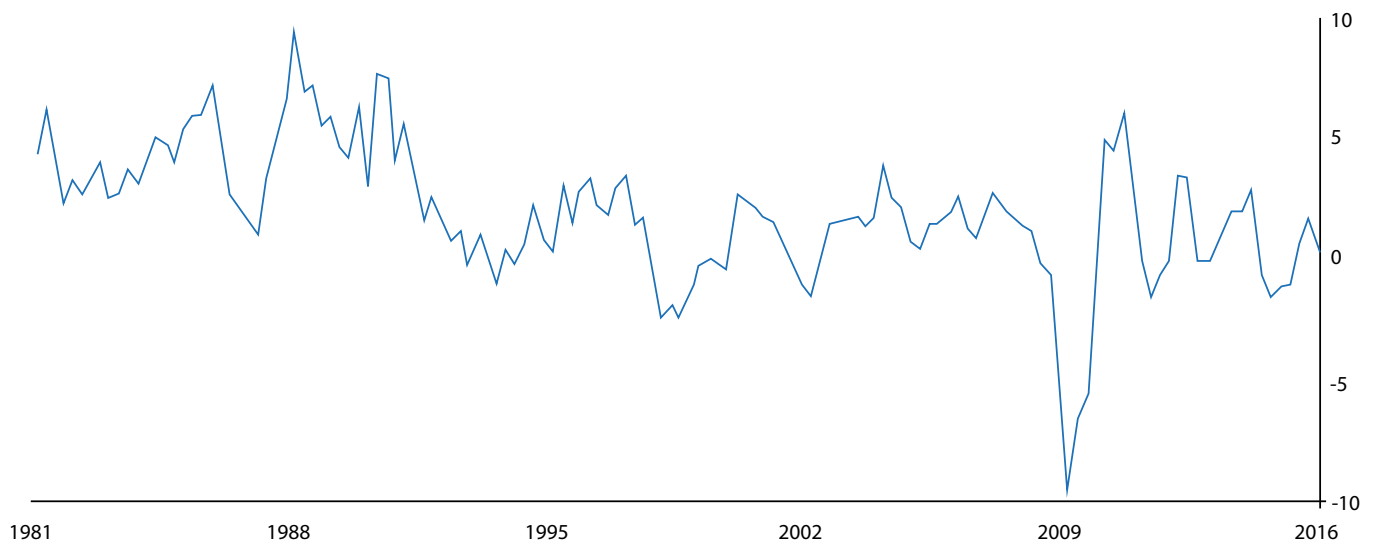


Chart 1. US and Japan GDP per capita in US dollar



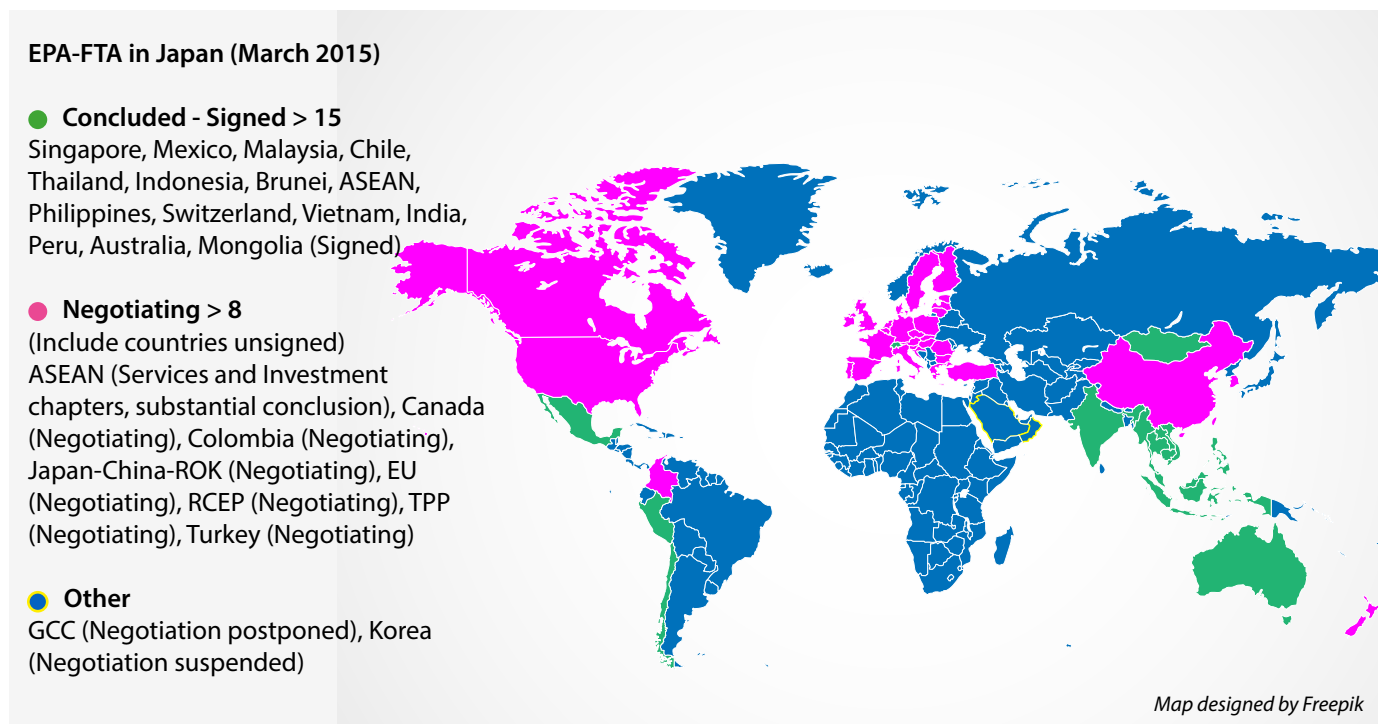
Source: <http://www.wolframalpha.com/input/?i=japan+gdp+per+capita+vs+USA+gdp+per+capita+1950-2014>

Chart 2. Japan GDP annual growth rate



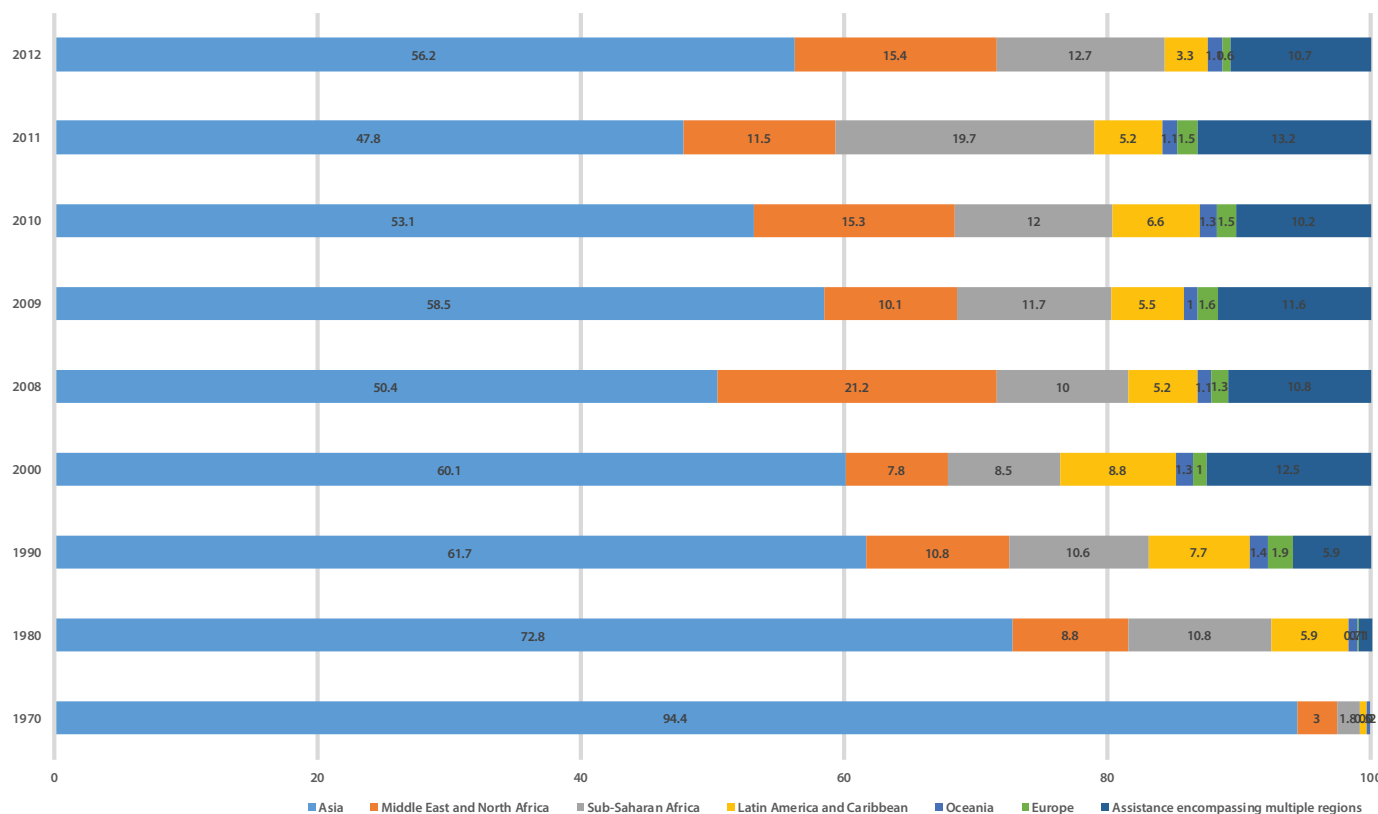
Source: <http://www.tradingeconomics.com/japan/gdp-growth-annual>

Chart 3. Japan's concluded and currently negotiated trade agreements



Source: <http://www.mofa.go.jp/policy/economy/fta/>

Chart 4. Trends in Japan's Bilateral Official Development Aid in gross disbursements



Source: <http://www.mofa.go.jp/policy/oda/white/2013/pdfs/0201.pdf>



German sectors in labour productivity by almost one-third.' The upside is that 'Japan can reach some 50 to 70 percent of its productivity goal simply by adopting practices that are already in use around the world.'¹ A second cause of low productivity is the acclaimed longevity of the Japanese people. As a consequence the share of labour force to general population is comparatively small, a trend that is reinforced by the very limited participation of female citizens in the labour force.

Abenomics is also seeking to tackle protectionist forces in agriculture, the post office, railways and cut down the excessive bureaucracy. But pushing through with these ambitious reforms requires continued domestic support and a favourable international environment. Fostering enough support at the Upper House elections in July 2016 is therefore just as important as a continually low oil price or the successful implementation of the TPP.

The liberal agenda of the latter reinforces Abe's agenda at home and so do the other seven free trade negotiations Japan is engaged in, fostering the opening up of its economy. Abe and EU leaders have declared that they wish to see the EU-Japan FTA negotiations concluded this year. According to officials in DG Trade this will be a tough deadline to meet.

Multilateralism

Japan's impressive post-war economic growth was largely dependent on exports which meant that Japan supported a liberal international trading system and was a founder member of GATT and the WTO. Even today Japan is heavily dependent on overseas market. Toyota, for example, sells seven out of

every ten vehicles produced outside of Japan. But there was always a reluctance to open Japanese markets, something that irritated both the US and EU. To deflect this criticism and to make up for its self-imposed military restrictions, Japan became a strong supporter of multilateralism reflecting a broad consensus that this was an active Japanese contribution to world peace.

Japan is a member and substantial funder of all major global institutions including the UN, IMF, World Bank, OECD, G7 and G20. In 2015 it provided 10.8%² of the UN budget making it the second biggest contributor to the UN and likewise 10.8% of the budget for its peacekeeping activities in the period 2013-2015³. As a result of this steady commitment and its economic power Japan has campaigned to become a permanent member of a reformed UNSC.

It has lobbied extensively together with Germany, India and Brazil for such a new status but so far without success. As a major democracy, Japan has also been a strong supporter of the promotion of democracy, human rights and the rule of law. This ties in with a similar normative agenda promoted by the EU and US and it is not unusual to see these three actors working together in bodies such as the UN Human Rights Council.

Japan has also been one of the world's leading providers of development, financial and technical assistance. In terms of official development aid gross disbursement, Japan has until the year 2000 been the most generous provider of aid worldwide and has since then only been overtaken by the US⁴. As Chart 4 shows, it has tended to concentrate on the Asian

region although its largesse has also extended to Africa, the Balkans and more recently, Ukraine.

Japan was a founder of the Asian Development Bank (ADB) and remains the principal shareholder. It was not surprising therefore, that Japan did not join the Chinese-led Asia Infrastructure and Investment Bank (AIIB) when it was established in 2015. Together with the US it regarded the AIIB as a competitor to the ADB.

Security issues

Since 1945 Japan has relied almost exclusively on the US for its security. The US still maintains significant armed forces in Japan, mainly on the island of Okinawa. Local residents are not happy with this arrangement because of the environmental damage to the island. Japan also pays a large sum to support American troops and bases on its territory.

Japan's constitution forbids any military role apart from self-defence but this has not prevented Japan from building a first-rate military machine. The military aggression of the 1930s and 40s plus the horrors of Hiroshima and Nagasaki have ensured a deep-seated, non-nuclear and pacifist approach to security issues among the population.

But with the rise of China and potential threats from the nuclear-armed DPRK, the Abe administration has sought to re-interpret the constitution to allow Japan to take on more security responsibilities and to adjust to a changed international environment. The most sensitive issue has been the government's aim to defend allies (notably the US) if it were to come under attack. Japan has also developed closer links with NATO. In July 2014 Abe signed a cooperation agreement at NATO HQ to deepen cooperation in areas such as piracy, cyber and crisis management.

There is also some concern in Japan that the US may not always be in a position to guarantee Japan's security and hence there is recognition of trying to resolve some of the most sensitive issues with its neighbours. Abe's new policy guidelines thus place emphasis on continued deterrence and détente. Tokyo lobbied successfully in Washington to have President Obama state publicly that the US security guarantee extended to the disputed Senkaku islands in the East China Sea which are also claimed by China. On the détente side Abe has agreed to a statement that recognises the 'deep remorse' for Japanese aggression against China and Korea and accepts responsibility for the use of 'comfort women' by the Japanese military during the 1930s and 40s.

A series of meetings between Abe and President Xi Jinping in 2015 paved the way for a resumption of the trilateral talks between the three big powers in East Asia. Japan is due to host a trilateral summit later this year. The three East Asian powers are moving steadily towards an FTA which is unlikely, however, to meet the same standards of the TPP or the EU-Japan FTA.

Abe has also been reaching out to ASEAN and invited all ten members to a summit in Tokyo in 2015. A visit to all ASEAN capitals early in Abe's term has led to recent poll results among

ASEAN citizens, holding that Japan was the ten states' most trusted partner for now and in the future – even surpassing the US. In addition he has invested considerable time and effort in forging new partnerships with India and Australia. The background to all these diplomatic moves is concern about a rising China that seems intent on changing the balance of power in the Asia-Pacific region.

EU-Japan

For two like-minded actors sharing similar values, the EU and Japan have often found it difficult to work together. An Action Plan dating from 2001 was remarkable for the paucity of action. More recently, however, there has been a significant intensification of relations as both sides have recognised that in a rapidly changing global environment they have many common threats and challenges to overcome.

These include the global economy, the environment, ageing societies and regional security. This is why the two sides are currently negotiating a free trade agreement (FTA), an economic partnership agreement (EPA) plus a strategic partnership agreement (SPA).

The EU and Japan are already strategic partners which provides for annual summits and a plethora of dialogues at all levels. There is some cooperation in the security field (anti-piracy, cyber, terrorism) while a number of member states are involved in joint procurement of defence equipment. Both sides have taken similar positions on issues such as human rights in the DPRK, the response to Russian aggression in Ukraine and China's island-building in the South China Sea. Cooperation on Africa is likely to be a top agenda item in 2016.

EU trade with Japan is roughly in balance – each exporting about 55 billion euros of goods and services to the other. The EU is also the largest investor in Japan and Japan the second largest investor in the EU. There has been a slight decrease in trade since 2014 and it is hoped that a successful FTA will reverse this trend. Some studies suggest there could be an increase in GDP of 0.8% and a 30% increase in trade after an FTA. But the first priority for Japan is ratification of TPP. Assuming this happens in the summer of 2016 there will be a push to conclude the EU-Japan FTA by the end of the year.

Conclusion

Japan has gone through a difficult period of economic adjustment since the heady days of the early 1990s. Abenomics has only partially succeeded with many structural reforms awaiting a further push. This pressure may come from the new trade deals that Japan has signed (TPP) or is negotiating (EU FTA).

Meanwhile Abe has sought to increase Japan's global standing by tackling disputes with neighbours and reaching out to new partners. At the same time he has embarked on a cautious strategy of allowing Japan to take on more responsibility for its own and regional security. 2016 will be a very active year for Japanese diplomacy and demonstrate that under Abe, Japan is developing a new international role. How successful this will be remains to be seen. ■

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2. Cf. http://www.un.org/ga/search/view_doc.asp?symbol=ST/ADM/SER.B/910
3. Cf. <http://www.un.org/en/peacekeeping/operations/financing.shtml>
4. Cf. <http://www.mofa.go.jp/policy/oda/white/2013/pdfs/0201.pdf>



The South China Sea in 2016. Towards recognising the global public good of the SCS

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The South China Sea has been seen as the growing centre of turmoil, with China and several Southeast Asian countries engaged in territorial disputes. What is more, Japan and the United States as well as other countries have both expressed their concern and commitment to the region, both in terms of rhetoric but also in terms of policy action.

This short essay will discuss what is at stake in the SCS for countries in and outside the region. It argues that the SCS resources and role as the major sea lane for the export and import of energy resources and commodities for countries within and without the immediate region dictate that the area needs a multilateral management to ensure mutual economic security and socio-economic development. The first section of this essay will highlight the region's importance in terms of trade and energy flows. The second section will then introduce the major actors and their interests in the region, with a special focus on China, Japan, the US and collectively the ASEAN countries involved in the territorial dispute. Lastly, I will draw attention to the possibility of cooperation to ensure multilateral management of the SCS to ensure mutual economic security and socio-economic development.

What's at stake?

The area represents a major source of trade flow to and from countries in Northeast Asia, Southeast Asia, the Middle East and both South and North America. Conservative estimates of trade flows in the region totals 5.3 trillion USD per annum¹. The area is also a transport corridor for energy resources to East Asia's largest economies, China, Japan and South Korea. A disruption, a territorial dispute or some other destabilizing incident, manufactured or accidental would not only harm regional economies but global flows of trade.

Of the above 5.3 trillion USD in trade in the SCS, according to the Centre for Foreign Relations at least 1.2 trillion of that belongs to the US. This amount will most definitely increase with the realization of the Transpacific Partnership (TPP) in October 2015. Japan and Vietnam being signatories to the TPP would also see their share of this total trade volume increase increasing their stakes in the SCS.

ASEAN countries, both from an import and export perspective, are also dependent on stability in the SCS region and particularly in win-win relations with China to ensure their own continued socio-economic development.

With global trade centred in the Asia-Pacific and tied to crucial sea lanes that traverse the SCS, not only do countries in the region have a stake of what goes on in the SCS but so do countries who utilize the region for import and export. In this sense, the SCS is not only a regional public good that needs to be safeguarded by and for regional stakeholders, but it is also a global public good that requires a global commitment to its stability and multilateral management.

Diversity of stakeholders

China

China's interest in dominating the SCS area is based on the SCS being the sole sea route in which imports its energy resources and imports. Importantly, it is the strategic choke point for its exports making the SCS a core interest for an economy that is still largely export-based. To secure its position in the SCS, China has imposed what it calls the eight-dash line representing its sweeping interests. It has also actively engaged in building islands on semi-submerged atolls in the SCS. To fortify their position, they have also placed military installations, missiles and radar facilities on the newly-built islands.

Habitation, management and control of the manmade islands strengthen Beijing's EEZ (exclusive economic zone) claim by demonstrating sovereignty. It also expands the exploitable under seas resources such as liquefied natural gas, oil, minerals and access to fishing resources. Lastly, the installation of radar facilities, 'defensive' missiles and runways for military aircraft allow Beijing to consolidate its military footprint in the SCS and to deter smaller nations from realizing their own territorial ambitions. At the same time, this forward setting by Beijing consolidates its position vis-à-vis the US in the region by significantly increasing the potential military, political and economic costs of getting Beijing to backtrack in its territorial claims.

Japan

Under PM Abe and in conjunction with a series of territorial disputes with China in 2005, 2010 and 2015, Japan has proactively courted Southeast Asian nations through economic and value diplomacy to counter China's influence in the region². On the one hand, Japanese businesses and the Japanese government have continued to invest in Southeast Asia to isolate them from political friction with China³. Joining the TPP has been part of the strategy as the TPP tethers economies with complementary comparative advantages to each other based on an agreed-upon framework of trade rules.

On the other hand, and from a longer term perspective, the Japanese government and business community have recognized the changing economics of doing business in China. The increased cost of labour in China, corruption and environmental challenges have all been contributing factors, compelling Japanese businesses to expand into Southeast Asia for manufacturing for global export while trying to remain in China by producing things in China, by Chinese, for Chinese with Japanese technologies.

This rebalance allows Japan to expand its overseas manufacturing platform from China to a region that includes Southeast Asia, and insulates them from economic downturns associated with souring political relations.

In looking to Southeast Asia and expanding its economic aims in the region through the TPP as well as value diplomacy, Japan has arguably transformed itself into a major stakeholder in the SCS. Political and business leaders clearly understand the potential economic impact on Japan in the case of destabilization of the region, and thus have engaged the region through its horizontal diplomacy/keiretsu gaikou (系列外交)⁴.

With the stakes high, PM Abe launched his initial foray into the SCS on his first visit to Indonesia in January 13th, 2013 in which he spoke on the 'The Bounty of the Open Seas: Five New Principles for Japanese Diplomacy'. His speech highlighted Japan's commitment and the championing of protecting freedom of thought, expression, rule-based governing of the seas, free, open, interconnected economies, promoting intercultural ties and promoting exchanges with young people⁵.

"... the South China Sea is not only a regional public good that needs to be safeguarded by and for regional stakeholders, but it is also a global public good that requires a global commitment to its stability and multilateral management"

Japan has also enhanced its enhanced cooperation with the Philippines through the provision of coast guard vessels, while at the same time strengthening military-to-military cooperation with Australia, India and Vietnam⁶. It is also supporting the future ascension to the TPP of South Korea, the Philippines and other nations in Southeast to increase the number of stakeholders in the region.

US

Although not the biggest winner in terms of trade volume and projected direct economic benefits from the SCS-centered TPP, the US's interest in the region germane economic, political and security dimensions. Three of TPP's member states are geographically located in the SCS and one, Japan, has major economic stakes in the disputed region. At the economic level, the TPP inculcates economic ties to the region that could be affected by a destabilization of the region such as the



militarization of disputed islands, a bilateral dispute between two claimants or the possibility of a nationalist from any of the claimant countries sparking a conflict.

At the political level, the US-led trade agreement is based on shared norms concerning trade, the rule-of-law and the direction of trade within the region and throughout the Asia-Pacific. This agreed upon, norm-based and volunteer trade agreement will benefit members economically but also increase the economic stakes for member countries in the case of a conflict.

This includes the US who will be firmly anchored to the region economically through the TPP. In addition to the economic benefits of increased trade, the 1st tier agreement which sets the rules for intellectual property rights to services and beyond, will become the benchmark in terms of trade rules linking partners in the SCS region to partners throughout the Asia-Pacific.

Lastly, at the security level the US has serious concerns over what they perceive as an assertive China who is illegally occupying territories in the region. Deepening US concerns are island building by the Chinese⁷, the positioning of missiles⁸, the installation of a radar facility in early 2016⁹. Each of

these initiatives is perceived by the US and the non-Chinese claimants in the region as unilateral, assertive and hugely destabilizing. With Japan being a treaty ally with the US and forging deeper and stronger military, economic and political ties with Vietnam, the Philippines, Indonesia, Singapore and Brunei, the US could be pulled into a conflict within the region because of economic interests or the or a real conflict between claimants in the region.

ASEAN countries

ASEAN countries, in particular those with territorial disputes with Beijing, continue to be concerned about Beijing's moves in the SCS. Whether it is directly over disputed islands or EEZ, ASEAN countries are greatly concerned over what exactly a Chinese regional hegemon would mean for them. Already, nations such as Laos and Cambodia find it difficult to oppose Beijing owing to their economic dependence with China. Others such as the Philippines and Vietnam struggle to resist Beijing's encroachment on what they conceive as their territorial waters.

With year-on-year bilateral trade relations deepening, ASEAN countries must be both pragmatic and prudent in their economic engagement with China and how they resolve political or territorial disputes with Beijing.



Multilateralization of the global common goods in the South China Sea

With each claimant having dug their heels in terms of their claims, it is important for countries within and without the region to recognize the global public good associated with the SCS. A zero-sum game in which there are clear losers and winners will result in more instability, less dialogue and a division of ASEAN into client states of Beijing and those who are not.

This has particular important consequences to how organizations such as ASEAN function. The ASEAN-way requires consensus to move forward on subjects of shared concern and growing overdependence on China could shift the equilibrium of the ASEAN-way to one that is bifurcated and in the end ineffectual in dealing with issues such as territorial disputes facing the region.

Recognition of the global public goods of the SCS, bringing in more direct and indirect stakeholders can decrease the chance for conflict of a destabilizing incident in the region. With that in mind, each stakeholder in the region can assuage each other's mutual suspicion through tactically contributing to multilateralization of the region.

China has continued concerns that the US and to a lesser extent Japan are using economic and security partnerships to contain China. The continued and strengthening US-Japan Alliance, expanding security ties and mega trade agreement that excludes China, consolidates China's containment fears. Here, the US and Japan need to demonstrate that the TPP will welcome China upon China agreeing to and meeting its standards. Using Vietnam as an example may provide a path for China as a new member. Furthermore, including China in any joint patrol of the region under the auspicious of anti-piracy or simply a coalition of naval powers that works together to keep sea lanes open, free and stable would be meaningful ways to assuage some of Beijing's concerns.

On the Chinese side, the recent unilateral and non-consultative process of island building, the placing of defensive missile and radar facilities on disputed territories, has been unhelpful in allaying the concerns of claimants. This non-consultative process needs to stop and the appropriate joint usage of the territories needs to be discussed in a transparent, multilateral forum. A declaration by the Chinese that disputes will not be settled by forceful means would also pave the way for multilateralization of resources in the SCS.

Claimant countries from ASEAN also have a role in this multilateral process by not further escalating Beijing fears of containment by engaging in bilateral partnerships with countries such as the US and Japan. They should continue to rely on international organizations and laws such as the UNCLOS (The United Nations Convention on the Law of the Sea) to stake their claims and garner international support through international law. Although Beijing may not agree to the process, arbitration and dialogue may be helpful in diffusing escalating tensions and further convey the message to the global community that the SCS region is a global public good that requires global attention because of its potential to destabilize and disrupt regional trade but also global trade and commerce. ■

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Will India be able to achieve and sustain high growth rates?



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Introduction

The Indian economy is in the midst of turbulent times. While on the one hand the global trading pattern and rules are on the course of a major shift in coming years, on the other India's four vital engines that enable economic growth, including demand, investments, production and exports, are performing poorly and are in an adverse state at present.

An unfavourable external situation, falling commodity prices, currency fluctuation and sluggish growth potential in major export markets, especially in China, are also an obstacle to India's growth story. As a result the government in the recent mid-year review of the economy had to downgrade the growth numbers from 7.5 per cent (projected in the annual *Economic Survey* of February 2015) to 7.2 per cent. With the revised estimates by the Central Statistics office (CSO), the India economy is now expected to grow at a 5-year high of 7.6 per cent in the current fiscal.

However, taking into consideration the key parameters and the pillars of economic growth and the weak cycles reflected by the frequency indicators and factors such as industrial production (IP), Purchasing Manager Index (PMI), business and employment surveys showing poor performance, it is difficult and unlikely that India will maintain high and sustained growth rates of 7.5-8 percent. Moreover, lack of domestic reforms due to consensus, low utilization rate of free trade agreements with major trading partners, land acquisition, environmental clearances and infrastructure building and infrastructure financing are continuing to be major obstacles to achieve and sustain high growth rates.

Factors driving GDP growth

Economic growth of any country is dependent on both aggregate demand and supply side factors. An analysis into both factors reveals that the state of the Indian economy is not depicting a promising scenario and is in fact struggling to revive from the downslide. Indian economic growth has remained flat in the past 20 months and has grown at 7.3 percent in the entire financial year of 2014-15.

Despite improved macroeconomic fundamentals and resilience compared to its peers, demand at both domestic and global level in the Indian economy is not picking up. Consumption, investments and exports in India have been in a troubled state for over a year now and require necessary reforms such that the estimated growth of 7.6 percent for this financial year is achieved.

Declining exports

India's share of world exports has remained stagnant at 1.5 per cent for quite a few years now. Despite several policy announcements by the government of India, including the new foreign trade policy (2015-2020), exports have not been able to revive. In fact, one of the major causes of concern for the government of India, who are keen to achieve a growth rate of 7.5-8 per cent, is the continuous decline in exports. India's annual merchandise exports stood at US\$320 billion in May 2014 and have seen a free fall for 13 continuous months and have contracted by more than 18 per cent during April-December 2015. While the imports too have contracted over the same period, their decline has not been as steep as that of exports, resulting in a widening trade gap, despite a downward shift in the overall trade.

The fall of exports in India has seen a progressive pattern and has finally set an alarm bell ringing, as the exporters are now demanding the intervention both by the government and the commerce ministry to step in to help and prop up the sector. The sluggishness in exports has hit almost all the industries, including leather and leather goods, iron ore and electronics. It is expected that India's exports will decline by 13 per cent to \$270 billion in the current fiscal year.

Currently the impact of poor merchandise exports has been visible in the manufacturing segment, where capacity utilization levels have steadily dipped each quarter. According to the reports released last year, the slack in manufacturing is reaching out to labour resources as well. Exporters were forced to shut their manufacturing units, the impact of which was felt in the job market as well.

According to the survey conducted by the Labour Ministry for the period April-June 2015, the net job creation declined by 43,000 people, of which export-oriented companies accounted for 26,000 of the net fall. During the same period, merchandise exports in India declined by 16.75%¹. A significant decline was observed in the cotton yarn industry, which saw a job loss of a staggering 3.5 lakhs people in last one year. Similarly, in the metals sector, severely hit by the global deflationary forces, layoffs or retrenchments rose.

A slowdown in employment will further hit the income growth, affecting the aggregate consumption in turn, to the extent that it will offset or subdue the boost that private consumer spending is otherwise obtaining from lower fuel and other prices². The decline in exports is also seen from the special

economic zones in the country. The recent CAG report of 2014 has raised serious issues and concerns on the performance, monitoring and evaluation of SEZ's. They have not been able to achieve the objectives for which they were set up.

Sluggish global demand

A large chunk of India's exports goes to OECD countries, in particular to the United States, the EU and Japan. However, the continuing impact of the global financial crisis, as indicated by the constant downward revision in the International Monetary Fund (IMF) global growth figures since 2011, means that demand stimulus from India's traditional trading partners will remain muted and may not be able to pull back India's export growth. The last financial year was one of the worst years for the global economy since the global financial crisis of 2008, with global trade growth collapsing to almost 0 per cent in 2015. In fact, over the years, the share of traditional partners such as the EU and India in India's total exports has been consistently declining.

Similarly, while South-South trade has continued to increase as a percentage of global trade, India cannot hope to counter the depression of demand from the global North by rebalancing trade relations with the global south. This is because emerging markets, in particular the BRICS nations, responsible for a large part of the growth in South-South trade, are now themselves struggling with the consequences of the Chinese economic slowdown and devaluation of the yuan.

For India, 50 per cent of its exports go to the developing countries. While income of the developing countries has been affected by the low exports to China, it has led to reduction in imports from India as well. The yuan devaluation has made Chinese exports more competitive and they continue to flood world markets and India, in particular. Further, appreciation in the 'real effective exchange rate' of the rupee, when China, Russia and Brazil have either devalued or allowed a big depreciation of their respective currencies, has increased the woes for India.

Rural and agrarian distress

India's agricultural sector is also facing a slowdown. Agriculture contribution to GDP has declined by 1 per cent in the last year,

"Sustaining the growth rate requires India to take necessary steps to address both supply and demand side bottlenecks"

down from 17.2 percent in 2014 to 16.1 percent in 2015. The latest data from the Labour Bureau shows that rural wages have registered an average annual growth of 3.8 percent last year, the lowest since July 2005. Further, the downward trend in Minimum Support Price (MSPs) of major crops is hurting the farmers and a large number of them have recently committed suicide. Moreover, lack of good quality seeds, especially by small and marginal farmers, lack of mechanisation, poor agriculture marketing facilities, poor storage facilities, lack of irrigation and small and fragmented land holding along with lack of reforms in the sector have led to the inadequate growth of the agricultural sector in India.

Stagflation in industrial production

On account of the weakness in domestic and external demand, manufacturing growth as indicated by the index of industrial production (IIP) growth has been tepid and the capacity utilization in the Indian manufacturing sector has largely seen declining trends. India's IIP contracted in November 2015; its worst performance in more than four years. Industrial output declined by 3.2 percent as only 5 out of 22 manufacturing sectors registered a positive growth rate. See Table 1 for details.

Further as per the Table 2, the index of eight core sector industries; coal, crude oil, natural gas, refinery products, fertilizers, cement, steel and electricity has slowed down to 0.9 per cent in December 2015, with cumulative growth for April-December down to 1.9 per cent in 2015 as compared to 5.7 per cent in 2014.

Similarly, Manufacturing PMI in India saw its first contraction of 49.10 in December from 50.30 in November of 2015, since 2013³. Painting an even gloomier picture, the monthly PMI

Table 1. Trend in IIP growth

	Sectoral				Use-based classification				
	IIP	Mining	Manufacturing	Electricity	Basic	Capital	Intermediate	Durables	Non-durables
Weight	100.00%	14.16%	75.53%	10.32%	45.68%	8.83%	15.69%	8.46%	21.35%
Month									
Nov 14	5.2%	4.0%	4.7%	10.0%	9.5%	7.0%	4.7%	-14.5%	7.0%
Dec 14	3.6%	-1.7%	4.1%	4.8%	5.9%	6.1%	1.1%	-9.2%	5.6%
Nov 15	-3.5%	1.9%	-4.7%	0.7%	-0.7%	-24.4%	-1.3%	12.5%	-5%
Dec 15	-1.3%	2.9%	-2.4%	3.2%	0.5%	-19.7%	0.9%	16.5%	-3.2%
Apr-Dec 14	2.6%	1.8%	1.8%	10.0%	8.0%	5.1%	1.8%	-15.2%	2.3%
Apr-Dec 15	3.1%	2.3%	3.1%	4.5%	3.4%	1.7%	1.9%	12.4%	-1.0%

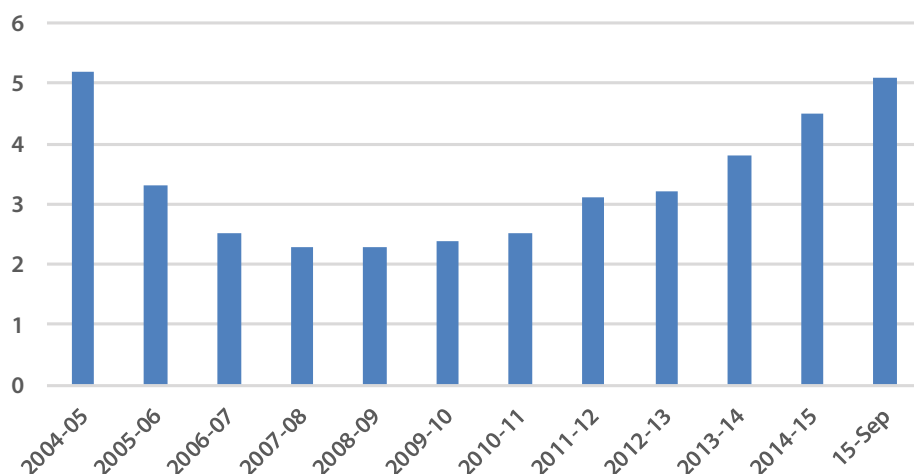
Source: Central Statistics Office (CSO), ICRA Research

Table 2. Growth in Index of Core Industries

Growth in Index of Core Industries	Index of Core Industries	Coal	Crude Oil	Natural Gas	Refinery Products	Fertilizers	Steel	Cement	Electricity
Weight	37.9%	4.4%	5.2%	1.7%	5.9%	1.2%	6.7%	2.4%	10.3%
Month									
Oct 14	9.0%	16.4%	1.0%	-3.9%	4.2%	-7.0%	14.2%	-1.2%	13.7%
Nov 14	8.5%	14.6%	-0.1%	-2.3%	8.1%	-2.8%	9.9%	10.5%	9.9%
Dec 14	3.2%	7.5%	-1.4%	-2.9%	6.1%	-1.6%	0.0%	3.8%	4.8%
Oct 15	3.2%	6.3%	-2.1%	-1.8%	-4.4%	16.2%	-1.2%	11.7%	8.8%
Nov 15	-1.3%	3.5%	-3.3%	-3.9%	2.5%	13.5%	-8.4%	-1.8%	0.0%
Dec 15	0.9%	6.1%	-4.1%	-6.1%	2.1%	13.1%	-4.4%	3.2%	2.7%
Apr-Dec 14	5.7%	9.5%	-0.9%	-4.9%	0.2%	-1.4%	6.9%	7.9%	10.0%
Apr-Dec 15	1.9%	4.6%	-0.8%	-2.7%	2.4%	10.1%	-1.9%	2.2%	4.0%

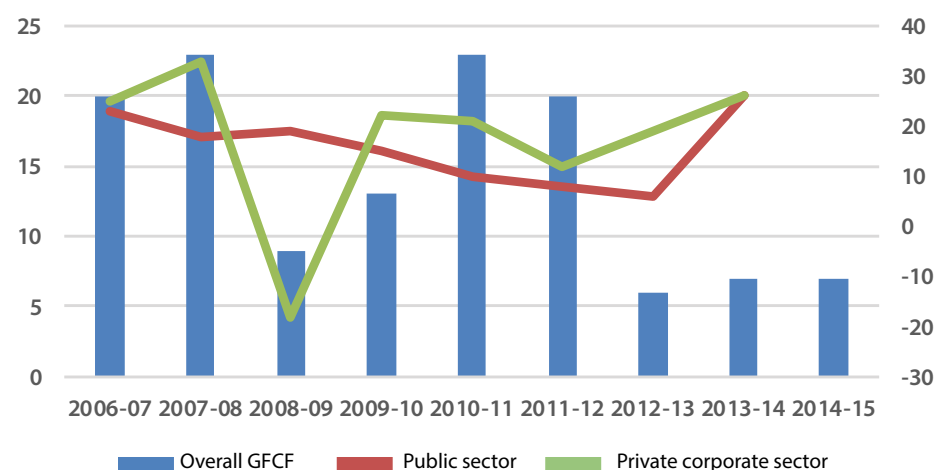
Source: Index of Eight Core Industries, Ministry of Commerce and Industry, Office of the Economic Advisor, ICRA Research

Figure 1. NPAs as a % of Gross Advances



Source: RBI

Figure 2. Growth in Gross Fixed Capital Formation, % change Y-o-Y



Source: Ministry of Statistics and Programme Implementation (MOSPI)

survey showed that the rate of contraction was sharpest in almost seven years since the global financial crisis.

Non-creation of capital assets and poor investment sentiments The Gross Fixed Capital Formation (GFCF), another major driver of GDP, has hardly observed any increment in the last four quarters. On the contrary, it has declined to 30.8 percent in 2015 from 34.3 percent in the financial year 2012. Similarly, Gross capital formation which is the summation of GFCF, change in stock and valuables also showed a declining trend from 39 percent of GDP in 2012 to 24.2 percent in 2015. Gross Domestic Investment (GDI) has reached at an all-time low of 24 percent down from 29 percent in 2012.

The decline in domestic investments is also underscored by low credit off take which has touched a 20-year low. Deceleration in credit growth to industry is observed in all major sub-sectors. As a result, the corporate sectors in India have been facing stressed balance sheets for a while, given that many investments made during the boom period have not yielded the expected results. It is a bit worrying that the level of non-performing assets as a percentage of bank's gross advanced have started creeping up and touched a high of 5.1 percent in September 2015.

In such a situation private sector investments are not likely to pick up and it is imperative that the government step up its public sector investments to fill the gap. From Figure 2 it is apparent that even as private sector capital formation has remained subdued, public investment has picked up to take up the slack. However, the growth in overall capital formation continues to remain at a low level.

Further, investors are losing confidence in Indian markets. Estimates have suggested that Rs 25,000 crore has been taken out from the Indian stock market in the financial year 2014-15⁴. Worse is the amount taken out in the first two weeks of 2016 which stood nearly at \$700 million, lowest ever since SEBI started publishing data in mid-1999. Savings of middle class families and retirement funds of professionals have taken a serious hit and savings to GDP ratio has declined to 32.9 percent in financial year 2015. Consequently, the Sensex (India's major stock index) has tumbled below its lowest level of 24,000 marks in 21 months, leading to outflow of money. The sustained foreign capital outflow is affecting the market sentiments adversely as demand continues for US currency from banks and importers.

Additionally, India's top 500 companies experienced zero revenue growth in 2015. The profits of Sensex companies rose by only 1 per cent during the April—June quarter, compared with 24 per cent growth in the same period a year earlier⁵. Profit growth in 2016, as forecasted by Morgan Stanley Investment Management, is likely to be negative for the financial year. Net sales began falling since the third quarter of FY2015 and have continued to dwindle for the fourth consecutive quarter, falling 5.5 per cent y-o-y in the second quarter of the current financial year. Considering these indicators, India's prospects of achieving the predicted growth rate seem very grim indeed.

Supply side factors

Beyond depressed demand factors, it is really supply-side constraints that have impacted India's ability to expand trade into newer products and service areas and thereby strengthening its growth and development.

The infrastructure sector is too big a sector and has the potential to turn around the economy. However, India is facing crippling infrastructure shortages which include power, roads, finances etc. due to low investment in infrastructure development. Investment through the public-private partnership (PPP) mode has also not come through as expected, leaving the government with few options. In fact, the PPP model, barring a few instances, has failed to take off in India and is still in its nascent stage.

As per the data compiled by McKinsey & Company, the average infrastructure investment in India during the period 1992-2010 constituted 4.7 per cent of the GDP as against 7.3 per cent across countries like China, Indonesia and Vietnam⁶. Reaching a peak of 24 per cent in the last quarter of 2009-10, the rate of gross capital formation has plummeted to zero in the third quarter of 2014-15. As a result of which the World Economic Forum *Global Competitiveness Report* of 2014 ranked India 85 out of the 144 countries in terms of infrastructure quality with 'inadequate supply of infrastructure', and infrastructure was also listed as the most difficult factor in doing business⁷. This internal supply side constraint is actually containing India's exports growth.

The inefficiency in logistics compounded by a weak trade facilitation regime is another factor that needs to be carefully looked at as India's manufacturing exports are losing price competitiveness. India's over-dependence on road freight means that the cost of logistics as a percentage of GDP remains as high as 13-14 per cent, compared with 7-8 per cent in developed countries⁸. India can easily be compensated by the export incentives of 2-3 per cent of the export value, if additional cost incurred on account of an inefficient trade infrastructure is avoided with necessary policy intervention.

Another area of concern impeding manufacturing output is India's outdated labour laws. These have consistently come in the way of enhancing manufacturing. India's labour laws are hazardous for businesses that face seasonality in their demand to set up mass production facilities. A firm cannot retrench a part of the workforce in accordance with depression of demand. While the Ministry of Labour has brought some reform proposals in recent months, the Government needs to ensure that it is going ahead with these much needed reforms.

Slow implementation of policies has done more to dissuade investment than the extant labour laws. The Government needs to continue its thrust on addressing challenges in these areas. This includes lack of access to credit, inadequate infrastructure and high transport costs, low availability and high cost of inputs, and difficult and limited access to land.

India is also becoming one of the most protectionist countries in the world. According to the Centre for Economic Policy Research, the United States, India and Russia have imposed the most 'trade distorting' measures since 2008. India, like Russia, has hit nine of the other top 20 global economies with protectionist measures more than 150 times since November 2008. India imposed 504 protectionist measures between 2008 and 2015. This surge in protectionist measures saps trade, hampering India's economic growth. It needs to be rectified urgently

Lastly, the country's exporters continue to face non-tariff measures and procedural obstacles, especially relating to

licensing, permits to export, inspections, certificates and taxes in almost all of India's exporting markets. Obstacles from the importing country include standards and conformity assessments, rules of origin and pre-shipment inspections; all of which are hurdle to the Micro, Small and Medium Enterprises (MSME) export community in particular.

Despite being part of the trade pacts and having signed free trade agreements both on bilateral and multilateral level, India has failed to negotiate to get improved market access for the country's exports. Most of the trade pacts that India has signed are more for geo-political reasons than commercial ones. Further India's preferential trade agreements are shallow in terms of product coverage, implying that India has failed to utilize PTAs for export promotion. Hence, fixing the trade regime and bringing about efficiency of trade policy should be a priority for the government.

Focus areas for intervention: the way forward

India's macro-economic fundamentals driving the growth of the economy have remained subdued in the financial year 2015 and the GDP growth has been almost flat. For a country keen on achieving and sustaining the high growth rates of 7.5-8 percent in an environment where China is slowing progressively and the rest of the world is also in a sluggish state (except the USA), domestic and structural reforms are the only way ahead for India.

Currently, an export-push strategy for growth would be ineffective when the industrial world has stagnated and emerging markets are rethinking on the exports-led growth model. China has also has shifted focus from an export led growth strategy to domestic demand led growth strategy. Looking to 2016-17, it is the regional and domestic demand that could give spurt to the growth in India. This requires examining each of the components of demand and addressing the supply side bottlenecks through reforms and policies such that India can sustain its growth.

Integrating into Global Value Chains (GVCs)

At this moment sustaining domestic demand is crucial for India. India needs to stimulate the demand and create demand within, by encouraging the agricultural and manufacturing sector. Indian firms need to recalibrate their production strategies to become a part of GVCs of production. With globalization, corporations expanded their manufacturing activities across the globe, and created global supply chains to integrate their manufacturing.

However, Indian firms are not integrated into the global production of intermediate goods, which today form the bulk of trade across GVCs. Further, the weak intellectual property regime (IPR) in India has also acted as an obstacle for technology transfer from foreign firms to India. In order to become a part of GVCs, India needs to establish a better IPR regime and create supply-chain efficiencies.

As part of the push to increase manufacturing output, the government needs to take substantive steps towards establishing a strong defence industrial base in the country, with world class manufacturing capabilities leading to strong export possibilities. This requires continued actions to release capacity and informational bottlenecks that restrict the participation of the private sector in defence manufacturing. India is one the largest importers of arms and defence equipment in the world and that needs to change.

Encouraging the private sector in defence is a key to step up defence manufacturing within the country.

Reviving exports

To encourage exports, particularly when China is devaluing its currency and exporting deflation to the world, India needs to improve competitiveness of its industries. Even after years of reforms, India is still exporting the same products to largely the same markets and as a result the trade has not seen a lateral or horizontal shift. Moreover, manufacturing, which constitutes more than 60 per cent of India's merchandise exports, its composition has not undergone much change.

Despite having several advantages in high-value added manufacturing, including engineering skills, a growing domestic market, a raw material base and a large pool of skilled labour, India's share in exporting high-value added manufacturing products is still very low. Gems & jewellery, textiles & clothing, chemicals & related products still have more than 50 per cent share in overall manufacturing exports which have seen a falling trend recently. Hence, the situation needs to be rectified, especially as India is keen to promote itself as a hub of global manufacturing through its flagship 'Make in India' scheme.

Policies supporting export-oriented manufacturing zones and the new coastal economic zones need to be relooked at. Further, norms on FDI can also be differentiated so as to have schemes that incentivize investments geared towards generating exportable goods and services.

The Government of India, and in particular the Ministry of Commerce and its affiliate bodies, need to enhance interaction with State Governments, with a view to building an understanding of the comparative advantages states enjoy in the production of certain goods and services.

Every State government must be mandated to come out with its own 'Export Strategy' document. The central government also needs to educate the state government about enhancing trade facilitation infrastructure, while concurrently improving the ease of doing business norms so that entrepreneurs and business can focus on improving products and services instead of focusing on compliance and administration.

Address supply side bottlenecks

Infrastructure financing is a major constraint that government also needs to look at. Development of financial sector market and institutions for infrastructure sectors is much needed to encourage private sector participation. Overall demand from rural economy is slow due to farm distress and therefore investment in rural/agricultural infrastructure like irrigation, storage etc. is needed. India should also design policies to attract money that is lying in pensions, provident funds etc. in developed countries like Japan and East Asia.

A quick rollout of the Goods and Services Tax (GST), amendment of land acquisition bill and removal of all impediments to banks' recovery of stressed loans are necessary steps. According to the central bank of India, a well-designed GST bill, by reducing state border taxes, would have the important consequence of creating a truly national market for goods and services, which would be critical for the country's growth in years to come.

Given the adverse external environment, India would need to focus on its internal market and work towards creating a

sustainable unified market which requires a reduction in the transaction costs of buying and selling throughout the country.

Fixing the trade regime through FTAs conclusion

Fixing India's trade regime should be a top priority for the government. India's ill-conceived trade pacts have resulted in inverted duty structures that discourage the production and exports of value added items such as apparel and finished products like laptops or cell phone. Further, India needs to negotiate on the market access and tariff and non-tariff barriers issues with its Asian partners including China, Korea, Japan and Indonesia to penetrate their markets more easily.

Also, India is presently going slow on trade pacts like the one with European Union that could be immensely beneficial, considering that the Trans-Pacific Partnership (TPP) has been signed by 12 member countries and the process of ratification is ongoing. TPP could hamper India's exports and, particularly, the textile industry. Hence India needs to be strategic and play a more judicious role in negotiating FTAs with its trading partners. This would further encourage exports from our country.

Conclusion

The fundamentals of the Indian economy are depicting a fragile picture. Investments, manufacturing and exports are sliding and showing a declining trend. According to the research by Duestsche Bank, India's growth is well below trend, irrespective of the over 7 per cent growth reported as per the national accounts data, and hence the government's claim of India as the fastest growing large economy based on GDP numbers needs careful analysis.

Despite the slowdown, China's exports declined by only 2.5 percent compared to 18.08 percent fall in India, and the yuan depreciated by only 6 percent compared to rupee depreciation of 9 percent in 2015. China on the one hand has a trade surplus of US\$595 billion and India on the contrary has a deficit estimated at US\$35 billion in 2015. Though the sharp fall in prices of crude oil in the international markets from US\$111 per barrel in 2014 to approximately US\$30 a barrel in February 2016 has provided the much needed cushion in managing the current account deficit, India has not made an optimum utilization of the windfall savings of US\$47 billion from the petroleum product pricing.

The 'Make in India' policy which aimed at creating productive jobs for rapidly expanding workforce in India's organised manufacturing sector by enhancing exports has undoubtedly sent signals of vigour and enthusiasm. However, India should be conscious of the fact that the window of growth through export led manufacturing is limited and hence should not miss the opportunity presented to it, as the costs of failure now are greater than ever.

Building productive capacities to enhance competitiveness, market linkages and enhancing investment attractiveness in selected sectors will have a strong impact on the export capacity of Indian business and will improve the country's trade balance.

In sum, export revival is one of the keys to sustaining and achieving high growth rates. But exports have shown a negative trend for the last year. The prime reasons for India's exports contraction are a slowdown of demand in global markets and moderation in commodity prices. India's export markets, mainly the US, China, the euro area, Singapore and Japan, are still going through either a slow revival or a decline. Prices have tanked and the impact is being felt through decline in the value of exports, particularly in top exports such as petroleum products, gems and jewellery, textiles, iron ore and so on. An uncertain global economic outlook has only added to the problem.

Sustaining the growth rate requires India to take necessary steps to address both supply and demand side bottlenecks. Supply side reforms will help restart the private investment cycle, notably through recognition and resolution of the balance sheet problems of firms and banks as well as creating a clean and favourable tax environment through implementation of the GST and planned corporate tax reforms.

On aggregate demand, both fiscal and monetary policy stances will need to be carefully re-assessed, to ensure they strike the appropriate balance between the short-term need to spur demand, especially private investment and exports, and the longer-term needs of preserving fundamental macroeconomic stability. In sum, taking forward and implementing key domestic reforms would help India attain a high growth trajectory and meet the aspirations of the teeming middle class population. ■

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AGOA and the future of US–Africa trade relations

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The US–African trade relationship has come under the spotlight regarding the extension of the African Growth and Opportunity Act (AGOA) towards September last year and around South Africa’s (as the largest beneficiary under this dispensation) continued benefits under the programme. The United States Congress passed the African Growth and Opportunity Act into law in 2000 in order to promote US and African trade relations and contribute to economic development on the African continent through export-led growth.

AGOA, unlike other preferential trade deals, is a unilateral trade deal that allows least developed and developing countries from Sub-Saharan African (SSA) additional market access in the US. AGOA extends duty free and quota free access to the US market on roughly an additional 2,000 Harmonised System product lines, above and beyond the 3,800 lines that are duty free under the US’ most-favoured nation offering, as well as the 3,400 lines under its General System of Preferences (GSP) programme. While AGOA is a non-reciprocal and unilateral agreement (ie. countries do not have to concede market access to the US), it is not unconditional.

In order to benefit under AGOA, the US requires countries to comply with a broad range of conditions such as respecting and promotion of the rule of law, respecting human and workers’ rights, and upholding democratic and market-based economic principles. AGOA eligibility criteria also dictate that barriers to US trade and investment should be removed.

The impact of AGOA has been significant: between 2000 and 2008, exports from SSA countries to the US increased from \$22 billion to \$82 billion. Despite a brief decline in trade following the global recession, exports totalled \$72 billion in 2011, before declining again due to a drop in oil exports from the continent. By 2015 exports had decreased radically, totalling \$19 billion last year, eroding a strong positive trade balance for African countries.

Nevertheless, AGOA has been successful in diversifying exports from Africa. Apart from oil, key exports include vehicles (31% of non-oil exports in 2014), followed by apparel (28%), iron and steel (17%) and aluminium (11%). While energy-related exports dominates exports for countries such as Nigeria and Angola (roughly 99% for both countries), non-oil producing states such as Kenya and Lesotho have successfully managed to grow their exports under AGOA. South Africa in particular has been able to leverage AGOA to grow its exports to the US in sectors

other than natural resources, notably automotive, chemicals and agriculture sectors (accounting for 28%, 14% and 6% of total exports in 2014, respectively). Between 2000 and 2014, South Africa doubled the value of exports to the US, totalling \$8.27 billion in 2014, of which nearly 40% benefited from AGOA and GSP preferences.

AGOA, originally set to expire in 2005, has twice been renewed for five year periods (in 2005 and 2010) and was extended in 2015 for a further ten years, set to expire in 2025. South Africa’s continued participation under the AGOA programme was especially contested in some quarters in the US ahead of the latest extension. Some argued that the continent’s most advanced economy should graduate from AGOA, while it was also perceived that the country imposed barriers to US trade, particular meat exports. Given the extension of South African value chains throughout the region, it was determined that excluding the country would have a detrimental effect on other economies on the continent. Ultimately South Africa remained a beneficiary of this programme. However, specific provisions were put in place in the renewed AGOA to review the eligibility of countries on an ongoing basis if they do not comply with AGOA criteria.

It is not surprising therefore that South Africa became the subject of the first of these so-called ‘out-of-cycle’ reviews. American businesses, through their representatives in Congress, contended that South Africa did not comply with the AGOA criteria, especially with regards to eliminating barriers to trade and investment. While various grievances towards planned legislation in South Africa restricting US investment in the securities industry, as well as proposed changes to intellectual property rights were discussed, it was ultimately long-standing barriers imposed by South Africa on US meat imports that led to possible suspension of AGOA benefits for the country.

South Africa has, for more than a decade, imposed anti-dumping duties on US chicken exports. The country contends that US producers want to export chicken pieces that are undesirable in their domestic market, to South Africa. While the contentious cuts (brown meat cuts such as drumsticks) are undesirable in the US market (and therefore unsellable), authorities argue that US producers can export these to South Africa below cost and still make a profit, resulting in unfair trade and competition. As a result, South Africa has imposed an anti-dumping duty (roughly \$0.60 per kilogram) on US chicken exports above the standard duty of 37% that

such exports already attract. After a nearly 15-year standoff on this issue, involved parties negotiated a duty free quota of 65,000 tons in the middle of last year (comparatively modest considering that the US imported more than 450,000 tons in 2015). However, slow progress on the implementation of this agreement by South Africa ultimately led to US President Barack Obama notifying Congress and Pretoria that he plans to suspend South Africa's benefits under AGOA within 60 days if outstanding issues are not addressed.

Following a period of intensive negotiations between US and South African counterparts, South African Trade and Industries Minister Rob Davies announced a few weeks ago that all outstanding technical and health and safety issues had been resolved. This bought some time for SA and led to another declaration by President Obama that unless the negotiated agreement has been implemented (evidenced by US chicken exports on South African shop floors) by mid-March, South Africa would lose trade preferences extended under AGOA for its agricultural exports.

Reports towards mid-February indicated that US poultry products were 'on the water' towards South Africa. Thus, unless there are any unexpected administrative hiccups, South Africa will maintain full benefits under AGOA. Nevertheless, the poultry-saga highlighted a number of key concerns for South Africa and other SSA countries under the current (unilateral) trading regime with the US.

Firstly, given that AGOA is an Act of US Congress, rather than an agreement, there is no clear and transparent legal dispute resolution mechanism as found typically under negotiated trade agreements. Instead, the US can unilaterally extend or remove AGOA, with crippling results for countries.

Madagascar experienced this first hand in 2008 when the US rescinded their benefits under AGOA following political turmoil in the country. A thriving textile and clothing industry, grown largely as a result of exports to the US through AGOA, saw activity in this sector drop significantly, resulting in massive job losses, disinvestment resulting in increased poverty in the country.

A similar scenario is currently playing out in Swaziland after the country last year saw their AGOA status removed following a failure to address the US' concerns over worker rights violations in the country.

Secondly, having gone through this process, the poultry affair created some kind of blueprint on how future issues could be handled, employing AGOA as leverage, both in South Africa and other SSA countries. While the US has in similar poultry-related disputes with China followed recourse through the WTO's dispute resolution mechanism, they have instead opted in the case of South Africa to employ AGOA as this programme arguably provided greater leverage.

As highlighted earlier, the US has other concerns in South Africa including the issues related to the proposed Private Security Bill and issues with copyright and intellectual property rights in South Africa. While both these bills have passed the South African parliament, they are awaiting signature from South African President Jacob Zuma. Once signed, a repeat of the 'poultry saga' could be on the cards. In an attempt to avoid future suspension (or threat) of AGOA benefits for the country, the poultry 'deal' included a clause that would suspend the

“AGOA has been a boon to many African economies, it is likely that benefits enjoyed under the Act will end within the next 10 years. As the AGOA deadline nears, South Africa and other countries in SSA should seriously consider their relationship with the US”

rebates offered to US poultry exporters if the country lose any benefits under AGOA. This bargaining chip is arguably small for South Africa given the significant power imbalance in US-SA economic relations.

Thirdly, the poultry dispute and the ensuing negotiations as well as previous experiences with negotiated trade agreements have shown that such processes require significant technical expertise and are timeous. Negotiations between South African and US counterparts involved multiple departments and ministries (eg. related to trade, health, and animal and environment among others) on both sides, in addition to consultations with private sector stakeholders. While South African authorities have done an admirable job throughout negotiations, striking a balance of trade promotion while protecting national interests, few African countries have such capacity.

This latter observation is especially relevant in light of indications from the US that they would like to pursue reciprocal trade agreements with African countries after the current AGOA extension comes to an end in 2025. Arguments against AGOA's latest extension pointed to the European Union (EU) who signed reciprocal trade agreements with African countries under the Economic Partnership Agreements (EPA).

In addition, the US, along with other numerous other countries, has become increasingly frustrated with the lack of progress on trade negotiations in the World Trade Organization, due to the stalemate within the Doha Development Round. As a result, the US has been keen on negotiating deals outside the ambit of the WTO, as evidenced by their engagement in the Trans-Atlantic Trade and Investment Partnership and the Trans-Pacific Partnership. Currently the US is not lobbying for any specific reciprocal agreement, but looking towards African countries to put forward suggestions.

There are a wide range of agreements for South Africa and African countries to consider: Trade and Investment Frameworks (TIFA); Bilateral Investment Treaties (BIT); Preferential Trade Agreements (PTA) or ultimately a Free Trade Agreement (FTA). The agreement to be made depends on the range of issues up for negotiation (e.g. trade in goods, trade in services, investments, etc.) and differs in level of complexity.

For bigger countries, such as South Africa and perhaps a handful of others, negotiating bi-laterally might be an option (although South Africa will have to negotiate as part of the Southern African Customs Union [SACU] in accordance with the 2002 SACU Agreement). Smaller countries, which will likely



have less leverage in negotiations, should look to negotiating within groups. Already a number of key regional economic communities (RECs) exist within Africa that could be used as a basis for negotiations, or ultimately the larger group of the Tripartite FTA or the Continental FTA. Yet, the EU experience negotiating with the respective RECs showed that these regional authorities had little mandate to negotiate on behalf of their members, with negotiations ultimately ending up as quasi bilateral negotiations.

Another key concern (and threat) for smaller African countries remains the attractiveness of AGOA and resulting over-reliance on this programme. Countries should recognise that over-reliance on AGOA benefits is not sustainable and hold potential disasters for economies. If these countries fail to diversify their markets, or at the very least their product offering to the US, the free lunch enjoyed for 25 years under AGOA will see their economies narrowly intertwined with one partner, resulting

in a similar fate as experienced by Madagascar and Swaziland. Alternatively, they should look to mitigate these negative affects if they proceed with a negotiated agreement, but this will require concessions in other areas of their economies.

Ultimately, while AGOA has been a boon to many African economies, it is likely that benefits enjoyed under the Act will end within the next 10 years. As the AGOA deadline nears, South Africa and other countries in SSA should seriously consider their relationship with the US.

While trade and investment ties with the EU were strengthened through signing of the EPAs, and increasingly closer relations are being crafted with emerging economies of the global south, the US will remain the largest global economy for the foreseeable future (and certainly past 2025). African countries cannot neglect this opportunity for engagement, but need to ensure they are adequately prepared. ■

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Can the Union avoid a breakdown?

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The menace of Brexit, which is to be decided in a June referendum in the UK, compounds enormously the pressure on a European Union which is transfixed by the migrants/refugees crisis. This crisis has come as another huge blow following the financial and the euro area turmoil of recent years. The migrants/refugees' crisis and the euro area troubles have underlined the fragility of the Union, which, for not a few, is a shocking revelation in itself. More than worrying is the pretty low response capacity of the Union to such headwinds. Can the Union pull itself together, can it find a way out of the whole mess?

Below is a brief reading of the Union's travails and many-sided policy imbroglio; it blends the immediate huge threat, which is posed by the migrants' crisis and that can cause a breakdown of the Union in the near future, with structural challenges which are of economic and financial origin in the main.

The context: a bunch of major crises

The European Union is going through the most critical period in its history; it is facing an existential crisis, as several of its top officials have emphasized. Its roots are economic and social, financial, and security related. The economic and financial roots are linked with a deep euro area crisis, the follies of finance, over-debt (debt-overhang'), demographics, and inadequate governance. The increasing security threats are related to the growing turmoil in the Union's close vicinities, in the Arab world in particular, to geopolitical risks (a questioned order in Europe after Crimea's annexation by Russia and other events in Ukraine), and, not least, to terrorism and cross-border crime.

Brexit and tackling the migrants' crisis are the fundamental policy issues in 2016, apart from the constant task to fight terrorism. Hopefully, the UK's referendum will keep this big EU member state inside the Union. And finding a workable solution to containing the migrants' flow is also a must for the sake of averting a dissolution of the Union.

When it comes to economic and social issues, 'regaining citizens' (to paraphrase Etienne Davignon insightful observation, that "we have lost the citizens"), hinges on redeeming what the EU means for Europe. It depends also on better policies at the national and European levels.

In this regard, the Union needs to strike more of a balance between public governance and market forces; the neo-liberal bent of the past decades has to be addressed, especially

during a period of extreme duress for most citizens and rising inequalities; and a thorough reform of finance has to go on.

There are no quick fixes for dealing with the Union's economic deep ailment. The *Five Presidents' Report*² opens new vistas and could be seen as quite far-reaching regarding euro area reform. But this is only a starter and is not devoid of conceptual contradictions. For instance, it alludes to a 'fiscal capacity', but this is envisaged only after structural convergence should have reached a high level in the euro area; this looks like a catch-22 problem for the governance of the euro area.

Asymmetric shocks are a major challenge and dealing with it cannot be put off until structural convergence will have taken place. The fracture between North and South in the euro area may even deepen in an environment of very feeble economic growth and major uncertainties, in spite of ongoing structural reforms (which, by the way, are time consuming).

The Union needs both more responsibility and solidarity. These aims and policy dimensions should be practiced both internally, in the member states, and in the EU, among member states.

The migrants' crisis

With the benefit of hindsight one can argue that the migrants' crisis has been in the pipeline for quite a while. The lack of a common immigration policy, botched interventions abroad that have misfired, the human disaster in Syria, permeable EU frontiers, and the diminishing cohesion and trust among EU member states have all, inter alia, brought about this crisis—quite likely, more threatening than the euro area crisis.

It is true that aging in Europe is a formidable challenge and that immigration can help improve demographic trends at home over the longer run. There are also humanitarian concerns and the very values of democratic Europe which commend certain actions and support a vision. But to hail the current massive flow of migrants/refugees as the solution to demographic strain at home, in Europe in general, is to underestimate the policy conundrum many governments are facing, which is, not least, related to security concerns³.

One should not mix up a possible opportunity over the longer term with existing policy trade-offs and enormous security concerns. Schengen turning, de facto, into a limbo state reflects the inability to deal with this crisis otherwise. It is also

ironic that Greece, which is a very weak economic link of the Union is expected to operate as a key outpost in the effort to control borders.

Europe cannot harbour whoever flees areas of much distress around the world. A wise balance has to be found in this respect between solidarity, humanitarian concerns, and pragmatism, common sense in public/economic policies. Otherwise we will see failing EU policies repeatedly.

The EU needs to have a more clairvoyant international aid and development policy. The EU needs to cooperate more closely with and to help countries where refugees are hosted. Turkey is clearly first *inter pares*. There are also Arab countries which need support. The sooner the war in Syria ends the better, and the Union has to play a significant role to this end. Finally, the flow of refugees from internal war-torn Libya has to be under control. And if there is need for money to achieve all this and in view of a highly strained EU budget, a 'security/solidarity EU

'If we accept that deeper integration is the way forward for the EU in order to cope with current and future challenges, a more balanced policy paradigm is badly needed'

tax', be it on a temporary basis, does make sense; a German proposal (a gasoline special tax) would serve such a purpose.

Brexit

It is good that the EU leaders have reached a compromise deal in the end. But what matters now is the outcome of the June Referendum in the UK. The EU needs the UK for many reasons. It has one of the largest European economies, the City is a world financial hub, British excellence in R&D is a yardstick



for European science and technology, the UK is militarily and technologically of prime interest to EU foreign and security policy and, not least, this country matters considerably for the balance of power inside the EU and, in Europe, in general.

That the compromise reached on February 19th in Brussels may create a risky precedent and could become a harbinger of other troubles down the road is not to be dismissed lightly. But the EU needs the UK and many Britons would, probably say, that their country is safer inside the Union than outside. If the UK citizens decide to take their country outside the EU, the latter would be dealt a terrible blow in the most difficult period of its existence.

The euro area crisis

The fate of the EU depends on the fate of the euro area. The latter has a poor design and improper policy arrangements, as the *Five Presidents' Report* says in a straightforward manner; in addition, it is not an optimal currency area⁴, which has favored a growing cleavage between North and South. The Greek debacle is only the tip of the iceberg.

Unless the euro area reforms its institutional and policy arrangements in a profound way it would be hard to see it survive, which would cripple the EU itself fatally. In spite of a new arrangement last summer, which has prevented a Grexit (for the time being), the Greek drama continues. This situation will keep pressure on the Union. And without debt relief Greece will continue to sink.

Germany is right to emphasize the need for rules to be observed. But rules need to be embedded in an appropriate institutional and policy setup, which is not the case currently. And policy incrementalism has shown its limits in helping the euro area reform itself.

The Banking Union is far away from being the exit from overall troubles. Joint institutions and policies that fit a monetary union are badly needed. A 'fiscal capacity' is a must in order to deal with asymmetric shocks, and a collective insurance scheme has to complete the Banking Union.

Some member states' insistence on rules needs to be complemented by fiscal integration and strong policy coordination; the latter asks for joint bodies including a sort of an 'executive' and 'legislative branch' for the euro area; these would take the euro area in the realm of political integration to be a longer term endeavour.

A less fortunate idea would be to change the rules of the game in the euro area and have countries entering and exiting depending on their economic performance. Such a euro area would no longer be credible, entailing a lot of uncertainty, and the euro itself would be a crippled currency.

A country could/should get into insolvency (as it can happen in the US), but not be forced out of the euro area; it should be prodded to undertake structural reforms, which may be quite painful, while the joint 'fiscal capacity' and other new policy arrangements should mitigate the pains for its citizens. If a country decides to leave the euro area, for various reasons, it would open a completely new chapter in the euro area crisis, it would create new uncertainties.

Policy coordination in the euro area asks for more symmetrical burden sharing when it comes to adjustment. It does not pay,

ultimately, for Germany to run enormous external surpluses, which dampen aggregate demand in the euro area and makes adjustment harder for deficit member states.

New member states, which are outside the euro area and are bound by Treaties to join it, should do it provided, first, they achieve a substantial amount of structural convergence and, second, the euro area reforms itself decisively.

Reconsidering the Single Market logic

The Single Market (which sees the EU as a whole) would better rely on a revamped conceptual framework—some of it outlined in the Monti Report of 2010. However much we praise and value competition as a driver of entrepreneurship and economic dynamism, there are market failures and power asymmetries in the EU, which need to be seriously addressed.

The financial crisis has indicated the flaws of a paradigm that takes for granted that markets always know better, that systemic risks are non-significant, that 'light touch regulation' is fine, that business unethical conduct is quite rare. The Single Market policies should heed the lessons of recent decades, which teach that increasing income inequality, 'winners take all' competition, harm economic growth over the longer term (OECD and IMF studies are quite telling in this respect).

The reform of finance has to go on and adequate regulation and supervision of financial markets (including shadow banking) should be implemented; this should rely on stronger capital and liquidity requirements, the taming of casino-type activities, and the introduction of a sort of Glass-Steagall legislation—as several reports commissioned by the European Commission have alluded to, although not clearly enough.

If we accept, as a working assumption, that deeper integration is the way forward for the EU in order to cope with current and future challenges, a more balanced policy paradigm is badly needed. To the extent member states are asked to relinquish more of their sovereign prerogatives, what would be lacking in the policy mix at the national level has to be replaced by an enlarged and more diversified tool and policy box at the supranational level; in the euro area this would take the form, for example, of a 'collective unemployment insurance scheme'.

This logic could be seen as a 'subsidiarity principle in reverse', and would fit a motion to a more integrated EU. Unless this is done, fragmentation and 'nationalizing' tendencies will gather force, and the Union will be constantly battered by internal shocks and conflicts among member states; muddling through will be the hopeful scenario, and fading away/demise would be the bad outcome.

It is hardly realistic to think that European economies could achieve, on average, the growth rates of previous decades—for the foreseeable future at least. Demographic change, an overwhelming debt overhang (on average, about 250% of GDP, both private and public, in the euro area), the poor functioning of the euro area, and too little investment handicap, *inter alia*, Europe.

However, there are ways to make economies less fragile and likely to achieve reasonable growth rates, be these rates lower than during the pre-crisis two decades. There is need to invest more (the Juncker plan is, arguably, insufficient), to improve the quality of public goods (education), to pay more attention to R&D and make the Union more attuned to the digital world,

and to defy the current deflationary bias of the euro area by changing its functioning.

Business and ethics

Big business has to show convincingly its social responsibility mission, if it actually operates. There has been a rising number of scandals in finance, in other industries, which foment hostility toward business companies and their perceived reckless profit-maximization behaviour (short-termism at the expense of society's stakeholders' interests).

Tax evasion and avoidance has turned into a big policy issue in the Union and blame has to be assigned to the connivance of not a few member states in this regard. Big business has to change its conduct, be more ethical. Unless this happens, even more radical ideas will encroach on peoples' minds, which may be inimical, in the end, to checks and balances, to democracy.

The latter relies on a strong middle class, on an equitable income distribution and on a sense of trust and fairness among social and political actors. When mistrust and animosities abound, the social fabric is torn apart and democratic politics are impaired. More authoritarianism in public and political life would be on the rise. And radical ideas, on the left and the right sides of the political spectrum will continue their rise.

The Investment and Trade Pact with the US has to serve society as a whole; citizens have to see benefits of this pact. If it will not happen, more hostility toward business will be invited in the EU.

Politics in the Union

Effective leadership has become a scarce commodity in the EU. It is fair to mention that hard times complicate policy-making, but the fact is that ever fewer governments are capable of delivering what they pledge during election times. And few politicians have the guts to speak honestly about the new economic and social environment. This enhances mistrust among citizens and poisons the relationships in the EU—which is seen by not a few as the cause of misery.

Credible leaders have to underscore the importance of the EU, to moderate people's expectations about economic growth in the new environment (the 'new normal'), combat racism, xenophobia, chauvinism, and foster EU identity and common policies.

The European Project, as a European public good, needs to be explained better to citizens, in the light of what it has brought about after the end of the second world war and the new challenges facing Europe. This demarche is a must in order to make more clear what this project means for the peace and economic wellbeing of EU member states in a world of tremendous change and when they are facing huge challenges.

But for this demarche to be successful policy-makers in Brussels and national capitals have to tackle the 'democratic deficit'. Unless this is done, the legitimacy of decision-making will be an increasing challenge in the Union; citizens have to sense and see that they have a say in the policy-making process at both the national and the EU/euro area levels.

Politicians need to pay attention to 'fairness' when they formulate public policies; wherever fairness is forgotten the road to social turmoil is nearing rapidly. In addition, it is hard to argue that democracy can be solid when social cohesion is damaged, when people at large feel that they do not benefit on policies bestowed on them, or that costs of adjustment (austerity) are not evenly distributed. Politicians need to be more honest and truth telling about problems and challenges.

Policies in the EU need to consider that unrestrained globalization and declining competitiveness of not a few member states is a recipe for 'inward looking' proclivities of citizens and national governments.

The European Parliament has to be more visible in domestic political debates. MEPs do not matter much in domestic politics, which is a nuisance if we think that the fate of the Union hinges on 'more Europe'. It may be useful to create joint committees among MEPs and MPs, be they under the guise of task forces, which should create bridges among national and European legislatures. MEPs should attend meetings of national parliaments periodically.

A Council of Wise People should be set up to advise EU institutions on issues of utmost concerns, including needed reforms. This group of people should produce its own report on the future of Europe, which should complement the *Five Presidents' Report*.

Security policy

Common foreign and security policies, a common intelligence policy, have to be strengthened (a joint energy policy would bolster common security policy as well). The Union has to develop more consistent, effective policies for tackling conventional and non-conventional threats, including cyber warfare and terrorism.

Devising better policies for dealing with the disorder in the Arab world, with the massive flow of migrants/refugees is a must; it should not rely on ad hoc measures only, and it should tackle the roots of the problem.

As Donald Tusk, the president of the European Council has emphasized, the borders of the EU must be protected. Otherwise, quite soon, we may no longer talk about protecting the Union's frontiers, but of national borders only (this is already happening to a certain extent). ■

These thoughts are strictly personal and should not be attributed to the institutions the author is affiliated with.

1. Kenneth Rogoff coined this term

2. A reform blueprint that was made public in 2015 and that is cosigned by the President of the European Council, the President of the European Parliament, the President of the European Commission, the President of the ECB and the President of the Eurogroup

3. As a deputy finance minister of Germany, Jens Spahn, put it, "No society in the world would be able to cope with the rapid influx of so many people from different cultures...the refugee crisis has the potential to tear the German society apart..." (Germany needs cool heads and a swift cut in migrant numbers", *Financial Times*, 17 February, 2016)

4. An optimal currency area, according to Robert Mundell and others asks for structural compatibility among its economic components when it comes to flexibility of markets, labour movement, level of development, overall competitiveness.



The eurozone needs less heterogeneity

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Misalignments of real exchange rates continue to be the most visible and painful symptom of asymmetric shocks within the eurozone. An important factor behind such misalignment is the difference in national wage formation and bargaining systems, especially between core and periphery members. This column argues that all members need to have institutions that ensure wage developments are in line with productivity developments. This would eliminate an important source of asymmetric behaviour and reduce resistance to EZ-wide fiscal mechanisms capable of absorbing asymmetric shock

Before the creation of the euro, the prevailing view in European economic circles was that economic and monetary union would reduce the incidence of asymmetric shocks. Policy-induced asymmetric shocks would be largely eliminated by the adoption of a single monetary policy and of fiscal rules that would impose sound national fiscal policies. Exogenous asymmetric shocks associated with structural differences between eurozone (EZ) countries were also considered less likely because EMU was supposed to produce structural convergence among these countries (see Buti and Sapir 1998).

Misalignments of real exchange rates may not be the ultimate source of asymmetric shocks, but they are typically their most visible and painful symptom. Whatever their fundamental cause, deviations of wage growth from labour productivity growth tend to create adjustment problems in a monetary union and should therefore be closely monitored and corrected before they become protracted and painful to adjust.

Unfortunately, the system of surveillance that operated in the EZ prior to the financial crisis was gravely deficient in this respect. In the days of the European Exchange Rate Mechanism, authorities monitored developments in real exchange rates (and competitiveness), and could use the nominal exchange rate to correct for losses in competitiveness. Prior to the crisis, however, national and European authorities seemed to have forgotten two elementary facts about a monetary union:

First, that the loss of the nominal exchange rate instrument does not imply that real exchange rates cannot appreciate or depreciate; and,

Second, that competitiveness adjustment risks being long and painful given the loss of the nominal exchange rate instrument.

As a result, real exchange rates in some EZ countries were allowed to become grossly over- or under-valued, creating difficult adjustment problems (see Levy 2012 for a related discussion).

Reducing the occurrence of asymmetric shocks in EZ

As Carlin (2013) emphasises, an important factor behind real exchange rate misalignment in the EZ, especially between the core and the periphery, is the difference in national wage formation and bargaining systems among its members. There is no easy solution to this problem.

One solution would be to harmonise wage-setting systems but this hardly sounds feasible given that national wage-setting systems have deep historical, political, and social roots. The alternative is to broadly maintain the existing systems but to constrain their functioning to ensure that they produce outcomes which are compatible with membership of a monetary union and the need to avoid persistent real exchange rate misalignment. This requires mechanisms to prevent and correct substantial misalignments of competitiveness between EZ countries.

The Macroeconomic Imbalance Procedure (MIP), established by the EU in 2011 in response to the economic and financial crisis, could be an important tool to monitor and correct macroeconomic imbalances in all EU countries. This is especially the case for countries belonging to the EZ for whom the MIP contains an enforcement mechanism, including the potential use of sanctions. The MIP's monitoring mechanism uses a set of indicators to assess macroeconomic imbalances and divergences in competitiveness.

In recent research, my co-author and I propose to complement the MIP by national procedures to monitor and, if needed, correct competitiveness problems and increase ownership at the national level (Sapir and Wolff 2015). These procedures would be required by EU legislation and their performance monitored by the European Commission.

All EZ countries would put in place a competitiveness-monitoring framework involving regular assessments and the definition of instruments to prevent problems. An interesting example is the Belgian legal framework, introduced in 1996 to preserve the country's competitiveness in the EZ by keeping the evolution of wages in line with wage developments in its main trading partners. A national body regularly reports on

the evolution of Belgian competitiveness. This assessment is used by social partners to fix a wage norm for the next round of wage negotiations. Although the norm amounts only to a non-binding guideline, it has generally been respected by the private sector (to which the system applies).

In case social partners fail to agree on a wage norm compatible with the evolution of competitiveness, the government can step in and make the norm legally binding. The system has worked fairly well – it left the wage formation and bargaining system that existed prior to the euro untouched, but made the behaviour of social partners compatible with membership of the euro. The result has been that unit labour costs in Belgium have evolved more-or-less in line with those in its main trading partners, thus avoiding significant competitiveness problems.

The Belgian system should not and cannot be exactly copied by other EZ countries, since they feature different wage-setting systems. What is important is that all EZ countries put in place a mechanism to ensure that, although operating within their own system, the behaviour of social partners and the outcome of their wage negotiations is compatible with membership of the euro, in terms of competitiveness and employment.

Improving adjustment to asymmetric shocks in EZ

The proposal to monitor and, possibly, correct labour competitiveness problems fits well with the Maastricht logic. This (implicitly) makes national authorities responsible for ensuring that national labour markets are sufficiently flexible to deal with asymmetric shocks. It also fits with the optimum currency area (OCA) literature which typically considers that the more a potential monetary union member risks being subject to asymmetric shocks, the more it needs labour market flexibility to compensate for the absence of the exchange rate instrument and adjust to such shocks (see, for instance, De Grauwe 2012).

However, the OCA literature never suggested that labour market flexibility, or even market flexibility in general, would

“The EZ cannot go forward with the degree of heterogeneity in national labour market institutions and outcomes that currently prevails”

be sufficient to deal with all asymmetric shocks. Instead it considered EZ-wide mechanisms to also be crucial, especially for big shocks. Two potential EZ mechanisms suggested by the OCA literature could have been labour mobility (as originally envisaged by Mundell 1961) or fiscal transfers (as first suggested by Kenen 1967) between EZ countries, but neither was promoted or put in place.

The Maastricht construction lacked one of the two adjustment mechanisms emphasised by the OCA theory – fiscal integration. The other mechanism, labour mobility, was theoretically possible by virtue of the EU treaties that guarantee the right of free movement of labour within the EU, but remained limited in practice.

The sovereign debt crisis came as a surprise. No one had foreseen that a EZ government could face a liquidity or even a solvency problem. As a result, the EZ contained no mechanism to deal with this crisis when it occurred. Several EZ countries found themselves suddenly unable to tap financial markets for their sovereign issuance and had to turn to supra-national public lenders.

One source was the IMF, but EZ countries needed their own rescue mechanism. They eventually created the European Financial Stability Facility (EFSF), a temporary mechanism later replaced by a permanent rescue mechanism, the European Stability Mechanism (ESM). EFSF/ESM loans come



with conditionality that, so far, has always included making recipients' labour markets more flexible. Hence, the new EZ regime set up in response to the financial and sovereign debt crisis includes an EZ risk-sharing mechanism in the form of fiscal assistance, along with structural reforms in product and labour markets.

Although this new regime is clearly better than the original EZ design it is still far from sufficient to provide the necessary adjustment within EZ.

What is still missing in terms of adjustment mechanism? Many support the notion that what the EZ needs is not so much a fiscal union per se, but an efficient risk-sharing mechanism that ensures both sufficient adjustment to asymmetric shocks and as little moral hazard as possible.

An international comparison of existing federations by the IMF shows that the EZ lacks the degree of risk sharing seen in other jurisdictions with respect to three dimensions (IMF 2014). First, contrary to federations such as the US, Canada, or Germany, which manage to smooth about 80% of local shocks, the EZ only manages to insulate half of that amount. Second, fiscal insurance compensates 25% of local shocks in Canada, 15% in the US, and 10% in Germany. In the EZ, fiscal insurance was virtually nil before the creation of the EFSF/ESM and remains very small. Third, most of the risk sharing in federations happens through private channels, mainly capital markets and banks. The EZ is no exception, but the role of capital markets is much less than in other jurisdictions.

The previous discussion suggests that the distinction between fiscal insurance and private insurance through financial markets, and the fact that the latter typically plays the dominant role in smoothing local shocks in federations, is not an argument against the need for a EZ fiscal union. On the contrary, the fiscal union should not only provide direct fiscal insurance but also a fiscal backstop against financial risks to allow private insurance to fully operate (see Gros 2014).

Even if an efficient fiscal risk-sharing mechanism can be designed¹, there is little chance that it will be implemented as

long as the fear of moral hazard and of the related 'permanent fiscal transfers' is present in the EZ. This fear largely reflects the heterogeneity that continues to prevail among EZ countries. In this respect, the *Five Presidents' Report* was right to emphasise that "there is significant divergence" across the EZ and that "completion of a successful process of economic convergence ... would pave the way for some degree of public risk sharing" (Juncker 2015). What the Report has in mind is structural convergence predicated upon structural reforms geared towards "more efficient labour and product markets and stronger public institutions."

In political terms, this suggests that the acceptance by (some) EZ countries of steps towards a fiscal union will only be possible if (other) countries undertake major structural reforms. Whether structural reforms should be left entirely in the hands of national authorities, or if they would benefit from EZ coordination as suggested by Draghi (2015), is an open question.

Conclusion

Let us be honest. The EZ cannot go forward with the degree of heterogeneity in national labour market institutions and outcomes that currently prevails. All members of the monetary union need to have institutions that ensure that wage developments are in line with productivity developments. This would eliminate an important source of asymmetric behaviour among EZ countries that can lead to painful adjustments.

At the same time, the EZ needs to put in place risk-sharing mechanisms capable of absorbing asymmetric shocks. Improving the functioning of capital markets in Europe would certainly be an important contribution towards that objective but fiscal mechanisms will also have a role to play. Yet there is much resistance in some countries to create EZ-wide fiscal mechanisms because they fear that structural weaknesses in other countries, in particular in the functioning of labour markets, will lead to structural rather than temporary fiscal transfers.

Reducing heterogeneity in labour market institutions and outcomes is therefore crucial for the sustainability of EZ. ■

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1. See Claeys et al (2014) for a discussion about the benefits and costs of a specific risk-sharing mechanism – European unemployment insurance.

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Held last November in Las Vegas, NV, NBAA2015 featured more than 1,100 exhibitors, and more than 27,000 attendees representing all 50 US states, and 96 countries. Approximately 100 aircraft were displayed throughout the event inside the Las Vegas Convention Center, and at a sold-out static display at nearby Henderson Executive Airport (HND).

A crowded Opening General Session kicked off the show, featuring leaders from government including Oklahoma Gov. Mary Fallin and FAA Administrator Michael Huerta. Other speakers included Mark Baker, president and CEO of the Aircraft Owners and Pilots Association (AOPA) and acclaimed singer, songwriter, and pilot Dierks Bentley.

A well-attended, second-day Opening Session on Nov. 18 featured aviation leaders and legends, including 'Miracle on the Hudson' hero-pilot, Captain Chesley 'Sully' Sullenberger, and the presentation of NBAA's Meritorious Service to Aviation Award to Joe Clark, the inventor of winglet technology.

Safety was also in focus throughout NBAA2015. In addition to the annual Single Pilot Safety Standdown held prior to the event's Opening



Dassault Falcon 900LX on the Static Display at NBAA2015



Day, NBAA2015 also hosted an inaugural National Safety Forum that brought together top government and industry leaders to discuss and address the principal safety issues confronting business aircraft operators.

A full roster of education sessions, held throughout the week, as well as sessions on the future of aviation, and on unmanned aircraft systems, held in NBAA's 'Innovation Zone' on the exhibit floor. New events devoted to attracting and retaining young talent to business aviation, including an education session on creating internships in business aviation, as well as a session about how to identify and support the next generation of business aviation leaders, and a Careers in Business Aviation Day and a young professionals networking event.

NBAA's 2015 convention was truly a memorable event that showcased our industry's vitality and relevance, and we are already looking forward to the 2016 convention in Orlando, FL, from Nov. 1 to 3, 2016.

Regional gatherings bring NBAA's messages to smaller communities

Of course, business and other obligations sometimes mean that it isn't always possible to travel to NBAA's annual convention. Each year, NBAA hosts three Regional Forums at some of the most accessible airports and FBOs across the country, bringing many of the features and benefits of NBAA's larger events – including educational sessions, influential speakers, and aircraft static displays – to venues closer to home.

These events bring together local business aircraft owners, operators, manufacturers, customers and other business aviation professionals to share knowledge, discuss issues affecting the region, and learn how business aviation can help companies succeed.

Already this year, NBAA hosted an extremely successful Regional Forum in West Palm Beach, FL that set an attendance record for NBAA's South Florida forums. That event, held in late January, established an impressive precedent for NBAA's other regional forums for 2016, scheduled for June 9 in Van Nuys, CA and September 15 in White Plains, NY.

Perhaps most importantly, NBAA's regional forums also provide a local venue for aviation professionals to network and expand their knowledge about specific airport policies, environmental protocols, safety and security proposals, taxation, risks and regulations. They also serve to underscore the importance of business aviation to local leaders in business and government, as it positively impacts communities by aiding companies in efficiently performing day-to-day operations, generating new jobs and spurring economic activity and local investment.

International events showcase the strength of business aviation. Business aviation's vital contributions to companies and communities of all sizes will also be shared at two upcoming international events, the 2016 Asian Business Aviation Conference & Exhibition (ABACE2016) and the 2016 European Business Aviation Convention & Exhibition (EBACE2016).

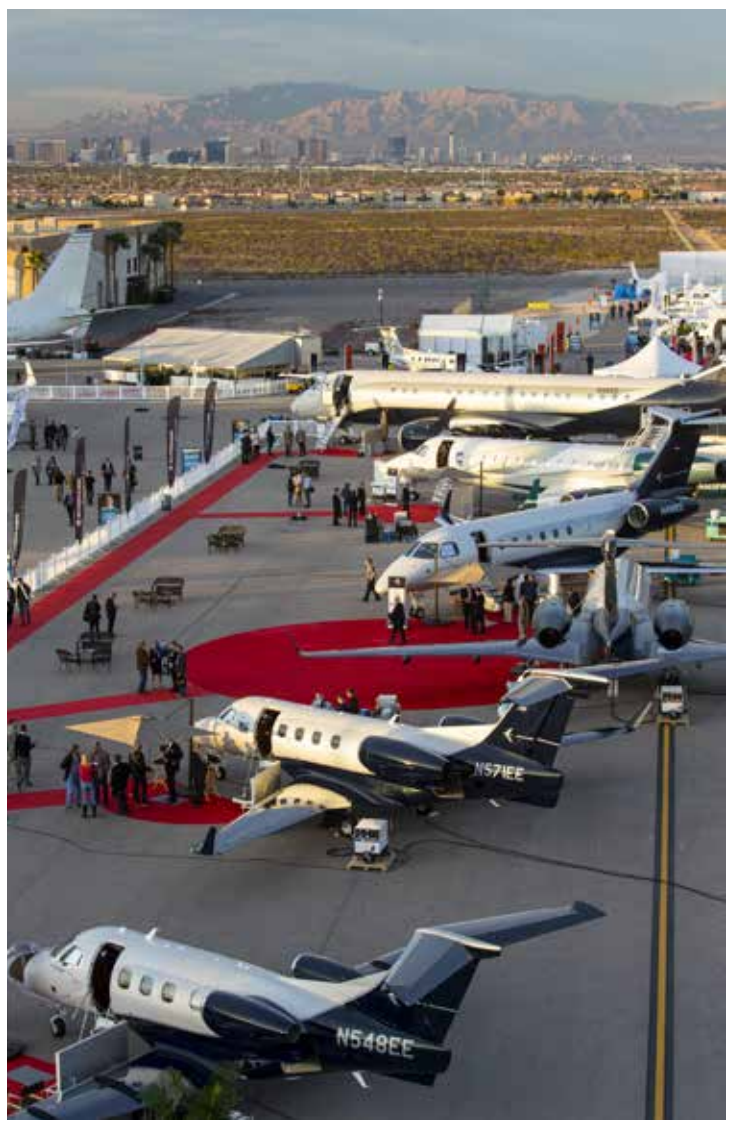
Coming to Shanghai Hongqiao International Airport from April 12-14, 2016, ABACE2016 is the largest event dedicated to showcasing business aviation's impact throughout China and the Asia-Pacific region.

Last year's ABACE featured an unprecedented number of exhibitors from across China and the Asia-Pacific, in addition to companies from around the world that traveled to Shanghai to demonstrate exciting products and valuable services to the expanding market for business aviation throughout the Asia-Pacific.

“NBBA is focused on ensuring the ongoing growth of this vital industry across continents, and around the world”

A number of indicators point to this year’s event surpassing this impressive performance, drawing Exhibitors and attendees from throughout the Asia-Pacific region and around the world. Available exhibit space at host facility Shanghai Hawker Pacific Business Aviation Service Centre has been expanded for to accommodate more Exhibit booths and Pavilions, as well as an anticipated increase in the number of attendees throughout the three-day event.

ABACE2016 will also offer an expanded static display area showcasing the unprecedented range of business aircraft models suited for a wide variety of specific roles and missions. Approximately 40 fixed-wing aircraft and rotorcraft will be on display, ranging from single-engine piston aircraft, to large-cabin intercontinental business jets, and even helicopters.



Attendees at the NBAA2015 Static Display of Aircraft at Henderson Executive Airport

As in past years, the show’s Opening General Session will include discussions about the importance of business aviation and the policy positions that help facilitate access to airports and airspace. Dr. Fang Liu, Secretary General of the International Civil Aviation Organization (ICAO), recently accepted an invitation to serve as a keynote speaker for the 2016 edition of the Asian Business Aviation Conference and Exhibition (ABACE2016).

The first woman to be appointed to the position of ICAO Secretary General, Dr. Liu came to ICAO following a 20-year career with the Civil Aviation Administration of China (CAAC) where she was responsible for numerous aspects of China’s international air transport policy. Her participation at ABACE continues a tradition of high-level international aviation officials speaking at the conference, and follows then-ICAO Council President Roberto Kobeh González’s appearance at the 2013 edition of ABACE.

Co-hosted by NBAA, the Asian Business Aviation Association (AsBAA) and the Shanghai Airport Authority (SAA), ABACE2016 will also offer a high level of educational content, addressing topics important not only to established business aviation operators, but also to those new to the industry who want to learn more about how the industry will improve their flexibility and competitiveness.

The following month will bring the European Business Aviation Convention & Exhibition (EBACE2016), to Geneva’s Palexpo Convention Center from May 24-26, 2016. Jointly hosted each year by NBAA and the European Business Aviation Association (EBAA), the leading association for business aviation in Europe, EBACE is Europe’s largest event showcasing business aviation products and services.

As recognition for the contributions of business aviation has increased throughout the European continent, so too has EBACE grown to become one of the world’s premier aviation events. Last year, EBACE2015 drew nearly 500 exhibitors, and nearly 60 aircraft on display adjacent to the Palexpo at neighbouring Geneva International Airport, with attendees from more than 100 countries across the European region and beyond.

This year’s show is expected to build on this impressive performance. Delegates attending EBACE will be able to speak directly with representatives with hundreds of companies in three Exhibit Halls. New business aircraft manufacturers, avionics firms, handling organizations, fractional providers, and charter/lease companies and aircraft resellers will display their latest products and services, and get critical business done for the year ahead.

Perhaps even more important than these event highlights, however, is the EBACE tradition for hosting discussions on matters important not only to business aviation operators across Europe, but also to the industry as a whole. EBACE also provides a forum for discussing new products and technologies, and the importance of developing the next generation of business aviation professionals.

Of course, EBACE also provides an important venue to continue the vital dialogue between regulatory



authorities and business leaders in the region about the benefits of business aviation. Throughout EBACE2016, attendees will also have the opportunity to discuss the multiple ways that the industry contributes to local and regional economic growth, and its importance to the European economy through the creation of jobs, improving the competitiveness of companies and industries, and increasing access for towns and cities across the region.

Although EBACE focuses on the unique challenges and opportunities of the European business aviation community, it attracts attendees from as far as Africa, Asia, the Middle East and North and South America. EBACE2016 will unquestionably serve as the focal point for business aviation worldwide, as industry stakeholders come to Geneva to discuss matters affecting the global aviation community.

Across the globe, business aviation offers the unparalleled capability to link cities like New York, Beijing, and London with smaller regional markets, including areas that may offer limited infrastructure for ground transportation. This directly serves to increase economic activity and investment in those areas, boosting regional economies in the process.

NBAA is not only committed to protecting and promoting the development of business aviation across the United States and throughout North America; our Association remains focused on ensuring the ongoing growth of this vital industry across continents, and around the world. On behalf of the more than 10,000 members of NBAA, I invite the readers of *World Commerce Review* to consider attending one of these impressive events in 2016, where you may experience the strength and scope of our industry firsthand. ■

The registry of choice

The Cayman Islands Aircraft Registry (the 'Registry') is the aircraft registry of choice for many owners of corporate aircraft, given its reputation of providing a safe, stable and credible flag for the operation of aircraft worldwide.

The Civil Aviation Authority of the Cayman Islands (CAACI) is responsible for regulation of the local aviation industry as well as all aircraft on the Registry operating globally. The CAACI's regulatory requirements are in full compliance with the standards and recommended practices of the International Civil Aviation Organisation (ICAO) including the Part-NCC requirements for aircraft operating in the EU which come into force in August 2016.

The CAACI also works in close partnership with local aviation specialists to ensure that aircraft registrants have expert

guidance on applicable law and procedures. To give an excellent example of this important partnership, the CAACI recently participated as a member of a local working group which included reputable local attorneys in the aviation finance practice along with key representatives from the Cayman Islands Government's Ministry of Financial Services.

The working group was established to assist with developing enabling legislation for the necessary legal framework to ready the Cayman Islands for The Convention on International Interests in Mobile Equipment and the associated Protocol on matters specific to aircraft equipment (also known as the 'Cape Town Convention') upon ratification by the United Kingdom and the extension to its Overseas Territories (OT's).

The importance of this exercise was realized when the UK did ratify the Convention in July 2015, the only OT to which the





ratification was extended to the Cayman Islands along with UK Crown Dependency, Guernsey, due to Cape Town enabling legislation being in place in both jurisdictions.

The Cayman Islands Government and the CAACI are therefore pleased to announce the enactment of The International Interests in Mobile Equipment (Cape Town Convention) Law, 2015, which brought the Cape Town Convention into force in the Cayman Islands effective 1 November 2015 and, accordingly, the Cayman Islands will have international recognition under the Cape Town Convention.

As a result, relevant filings under the Cape Town Protocol such as the Irrevocable Deregistration and Export Authorisation (IDERA) can now legally be filed with the Registry.

The extension of the UK's ratification of the Cape Town Convention to the Cayman Islands is a significant development

for the Cayman Islands financial sector, particularly as this should provide further comfort to established global financial institutions that participate in aircraft finance transactions who wish to transact with parties in jurisdictions that are recognised under the Cape Town Convention.

The CAACI believes this milestone development assisted by the responsiveness and expertise of the professionals in the local financial sector will raise the profile and credibility of the Registry which is already known for its strict safety standards, as a key player for aircraft owners wanting to register their aircraft on a professional and reliable offshore aircraft register and the institutions providing financing. ■

For further information visit:

<http://www.caacayman.com/>

“The extension of the UK’s ratification of the Cape Town Convention to the Cayman Islands is a significant development for the Cayman Islands financial sector”





LEADERSHIP

The power of positive leadership

Whether directly through personal interaction or indirectly through their decisions, leaders shape the quality of a workplace. Siegfried Hoenle describes how leaders can act to boost employee engagement.

SHIP -

“Positive leaders... help their followers to feel significant. They stress the importance of the shared mission and the criticality of every team members’ contribution”



Considering research results across organisations worldwide, leaders do not seem to deliver on engagement¹. The levels of disengagement are high, harming the productivity and creativity of the workforce. What can leaders do differently to address this alarming state?

Positive psychology – a new pair of lenses

Unfortunately, leadership cannot be ‘fixed’ by applying a new technique. No programme, policy or project will do the trick. What leaders need is a new set of lenses through which to look at leadership – and re-wire it.

Positive psychology offers that new set of lenses. The research in this field searches for the keys to human flourishing. The aim is to find out what ingredients a life requires in order to be rich and fulfilled. Martin Seligman, one of the founding fathers of positive psychology², has found two concepts central to it:

Strengths are underlying personal qualities that energise us, contribute to our growth and lead to peak performance. When we tap into these sources of energy, we can reach full immersion in our task at hand, a state Hungarian psychologist Mihaly Csikszentmihalyi calls ‘flow’³.

Meaning is what gives purpose to our existence and to what we do. We gain happiness from our actions when they are based on choices that make sense to us. Many definitions of employee engagement include energy and meaning. Accordingly, employees are engaged when they are energised by work and show a genuine willingness to go the extra mile.

What does this mean for leadership? To boost their employees’ engagement, leaders have to help their people play to their strengths and find purpose at work. Positive leaders drill for strengths and make meaning.

Drilling for strengths – mining for passion and energy

Positive leaders look for strengths instead of relentlessly focusing on deficits and gaps. They help employees leverage their passions and perform at their peak. In practice, they take three steps (remember these steps with the acronym ACT: Assess, Challenge & Support, Team Design):

1 Assess

Positive leaders are curious about the people they work with. They care about more than skills, knowledge and professional experience. They believe that energy trumps everything else; they want to understand what makes their followers tick. Where employees have a passion is

“Especially in large corporations, employees often perceive their work as ‘meaningless’. Opaque decision making, political agendas, a fragmented value chain, bureaucracy – all these devalue what employees perceive as the actual, often-energizing purpose of work”

“To boost their employees’ engagement, leaders have to help their people play to their strengths and find purpose at work. Positive leaders drill for strengths and make meaning”

where they have the largest potential to perform, learn and grow. Positive leaders know that positive energy unlocks human potential and, therefore, engagement at work.

2. Challenge and support

Positive leaders challenge their followers to work in their areas of energy. They do not merely fill ‘gaps’ revealed by a competency model. They help their followers maximise the advantages of their strengths. They challenge employees in two ways: first, to use their strengths to tackle problems they have not tackled before; and second, to achieve true mastery in their areas of strengths. Along the way, in addition to the challenge, they coach them, providing support.

3. Team design

Positive leaders recognise that beyond leveraging individuals’ strengths, they need to leverage team strengths. Team strengths depend on how each team member’s strengths interact with other team members’ strengths. This interaction influences how well the team performs as a group. Positive leaders leverage the full diversity in their teams. They ask questions like:

- Do we have a critical mass of individuals in our development team who are courageous enough to go against the grain?
- Is our production team sufficiently passionate about the critical detail?
- Do the strategic thinkers in our management team hear the single voice of pragmatism?

Making meaning – if not the leader, then who?

Especially in large corporations, employees often perceive their work as ‘meaningless’. Opaque decision making, political agendas, a fragmented value chain, bureaucracy – all these devalue what employees perceive



400%

Adam Grant at Wharton Business School conducted a series of experiments with university call centres, which are tasked with raising scholarship funds. In one trial he brought in a student who personally thanked the entire group of agents for changing his life by raising the funds for his scholarship. In the following month, the call centre employees doubled their calls and increased their revenues by up to 400%



as the actual, often-energizing purpose of work. Consequently, positive leaders need to offer meaning to their followers – no one else will! There are various sources of meaning; here, we focus on four that are particularly relevant to the workplace⁴:

Personal values

At work, people want to uphold their values. Workplaces that subtly require employees to compromise their basic moral standards destroy their identification with work and employer. Often, such organisations have a dysfunctional culture that can open the door to misconduct or even criminal behaviour. Leaders who evince clear values in their words and actions help employees connect with their work and experience a sense of purpose.

Community

Since the early days of evolution, human beings have been hyper-social animals. The group we belong to gives us the safety we miss when we are on our own. The members of a cohesive community have each other's backs; they are there when an individual needs help. The good of the group takes priority over selfish motives because it promises future benefits to the individual.

Being part of a group makes sense. Research conducted by Gallup shows that people who have a best friend at work are seven times more likely to be engaged. Positive leaders know this. They emphasise the team over individuals, reducing internal competition for the benefit of mutual support and collaboration.

Positive impact on others

Giving makes us happier than receiving. Seeing the positive impact we make on somebody else's life gives our actions meaning. Adam Grant's research at Wharton Business School in the US underlined this impressively⁵.

He conducted a series of experiments with university call centres, which are tasked with raising scholarship funds. He looked at different ways to motivate the call centre agents. In one trial he brought in a student who personally thanked the entire group of agents for changing his life by raising the funds for his scholarship.

In the following month, the call centre employees up to doubled their calls and increased their revenues by up to 400%. Positive leaders work with this powerful source of meaning. They enable their followers to feel helpful to others, be it clients, colleagues or the general public.

Leaving a mark

Meaning is about having an impact on the world that transcends our own short existence. We want to be part of something that still influences the world when we are no longer here. We want a glimpse of immortality; we care about how we will be remembered. Positive leaders know this and they help their followers to feel significant. They stress the importance of the shared mission and the criticality of every team members' contribution.

Conclusion

Positive leadership goes beyond leveraging strengths and making meaning. But the practices suggested in this article are a start. For employees and organisations, the potential benefits of positive leadership are huge. Leaders who engage their employees help them flourish in life. And for their companies they boost productivity, creativity and financial returns. ■

ABOUT THE AUTHOR

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Restricted access for migrants: a liberal justification

Fleur de Beaufort is a researcher and Patrick van Schie is director of the Telders Foundation, the Dutch Liberal think tank

Introduction

Is Pope Francis busy preparing a list of politicians he would like to excommunicate? One wonders, since the pontiff recently declared that he considered a politician who proposes building walls in order to keep immigrants at bay to be unchristian. A Christian politician should build bridges instead, he added. The Pope's remarks were specifically targeted at Donald Trump, the leading contender for the Republican nomination in the United States. Trump is (nominally) a Protestant, so in his case excommunication is not an option.

But much nearer to the Vatican, in its backyard as it were, walls and fences have already been built by Hungary, Slovenia and Austria, all predominantly Catholic countries. Will the Pope lecture their leading politicians as well? And does the (Protestant) German chancellor Angela Merkel, with her 'welcome culture', qualify as the embodiment of the true Christian spirit in his view? If so, should anyone in the mainly Catholic Bavarian CSU who criticises her be considered – and treated – as some kind of heretic?

A liberal approach

It is not for us to judge which migration policy is Christian or unchristian in this dispute. Similar lines of arguments, though, can be drawn from a liberal point of view. From a liberal

perspective, on the 'popish' side of this argument about migration is the proposition that each individual should be treated as having an equal value regardless of their background.

Why should any individual be 'condemned' to a life of misery, having to endure insecurity and poverty, just because of their birthplace? Did Franklin Delano Roosevelt's 'freedom from fear' and 'freedom from want' only apply to selected groups of individuals, or did these freedoms hold out a brighter prospect for all people everywhere?

We will not approach questions such as these from an American 'liberal' point of view, because – at least since FDR's New Deal – the meaning of the word liberal in the United States has come to stand for almost the opposite of what liberalism originally entailed, and what we as European liberals hold dear. The current US style of 'liberalism', with its high proportion of collective action, and thus preference for government interference, is ideologically much nearer to European social democracy than to (continental) European liberalism.

Our prism will be that of the classical liberal. In this original brand of liberalism it is, as much as possible, the individual who makes his own decisions. And in most cases those individuals



cooperate freely with their fellow-citizens, creating a spontaneous process. We will add the social liberal perspective, which came to the fore in the last quarter of the 19th century. This is a form of liberalism in which the individual is seen as being more embedded in his environment, although the mutual cooperation of all individuals and their organisations, rather than government bureaucracy, remains – according to social liberals – the driving force of society.

Liberal nation building

Classical liberalism is best known for its preference for the free market and, in an international context, for free trade. Classical liberals have always rejected protectionism, viewing the free movement of goods, services and capital as beneficial to all countries and their inhabitants. But does this also include the free movement of people?

In principle, the answer is yes, but the right to move freely between countries is not the same as the right to settle wherever you want. This applies all the more when immigrants gain the right to enjoy all the entitlements and social benefits enjoyed by the native born citizens of the country concerned.

Very few liberal philosophers have considered all men to be citizens of the world as a whole, as if their cultural backgrounds were of no relevance. The 18th century Scottish Enlightenment philosopher Adam Ferguson wrote that men will always live in 'a plurality of nations'. It would seem to be preferable for men to act with humanity towards all their fellow-creatures, but if there were a nation that could be persuaded to such a humanity '...we would probably break or weaken the bands of society at home...'¹.

Some might doubt Ferguson's liberal credentials, and classify the not overly optimistic Ferguson as an epigone of conservatism. Let us examine what his friend Adam Smith, whose liberal credentials are undisputed, had to say about the cosmopolitan dimension according to which men are supposed to be 'willing that all those inferior interests [of the state or sovereignty; FdB and PvS] should be sacrificed to the great system of the universe'.

Smith deemed: *'The administration of the great system of the universe, however, the care of the universal happiness of all rational and sensible beings, is the business of God and not of man. To man is allotted a much humbler department, but one much more suitable to the weakness of his powers, and to the narrowness of his comprehension; the care of his own happiness, of that of his family, his friends, his country.'*²

In the 20th century, the Dutch liberal professor of international law, Benjamin Telders, thought it was 'foolish to deny, that consanguinity and commonality of land are the natural elements, upon which a public spirit such as nationalism can develop.' As such, this was not enough. 'What is really important is the awareness of connectedness, the knowledge of the national tradition (...) as one's own.' This implied that a kind of internationalism that reckoned with the disappearance of nations and their absorption into a supra-national world-state, should be considered absurd³.

One could make the counter argument, of course, that such reasoning is based upon historical or sociological realities, but not upon any normative conception. Individuals certainly tend to gather in groups such as nations, but they shouldn't. It would be better, and more liberal, the argument then runs, if

"... freedom of movement as vital, but it must always be limited by the freedom of others not to be disturbed"

they regarded themselves as individuals to the fullest extent, and treated all other individuals in an equal way.

We agree that normative values should indeed steer humanity in the direction of a better world, but it is dangerous to formulate and implement policies without a keen eye for realities. An ideology should be a symbiosis of ideals and realities, based on the world as it is, but with the hope that we can achieve a world that better resembles the world as we would like it to be. If this is disregarded, there is a tendency to deviate into flights of fancy. The great liberal philosophers certainly made no such error. They tried to understand the world in order to improve it, but they were certainly not utopians.

So in our view, the observations of liberal philosophers as mentioned above are highly relevant. Nations with an inner coherence will remain the base of political units, at least for the foreseeable future. And even if we could start from scratch, things would not be so very different.

Some philosophers have used the concept of a contract theory as the starting point for their thinking about a perfect, liberal state; for example, John Locke in the 17th century and, more recently, John Rawls a few decades ago. They have always reasoned that if there is no political order, individuals will soon come together to construct something like a state authority, because they need security and/or basic justice. To safeguard their own interests, individuals will, as it were, draw up a contract to provide guidelines by which everyone should abide. When a number of individuals sign a contract, other individuals are consequently excluded. But they, in turn, will be able to enter into another contract with a number of different individuals. Thus, even when starting from scratch, we will end up with a number of coexisting contracts.

In fact, even the historical developments that have actually happened can be seen as having resulting in 'contracts' in which the citizens of a state engage, provided that these citizens have had a voice in the political arrangements. This was made clear by Ferguson, who wrote that nations '...have been fortunate in the tenor, and in the execution of their laws, in proportion as they have admitted every order of the people, by representation or otherwise, to an actual share of the legislature. Under establishment of this sort, law is literally a treaty, to which the parties concerned have agreed...'⁴.

Thus it can be concluded that, in modern democracies, the state is not an abstract construction, but is and should be the work of participating citizens. They should have a genuine say in its construction, and they should be able to identify with the policies produced by the state.

Freedom of association, cohesiveness and rights

One of the fundamental freedoms in classical liberalism is the freedom of association. This freedom would be a hollow one if each association were obliged to accept anyone as a new member without the right to check whether or not they met the membership requirements. The right to freedom of association

implies the possibility of at least several associations operating in the same field.

This is similar to the principle of competition in the economy, which can only work if there is more than one company and the real possibility of starting new companies making similar products. If you are running a company, you do not indiscriminately allow people access to your business information simply because they must be treated as equals.

That would make it too easy for any competitor to learn how you operate and steal the ingredients of your success, taking advantage of the open door that has been enforced upon you. The right to establish and run a company, or any association whatsoever, is only meaningful if you have the right to decide who may enter and who may not.

If this strikes you as too severe – as the product of a ‘cold’ kind of liberalism – you might be inclined to suppose that the social liberal view of political cooperation projects a ‘warmer’ approach towards ‘outsiders’. On the contrary, social liberalism lays even more stress upon the cohesiveness of society.

According to social liberals, the individual must always be viewed not as an isolated human being, but in close connection with their social environment: family, neighbourhood and the larger society in which they were born and raised and in which they live. Society enables the individual to ‘grow’ and develop to the best of their ability. In this way, each individual enriches society by their own development.

In the social liberal view, this is also precisely the way in which rights grow. They do not drop out of the sky, as if sprinkled at random on individuals. Rights are the products of a given society, they result from the way in which individuals and their organisations have arranged themselves and have influenced each other’s thoughts and thus legal activities.

No one can claim to have ‘rights’ unless other members of society, and its ‘instrument’, the State, will recognise those ‘rights’. One of the main social liberal theorists, Leonard Hobhouse, put it quite bluntly: *‘A right is nothing but what the good of society makes it.’*⁵

Reciprocity and security

If states had stuck to the core task of providing so-called ‘negative freedoms’: civil rights (guaranteeing citizens the right not to be hindered) and safeguarding the security and property of all inhabitants, the problems they have encountered with the admission of foreigners to settle on their territories would probably have been fewer.

But modern states engage in many other activities. They deliver or subsidise healthcare and social benefits, to name only their most costly expenditures. Liberals are critical of some of these policies and certainly of the massive scale of present-day welfare states, but most of them do support at least some of its aspects. In any case, when it comes to discussing current

migration rights, it is the welfare state as it is which must be considered to be a reality, whether one likes it or not.

In these circumstances, it is not at all unreasonable, nor in any way anti-liberal, for citizens of the host nation to want to ensure that migrants will not be entitled to receive healthcare or social benefits without first having made a meaningful long-term contribution to society. Specifically, newcomers should pay taxes and social contributions for a certain number of years before they are entitled to make a claim for benefits.

Letting in new people without such a quid-pro-quo undermines the basic solidarity that underpins the welfare state. Without reciprocity, no society will be able to survive. A country flooded by foreigners entitled to make all kind of claims will implode – and no nation can be asked to commit suicide.

Nor should a nation be compelled to admit newcomers who are hostile towards the country or its most fundamental values. No church should be forced to admit new members who have proclaimed themselves to be atheists, and whose aim is to secularise the organisation they are joining.

Neither should any liberal democracy which adheres to basic civil rights, the freedom of its citizens and separation of church and state (in large measure), feel obliged to open its doors to migrants whose avowed intent it is to establish a theocracy, or of whom the intent to use violence has been proven, for example, by acts of terrorism. The minimum requirement for any newcomer must be that he or she will contribute in a positive way to the host nation.

Different kinds of wall

But what about the Pope’s statement that building walls is unacceptable? Regardless of whether or not it is deemed unchristian, should not such a policy be condemned as anti-liberal?

If you accept, as we have argued, that liberal societies must be allowed to restrict entrance, then they must also have the means to carry out such a policy effectively. Whether this is done by physically building walls or by other means is not what matters.

Furthermore, it is important to understand that there are many types of wall. A wall to keep people in is not at all the same as a wall to keep people out. Think about the walls of your house. No one is allowed to detain guests in their house against their will. To do so would be committing a crime.

However, neither can anyone be compelled to accept guests they do not want in their home. To force them to do so would be to infringe a fundamental freedom. This is why any comparison of the walls that have been built to keep immigrants out of European countries with the Berlin Wall or the Iron Curtain is totally inappropriate. Yes, liberals see freedom of movement as vital, but it must always be limited by the freedom of others not to be disturbed. ■

1. Adam Ferguson, *An Essay on the History of Civil Society* (Cambridge, 1995 [originally 1767]) pp. 26 and 29.

2. Adam Smith, *The Theory of Moral Sentiments* (Indianapolis, 1982 [originally 1759]) pp. 235 and 237.

3. Translated from the Dutch article by BM Telders: ‘Nationalisme en internationalisme’ in: Telders, *Verzamelde geschriften*, V (The Hague, 1949), pp. 72-75.

4. Ferguson, *An Essay on the History of Civil Society*, p. 159.

5. LT Hobhouse, *The Labour Movement*, New York, 1912, p. 149.

WORLD COMMERCE REVIEW

AWARD

Best Financial Services Provider 2016

World Commerce Review is pleased to announce that Knox House Trust Limited has been awarded the Best Financial Services Provider 2016.

The selection panel took into account service innovation, on-going customer support and best practice criteria.

In addition, forward planning and CSR were seen as key areas for the award committee.

The World Commerce Review awards are recognised as the principal indications of professional conduct and excellence.



Why leaving is the safer option

Oliver Lewis is Research Director at Vote Leave

Let's imagine that we decide to Vote Leave on 23 June. What happens on 24 June? The very next day after the referendum Britain will remain a member of the EU. The same laws will still apply. Legally, nothing would have changed. There is no legal obligation on the British Government to take Britain out of the EU immediately.

Instead what happens is that there is a new political incentive for our leaders to create a new UK-EU Treaty and to take us out of the EU at an appropriate point in the future. There will be no need to rush. We must take our time and get it right.

We will negotiate a UK-EU Treaty that enables us 1) to continue cooperating in many areas just as now (eg. in areas like maritime surveillance), 2) to deepen cooperation in some areas (eg. scientific collaborations and counter-terrorism), and 3) to continue free trade with minimal bureaucracy. The details will have to await a serious negotiation but there are many agreements between the EU and other countries that already solve these problems so we will be able to take a lot 'off the shelf'.

What will happen after we Vote Leave is that informal negotiations will begin, laying the groundwork for a smooth

transition out of the EU. No rational government would immediately begin any legal process to withdraw so there is no issue of an immediate use of Article 50, the EU's preferred legal route for a member to leave that imposes a basic two-year timetable. The government will explore how the other EU countries and the Commission want to proceed. Safety and stability will be at the top of the agenda.

We will be helped enormously by the fact that the European Commission, Berlin, and Paris now have an official roadmap for another Intergovernmental Conference and another Treaty centralising many more powers including over taxes with the EU. They think they need this to save the euro. What it certainly provides a clear opportunity for us to strike a new deal based on us letting them plough ahead while we take back control.

After these informal talks, there will be formal negotiations to change the legal situation. This may involve Article 50, or the EU and UK may decide to use a different tool.

At the right point we will also need to repeal section 2 of the European Communities Act 1972. This is Parliament's instruction to our courts to treat EU law as supreme. By repealing it we will restore democratic government. Daily in government



departments, ministers are told 'you can't do that because we will be judicially reviewed under European law', on a vast range of subjects from building hospitals and aircraft carriers to which terrorists we can deport. This causes administrative and management chaos and adds billions to costs. By ending this, we will help restore competent and democratic government.

Taken together, these changes we will allow us to retake control of our trade policy. We will leave the Common Commercial Policy (that gives the Commission control of all UK trade agreements). After we retake control, we will negotiate new agreements with countries like India, which represent the future of global growth, much faster than the EU slowcoach wants to or is able to. We will also continue to trade with our European allies.

There is a European free trade zone from Iceland to the Russian border and we will be part of it. The heart of what we all want is the continuation of tariff-free trade with minimal bureaucracy. Countries as far away as Australia have Mutual Recognition agreements with the EU that deal with complex customs (and other 'non-tariff barrier') issues. We will do the same.

Britain will have access to the Single Market after we vote leave. British businesses that want to sell to the EU will obey EU rules just as American, Swiss, or Chinese businesses do. Only about one in twenty British businesses export to the EU but every business is subject to every EU law. There is no need for Britain to impose all EU rules on all UK businesses as we do now, any more than Australia or Canada or India imposes all EU rules on their businesses.

British businesses that wish to follow Single Market rules should be able to without creating obligations on everybody else to follow them. The vast majority of British businesses that do not sell to the EU will benefit from the much greater flexibility we will have. The vast majority of firms will take advantage of the fact that they no longer have to comply with EU red tape that costs the UK economy £33.3 billion every year.

"The only realistic way to influence Europe is to vote leave"

The idea that our trade will suffer because we stop imposing terrible rules such as the Clinical Trials Directive is silly. The idea that 'access to the Single Market' is a binary condition and one must accept all Single Market rules is already nonsense - the Schengen system is 'Single Market' and we are not part of that. After we vote to leave, we will expand the number of damaging Single Market rules that we no longer impose and we will behave like the vast majority of countries around the world, trading with the EU but, crucially, without accepting the supremacy of EU law.

Once we have left the EU we will increase our international influence. We have never managed to exert much influence on the EU project. As the UK negotiator for our entry to the EEC put it, the Foreign Office strategy from the outset was to 'swallow the lot and swallow it now'. This situation recently got even worse - we surrendered our one meagre surviving true red card, the ability to stop other states going ahead by themselves with things that will damage us. Every time a British Prime Minister has tried to oppose something they have failed.

This bureaucracy over which we have so little influence now supplants Britain in many global bodies. Many supposed 'EU rules' now actually transpose rules agreed in these global bodies where Britain has given away its representation to the EU. Our new deal will therefore also include Britain retaking our seats on all these bodies, such as the World Trade Organization. If Canada has adopted the same rules as Norway or Luxembourg over car safety glass, and can export windscreens to Britain or Ukraine, it is because the relevant standards have been agreed at a higher level than the EU.

A leave vote means the opposite of isolation - it means regaining a voice in global bodies that will be increasingly important as the EU shrinks in importance. We will use our freedom from EU law and our strengthened international voice to promote more effective and faster international cooperation often at a global level. European cooperation will continue in fields where it already exists such as air travel, sanitary controls, disease, and counter-terrorism.

We must go much further particularly to deal with rapidly accelerating technological revolutions such as genetic engineering and machine intelligence. The EU is clearly unable to cope and there is widespread recognition of the need for new global economic and security institutions to deal with humanity's biggest problems. We need institutions that are much faster to adapt to accelerating changes.

Another key thing we will have to do is introduce a sensible regime for the movement of people that allows us to replace the awful immigration policy we have now - a combination of an open door for low skilled labour and convicted criminals from the EU while simultaneously stopping highly skilled people from outside the EU coming to the UK to contribute.

We will take back control of our asylum policy from the European Court, including over the vital 1951 UN Convention



on refugees. As another billion people are added to the world population and this population becomes more urban and mobile, it is vital for our prosperity and democratic legitimacy that we regain the power to change our immigration policy according to changing circumstances.

Finally, we will be able to spend our money on our priorities. Instead of sending £350 million per week to Brussels, we will spend it on our priorities like the NHS and education.

The new UK-EU Treaty should be ready within two years. In many areas we will continue existing arrangements at least for a while. Obviously the relationship will change and improve over time but a main goal for the first phase is to avoid unnecessary disruption. All the important elements of a new Treaty should be in place well before the next election.

There will be no need to rush this process. The great advantage of a 'leave' vote is it gives Britain wider options. It is the best move regardless of how the EU responds. If they refuse to face reality and accept the need for changes in the European architecture, we will obviously have done the right thing. If it forces them to face reality and accept sensible changes, we will not only have helped Britain but we will also help Europe avoid continued decline.

The Establishment says 'stay and reform from within'. The Foreign Office has said this for decades. It never happens. The Government's deal is just the latest failure. If we vote remain, it'll be like getting locked in the boot of the car - we'll be taken

to an awful place that we know we don't want to go to but can't swerve.

The euro was always intended to spark deeper centralisation and 'political union' and the next EU Treaty is intended to complete this process soon. On top of all the things Brussels already controls it is also planning to take control of policies on banking, energy, and more. Centralisation in Brussels is not a bug - it's the main feature.

It is delusional to think that voting to 'remain' will give us any leverage to persuade the EU to change radically. Brussels will not, understandably, take our complaints seriously. Whitehall will hand over more power as usual. The European Court will continue taking more power every week, particularly using the Charter of Fundamental Rights. Our money will carry on being squandered. We'll be paying for the euro's bailouts. Our ability to shape the international system will continue to shrink.

The only realistic way to influence Europe is to vote leave. Relations will be friendlier after we vote leave as we will stop blocking our European friend's efforts to integrate. In return, they will stop interfering with our democracy. We will all become better friends and allies and together build a new model for free trade and friendly cooperation.

Since the Suez debacle of 1956, British politics has rested on illusions about the European project. It is time for a new generation to save ourselves by our exertions and Europe by our example. ■



Will Brexit require a re-write of tax legislation?

Les Secular is Managing Director of TPC Management (UK) Limited

This is not an article to convince you to vote one way or the other in the referendum nor does it cover all the possible changes to the UK tax legislation that might arise if the vote calls for an exit from the EU; instead it considers three areas of international tax where changes may have to be made.

Being someone actively involved in transfer pricing it is natural that the first area I consider is the EU Arbitration Convention ('AC') and double taxation arising from transfer pricing adjustments.

Initially in force from 1st January 1995 for a period of five years with extensions, an amending Protocol was ratified in 2004 and the AC re-entered into force on 1st November 2004 with retroactive effect from 1st January 2000. The AC applies in all EU member states and establishes a procedure to resolve disputes where double taxation occurs between enterprises of different

member states as a result of an upward adjustment of profits of an enterprise of one member state. It specifically refers to arbitration and a 3-year time frame and imposes a binding obligation on the contracting states to eliminate the double taxation.

The AC only applies to member states and unless a specific deal is brokered or transitional arrangements are applicable, a Brexit should require the UK to disapply the AC. This would mean that taxpayers suffering double taxation on their profits/income/gains would have to resort to the pre-1995 system of relying on the provisions of the specific double taxation with each separate member state of the EU.

Whilst some double tax agreements with EU member states provide for Arbitration and a time limit under the Mutual Agreement Procedure Article, which, in turn, is subject to the proviso that a decision has not already been reached by a

court or administrative tribunal in either state, the provision is not in all treaties with EU members-until such treaties are re-negotiated, any action may therefore become more time consuming and there is no guarantee that a decision will be made between the states to eliminate the double taxation.

The second area to consider is the Interest and Royalties Directive. Under this Directive, interest and royalties paid between associated entities in different member states can be made free of any withholding taxes. Following Brexit, unless a new arrangement is entered into and/or transitional arrangements apply, withholding taxes will be governed by the provisions of double tax treaties and, again, not all double taxation agreements between the UK and EU member states provide for full exemption from withholding taxes on interest and royalty payments.

For instance, under the double taxation treaty with Poland withholding taxes of 5% can apply on certain payments of interest and royalties. The treaties with Italy and Portugal also contain provisions allowing certain interest and royalty payments to be subject to withholding taxes albeit reduced rates.

The third area for consideration is the Mergers Directive ('MD'). Adopted in 1990 the MD introduced a common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different

"... the potential impacts will also have similar implications for EU entities investing in the UK"

member states and was designed to remove fiscal obstacles to cross-border reorganisations involving companies situated in two or more member states.

In the case of mergers and divisions, where the transferring company transfers assets and liabilities to one or more receiving companies, the MD provides for deferral of taxes that could be charged on the difference between the real value of assets and liabilities transferred and their value for tax purposes.

Where there is a share exchange the MD provides for tax deferral of the taxes that could be charged on the income or capital gains derived by the shareholders of the transferring or the acquired company from the exchange of such shares for shares in the receiving or the acquiring company. With Brexit, potential capital gains could arise.

It should be noted that the potential impacts mentioned above will also have similar implications for EU entities investing in the UK. ■





Grabbing the third rail

Lukas Paul Schmelter is Head of Strategy at the Project for Democratic Union (PDU)

An objective examination of the current state of global affairs must surely lead one to the conclusion that Europe now, more than ever, needs to create and support a unified strategic foreign and defence policy if it wants to retain and strengthen its global influence.

A number of crises have made clear that those who continue to believe in the ability of individual European nation-states to actively shape global affairs and thereby maintain full control over their own fate, are hopelessly misguided. Recent developments have demonstrated that in today's world the role of 'dreamers' is occupied by the ardent advocates of the classic nation-state model, whilst the proponents of federal European solutions are driven by realism.

This is because no rational observer of current events, whether it be Russian aggression on the continent's Eastern periphery, the ongoing sovereign debt crisis, or the unprecedented influx of refugees, can truly claim that a retreat to a Europe of nation-states would translate into concrete improvements in our situation. Those who nevertheless make this claim, do so out of ignorance or more often due to short-term political calculations.

The fact of the matter is that if Europe is to remain master of its own fate, the 'third rail' of European politics, namely the subject of closer cooperation in the realm of foreign and defence policy, must be tackled. Over 60 years after the most far-reaching proposal on this matter, the European Defence Community (EDC), was offered and subsequently rejected, the topic is once more on the political agenda.

Following Jean-Claude Juncker's call for a joint European army shortly after his election as EU-Commission President, the debate surrounding the possibility of further integration amongst Europe's armies has been led with the familiar controversy.

It is undeniable that the existing structure simply delivers too little effect and consumes too many resources. Taken together, EU member states still inefficiently deploy soldiers in far too many garrisons, equipped with partly incompatible weapons systems. Moreover, inefficient procurement is under the command of too many generals and administered by vastly oversized ministerial bureaucracies. Based on 2011 data, EU member states spent more on defence than Russia and China combined, second only to the United States, which spent about 2.5 times the combined European effort. Europe's current defence has no rationale other than the fact of its existence – it is neither adequate nor efficient.

A unified European army would almost certainly produce an overall positive effect in this area, as several studies have indicated. The member states could achieve much more value for money than the €190 billion that they spend to keep up 28 national armies, comprising roughly 1.5 million service personnel. Defence industries across member states would be able to follow a stronger common framework; and R&D as well as military hardware would become less diverse and more standardised.

Faced with the weakness of financial flows allocated to defence research in Europe, and given that military research can have significant positive benefits for the civilian market (see the cases of ARPANET (Advanced Research Projects Agency Network)/internet or the civilian use of the GPS signal), a closer coordination of spending in this area could not only see the production of superior military capabilities but also boosts in Europe's economic growth.

Most importantly perhaps, costly and ultimately unnecessary duplications would be avoided. To cite just one example, the development of three fighters in Europe (the Rafale in France, the Gripen in Sweden and the Eurofighter created by a consortium bringing together Germany, Spain, Italy and the UK) generated significant duplications in spending – both in terms of research and equipment – to arrive at similar results. A similar squandering of resources can be observed in the development of other equipment, such as frigates or tanks.

In addition to these considerations about likely efficiency gains, one must point to the remarkable, and in many ways paradoxical, effects of European defence expenditure when discussing the possibility of a joint European army. The EU member states wish to maintain the illusion that they are independent in matters of defence, largely due to domestic political circumstances.

As a result, they reject closer cooperation through initiatives such as NATO's smart defence or the EU's system of pooling and sharing. Though collaboration of this kind would improve the defence capabilities of Europe as a whole, and thereby benefit each individual nation, it would also involve admitting the fact that the EU member states are undeniably mutually dependent upon one another when it comes to defence policy.

This act of self-betrayal has led to Europe losing substantially in its capabilities (roughly 20 percent over the last five years). This development has ironically increased the extent to which individual EU member states are reliant upon one another. No individual member state is today in a position to effectively

defend itself without the assistance of others. In reality, virtually all military engagements are built upon multilateral structures, exposing politicians' references to autonomy in defence matters as utterly absurd. Moves to cut defence budgets unilaterally, that is to say without consulting the EU or NATO, in an effort to demonstrate national sovereignty, ultimately increase the degree of interdependence.

Few critics of a unified European army in fact deny the advantages outlined thus far. Rather they point to the issue of practicality and more importantly to what they see as a lack of desirability amongst European member states for such a unified army. They outline the fact that it makes little sense to establish a unified army, if the individual member states evidently have differing defence policy priorities. Indeed this is true. Germany surrounded by friendly neighbours in a central geographic location has very different security needs than Poland with its proximity to Russia, or Italy with its coastline facing a region in turmoil.

On the face of it therefore, such a differing range of priorities makes a unified defence policy appear unfeasible. The crucial point however is that none of these states can in fact deal with the particular challenges posed to their security individually. We therefore need a mechanism by which western member states, like Portugal and Spain, are obliged to address the threats posed to the Eastern periphery and vice versa. A unified European army would be such a mechanism. It would essentially ensure that individual member states take an interest in and contribute to the countering of threats that face members geographically distant from themselves, in return for help in maintaining their own security.

This is by no means a novel idea, yet one gets the sense that recent events have really driven home this point amongst policymakers throughout the continent. Particularly the refugee crisis, the prime example of what happens when some member states choose to ignore the concerns of others, has exposed the need for some kind of grand bargain amongst Europe's member states.

Particularly Germany, which due to its geographic location has largely been insulated from the turbulence experienced by other member states located on the periphery of the union, has finally come to realise that it must take an interest in the concerns voiced by other member states. If it fails to do so, the problems will eventually traverse the continent and make it to the borders of the Federal Republic.

With the EU's member states being demonstrated what mutual interdependence in a dangerous, constantly changing world truly means, the prospects for a new initiative in the field of

“We therefore need a mechanism by which western member states, like Portugal and Spain, are obliged to address the threats posed to the Eastern periphery and vice versa”

defence policy do not seem as bad as they perhaps were several years ago. Times of crisis always present opportunity. As the particles are in flux, and we are called upon to determine how they fall into place, the entire process of European integration, of which defence policy is an important aspect, is up for debate. The big casualty of the last five years has been the 'gradualist' fallacy, the belief that Europe would be 'built' brick by brick, little by little, peu à peu.

What we need instead is a brief collective furnace in which new institutions and ultimately new identities are forged in the face of extreme foreign-political threats. If it is to be done, Europeans will have to turn their gaze to the example of the Anglo-American democracies of the West, where similar problems have been addressed and mastered in the past. The solution will have to be to take a leaf out of the Anglo-American book, both in the general and the particular. We need to turn the eurozone into a mighty union built on the same principles as the United Kingdom and the United States. The single state will by definition have a single border and a single army to defend it.

The historical record shows that successful unions have resulted not from gradual processes of convergence in relatively benign circumstances, but through sharp ruptures in periods of extreme crisis. They come about, not through evolution but with a 'big bang'. They are events rather than processes. The European political unity which the continent so desperately needs therefore requires a single collective act of will, by its governments and elites and ultimately by its citizens.

As Hans-Werner Sinn has argued, there is no need to 're-invent the wheel' when a tried and tested model is available to us across the Channel and the Atlantic. We should instead follow the path set out for us more than two hundred years ago by the United Kingdom and the United States by establishing a full parliamentary, defence and fiscal union. This is the only way of solving the debt crisis, of deterring outside predators, resolving the historical paradox of Germany's power and powerlessness in Europe, and turning Europeans and Germans into the force for good in the world that they should be. ■





Combating hiring discrimination with anonymous job applications

Ulf Rinne is Deputy Director of Research at the Institute for the Study of Labor (IZA) in Bonn, Germany

Even in today's globalized world, discrimination is still a big problem. It is both unfair and costly – and not just for the individuals who experience discrimination, but also for society at large. While biased behaviour, for example on the basis of race and ethnicity, has been documented in a wide range of consumer markets, labour market discrimination receives the most attention.

False hope for a fair hearing

A key barrier is access to jobs. Societal costs may be particularly large when skills, experience and qualifications are not the main criteria on which recruiters base hiring decisions. Nonetheless, strikingly different callback rates following initial job applications have been documented for similarly qualified applicants from minority or other disadvantaged groups, such as immigrants, women, and older workers.

It is simply a false hope that only a candidate's skills, experience and qualifications influence the response when sending off a CV to a prospective employer. For example, research from across the globe suggests that already a candidate's name can lead to far fewer calls to interview. This means that Lakisha or Jamal will receive less invitations to a job interview than Emily or Greg in the United States if they are equally qualified. Similarly, Ali will receive fewer callbacks than Erik in Sweden, and Fatih will be less frequently invited than Dennis in Germany.

A straightforward idea

What will happen if the characteristics identifying minority group status are unknown to recruiters? Hiring discrimination should become impossible. The concept of anonymous job applications puts this straightforward idea into practice. It means that certain key pieces of information remain undisclosed in the written application documents which recruiters use in deciding whom to invite for a job interview. The hidden characteristics can vary in different settings, but they would typically include the applicant's name, gender, age, race and ethnicity, and photo.

Whereas this approach is new and innovative in recruitment, anonymous procedures have long been used in other areas. For example, scientists have long used double-blind and single-blind procedures in experimental research studies. Blind auditions for symphony orchestras have demonstrated a strong impact on gender composition. Similarly, and more recently, the reality TV singing competition franchise *The Voice* features in its first stage of competition the 'blind auditions'. This is one important reason why the show is often regarded

as primarily focusing on singing ability, especially when compared to its main rival franchises *Idol* and *The X Factor*. These experiences clearly demonstrate that it is generally possible to decide or select anonymously and to achieve the intended outcomes.

Practical experiences in Europe

Although the use of anonymous job applications has also been proposed in the United States, empirical evidence on their effects is mainly available from field experiments in European countries. Among the practical experiences that have been rigorously evaluated are relatively large projects in France, Germany, the Netherlands, and Sweden. More recently, it has been announced that the new policy tool will also be implemented in the United Kingdom. According to Prime Minister David Cameron, the substantial amount of hiring discrimination is "*disgraceful for 21st century Britain*". Hence, renowned British employers and universities will soon only see application documents without the applicant's name.

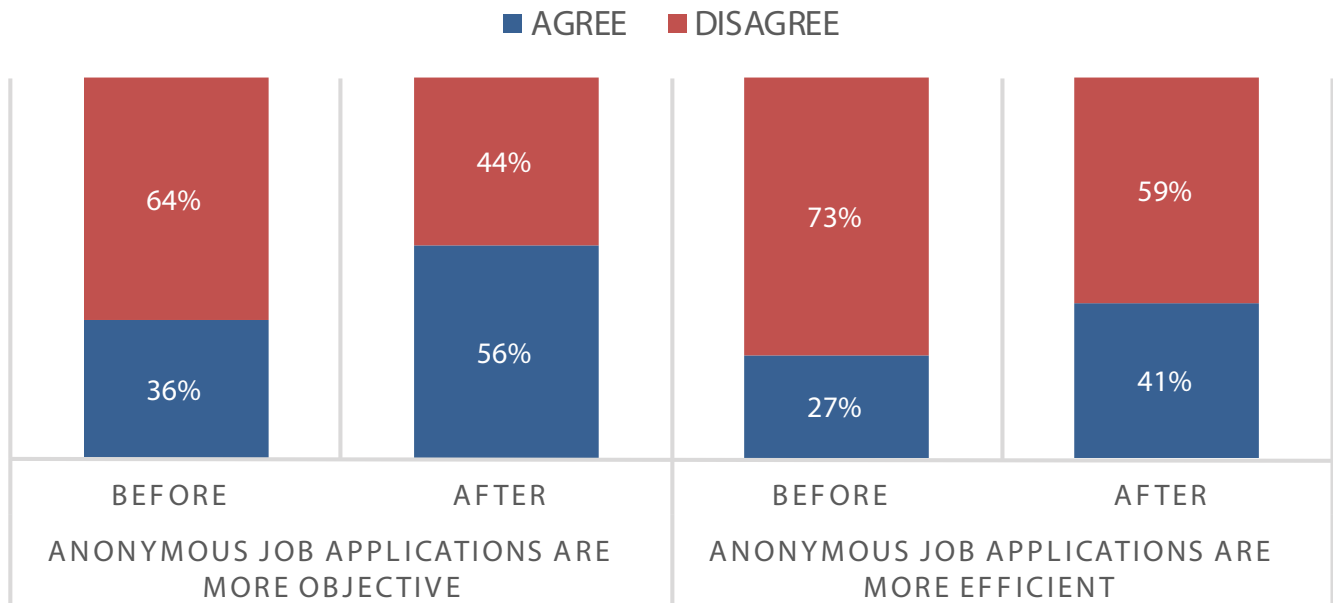
In Germany, meanwhile, the process of rethinking recruitment practices has stagnated. Despite positive findings from pilot projects, anonymous job applications are not broadly used by German employers. This is unfortunate because a simpler, fairer and more efficient principle of candidate preselection is hard to imagine. This view is supported by the encouraging findings of several European studies. In most experiments, the callback rates of minority group candidates do not differ from those of comparable majority group candidates when 'blind' recruiting is introduced. This is what one would expect: If application documents preserve anonymity effectively, discrimination becomes impossible.

Stereotypes, prejudices and implicit bias

Even if recruiters rarely consciously discriminate against minority candidates, their hiring decisions will be regularly not only based on rational grounds. Unconscious thoughts play a significant role in the preselection. Stereotypes and prejudices influence recruiters' choices, resulting in implicit bias. As a result, the best candidates might not survive the preselection stage, simply because of a foreign-sounding name or a disturbing photo. The imminent danger is therefore that objectively important criteria – such as skills, experience and qualifications – do not matter as much as they should.

That is very hard to understand, especially in times of incipient shortages of skilled workers. And it is even harder to understand when there is a reasonable alternative available that can be

Figure 1. Recruiters’ perceptions about anonymous job applications before and after participating in a regional German experiment



Source: Annabelle Krause, Ulf Rinne, and Klaus F Zimmermann (2014): ‘Abschlussbericht des Projektes ‘Anonym Bewerben in Baden-Württemberg’, IZA Research Report No. 63.

tion cannot be used to rationalize below-average education outcomes, a lack of labour market experience, or insufficient language skills.

Experiments tend to show that anonymous job applications increase the probability that minority applicants will be invited for interview. However, there are also some indications of the opposite effect, when anonymity prevents employers from favouring minority applicants or taking extenuating circumstances into account. That means that before introducing anonymous job applications it is crucial to identify which of three initial conditions exist: discrimination, affirmative action, or equality of opportunity.

Not surprisingly, the effects of anonymous job applications are as different as the established practice to be changed. The often-voiced complaint that anonymity prevents employers from favouring minority applicants when credentials are equal may thus be valid – at least in the initial stage of the hiring process, and depending on the initial conditions. But the sad truth is that in most cases, there is initially at least some form of hiring discrimination. Minority candidates will thus on average benefit from the introduction of anonymous job applications.

Recruiters’ perceptions may change

Empirical evidence shows that the recruiters’ perceptions of anonymous job applications substantially change when they have had practical experience with this novel approach. For example, the results of a survey among the participating employers in a regional German experiment, displayed in Figure 1, clearly document their opinion change.

Before the experiment had started, recruiters were rather sceptical that anonymous job applications are a more objective

and more efficient method of screening and selecting candidates. Only about a third of them thought that the new approach was more objective and an even smaller share supposed that it was more efficient. However, after the project had ended, a clear majority of recruiters perceived the novel approach as superior in terms of objectivity. Also substantially more recruiters regarded it as being more efficient than standard practices at the end of the experiment.

So even sceptical recruiters may finally support anonymous job applications – in particular if they have made some practical experiences with them. In contrast, a survey among applicants in the same regional German experiment documents a very broad support for ‘blind’ recruiting on the supply side: an overwhelming majority of 80 percent perceives anonymous applications as the more objective method.

No universal remedy, but large potential

Ultimately, anonymous job applications are not a panacea, but they have the potential to level the recruitment playing field to a substantial extent. In a number of contexts, the callback rates of minority applicants would not differ anymore from those of comparable majority applicants. But it is also true that anonymous job applications have their limits.

They are clearly not a universal remedy to combat any form of discrimination. They target one specific stage in the recruitment process and may eliminate discrimination at that stage. But there are many other circumstances where discrimination against minority candidates is present that are not affected by anonymous job applications. For example, combating discrimination in education or promotions is clearly beyond the scope of this approach. ■



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The power of harnessing data in the anti-money laundering fight

Chrisol Correia is International Head of AML Compliance at LexisNexis® Risk Solutions

Anti-money laundering (AML) compliance requirements have risen steadily over the years, with global banks under more pressure than ever to keep criminals running money laundering operations out of the financial system.

The increasingly changing landscape of AML compliance has seen financial institutions grappling with escalating costs and demands on their personnel resources. Many are faced with the challenge of maintaining an effective compliance program whilst also managing increased regulatory expectations and customer friction. The pull on resources can have a serious impact on core business deliverables and negatively impact risk prevention, but how can financial institutions overcome the AML burden?

The implications

According to a study by LexisNexis® Risk Solutions,¹ the spending of mid-tier financial institutions on AML compliance varies from \$51 to \$100 billion in the US. More than 50% of the large financial institutions that took part in the study said they expect to increase the amount spent on AML activity between 25% and 100%, with some predicting an increase of over 100%. Additionally, most organisations anticipate increasing their AML investment over the next three years – most by 10%-24%.

In addition to the mounting costs, increasingly strict AML compliance requirements are draining resources, in part due to the time and effort financial institutions need to dedicate to due diligence checks on customer identities.

Our research has highlighted that the time needed to perform a risk assessment will increase to 10 weeks over the next three years, which means that financial institutions will need to dedicate even greater amounts of manpower and resources to the process.

Many financial institutions are already managing delays and challenges caused by a lack of industry specifications and global standards around the risk assessment process. According to the report, this can be attributed to a lack of standards set out by the regulator.

The role of the EU 4th Directive

The scope and complexity of AML compliance is set to increase in 2016 and beyond. The gradual roll-out of the EU 4th Money Laundering Directive (MLD), which has been driven by the increasing amount of illicit money flooding global markets, will tighten and increase the regulatory burden placed upon financial institutions.

The 4th MLD requires European member states to update their respective money laundering laws and transpose the new requirements into local law by 26 June 2017. This will facilitate a series of necessary reforms to previous regulatory practices, but crucially will also introduce new ones.

Key areas of change over the prior directive due to be implemented by June 2017 include:

The Ultimate Beneficial Ownership (UBO)

We have seen greater emphasis on UBOs that control 25% of shares or voting rights, which include a large number of trusts and funds. With a view to enhancing transparency, member states should ensure this data is stored centrally in a secure register outside of the company. This will lead to the creation of central registries by country and include funds and trusts.

However, it is yet to be established how this will be implemented country by country, the level of information that will be made available and to whom, and how often it will be updated.

Lifting the lid on cash payments

Under rules set out by the 4th MLD, when a company trading in goods makes or receives a cash payment of €10,000 or more, which has been made as a single transaction or a series of transactions that appear to be linked, the bank processing the payment must conduct Customer Due Diligence (CDD) checks, including 'Know Your Customer' (KYC) screening, on that customer.

Previously, the banks were only obligated to carry out the checks if the transaction was higher than a threshold of



€15,000. This change will put increased pressure on banks' resources due to the rising cost of CDD checks.

Tax crimes

Tax crimes will now be classed as an offence that can produce proceeds which may become the subject of money laundering offences. This will put added strain on financial institutions, who will now be obligated to screen additional data sets to identify potential tax criminals.

Data protection policies

Finally, data protection policies will be mandated under the new AML policies and procedures for customer information sharing. Consequently, banks will have to invest further in the protection of customer data when exchanging information with the authorities.

An era of new measures for Europe

The European Commission's (EC) plan of action to stop terrorist financing was announced in February 2016, significantly widening the scope of the 4th MLD. Both virtual currency platforms and lower-level prepaid cards, some of which are suspected to have been used to orchestrate recent terrorist attacks in Europe, are now subject to greater regulatory scrutiny.

This has several implications for financial institutions. The EC intends to widen the jurisdiction of national and international 'Financial Intelligence Units'. In addition to streamlining compliance processes for many banks, it will support the creation of centralised national bank and payment account registers in all EU member states. This will provide intelligence agencies with easier and quicker access to information on the holders of bank and payment accounts held by financial institutions.²

Although a step in the right direction when it comes to fighting terrorism, these new measures further complicate and expand already complex AML regulations. Based on these plans, banks should expect increased KYC requirements, and will have to manage their data more efficiently in order to monitor suspicious transactions effectively.

The power of sanctions

Outside of Europe, we have seen sanctions increase the AML burden, including the recent Russian sanctions, which encompassed 70% of the Russian banking system, along with other key sectors such as energy, metals and mining.

Contrary to popular belief, sanctions programmes may increase money laundering rather than help to control it. Some targeted financial institutions may look for proxies to develop new corporate structures to allow them to operate internationally in a similar scale to pre-sanctions positions.

To ensure effective sanction controls are implemented, banks need to focus on compliance processes and data collection, which should also ensure that any attempted circumvention is recognised and prevented.

"Compliance pressures surrounding AML are showing no signs of abatement"

To manage growing costs without compromising on compliance expectations, banks need the ability to access the intelligence held in their client and transaction data more easily, improve the quality of the data to provide better risk intelligence, and combine comprehensive screening with technology.

Overcoming the global AML challenge

Financial institutions face the challenge of striking the right balance between preserving the customer experience and protecting their interests by collecting adequate and accurate information to complete due diligence processes, but also widening the screening process for more effective risk management.

Our research has also revealed that one of greatest challenges faced by firms was overcoming the barriers to perform effective customer enhanced due diligence checks. Respondents indicated that it is becoming increasingly difficult to gather specific information from customers because they feel their privacy is being invaded and do not wish to divulge personal information, resulting in less accurate information being gathered.

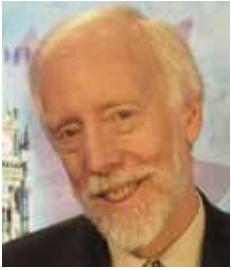
Most financial institutions can overcome this challenge by leveraging third-party data providers and using information such as source of wealth, adverse media, source of funds and public records. Smaller financial institutions that are not leveraging the information through third-party data providers could be at greater risk, however.

To overcome these issues, banks need to remove any low-value and/or counter-productive reporting requirements in order to lighten the heavy burden of AML on the bank and its customers. At the same time, firms must also be willing to adopt technological innovations to achieve this goal.

Big-data analytics, knowledge-based authentication (KBA), document authentication, electronic ID verification (e-IDV), biometrics and one-time password (OTP) are just some of the ways in which banks are trying to manage AML risks more effectively. With this approach, some AML compliance platforms not only increase operational efficiency, but also reduce the time it takes to process alerts and cut costs.

Compliance pressures surrounding AML are showing no signs of abatement, and regulatory uncertainty adds another layer of confusion as banking professionals endeavour to stay abreast of the constantly changing landscape. Managing AML risk effectively will require the banks align their investment in AML expertise with the technology that is needed to identify the real and present risks of financial crime. ■

1. LexisNexis Risk Solutions 'Current Industry Perspectives into Anti-Money Laundering Risk Management and Due Diligence' report – December 2015
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Developed countries must opt out of expensive climate mitigation commitments

Risks of misguided climate change policy far outweigh risks of man-made climate change, Tom Harris argues

To make rational public policy decisions, governments must compare the risks of taking specific actions with the risks of inaction. Yet they rarely do this on high profile environmental issues, often choosing to enable policies that merely appease activists. By not engaging in sensible risk management activities, politicians may cause more harm to society than good for the environment.

Climate change policy is a case in point.

Politicians usually speak as if scientists know the future of climate change. They tell us that we are facing an unmitigated disaster if we do not ween ourselves off hydrocarbon fuels such as coal, oil and natural gas.

These so-called fossil fuels are the source of 86% of the today's world energy supply. This massive transformation of our energy systems can be done quickly and with little pain, politicians often assert.

But does this confidence make any sense? Is the science of climate change as settled as most opinion leaders would like us to believe? How easy would it really be to move away from fossil fuels?

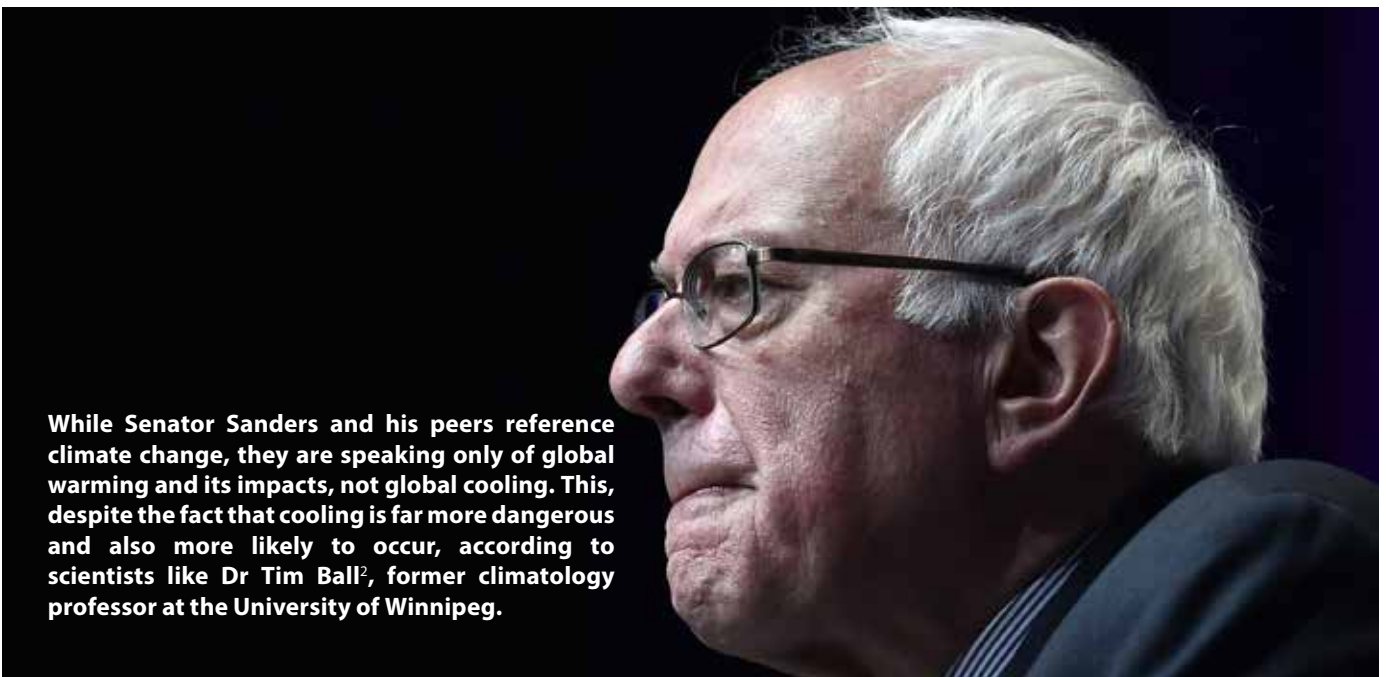
No one promoting climate alarm has been more active in 2016 than Bernie Sanders, US Democratic presidential candidate and Vermont Senator. Speaking at Hibbing High School in Minnesota on February 26, Sanders told cheering students:

"I have talked to scientists all over this world. And what they say, almost unanimously, is that climate change is real; it is caused by human activity; it is already causing devastating problems in our country and all over the world."

Sanders has been giving the same message all over the country, as have other leaders worldwide for years, of course. But these statements are so obvious that they are irrelevant to the climate change debate.

Like gravity and sunrise, climate change is unquestionably real. No scientist would say otherwise. The only constant about climate is change; it has changed continually for billions of years, at times far faster than today. It will continue to do so no matter what we do.

All experts also recognize that climate change is caused, at least to some extent, by human activity, whether that activity is land use change such as clear cutting forests to make way



While Senator Sanders and his peers reference climate change, they are speaking only of global warming and its impacts, not global cooling. This, despite the fact that cooling is far more dangerous and also more likely to occur, according to scientists like Dr Tim Ball², former climatology professor at the University of Winnipeg.

for farms and cities or burning fossil fuels to power our society. And, of course, anyone who studies history knows that climate change can cause devastating problems when large variations occur quickly. Societies that did not adapt to extreme climate change are no longer with us.

If Sanders and his allies then merely advocated that we harden our infrastructure by reinforcing buildings and burying cables underground to prepare for climate change and extreme weather, they would be on solid ground and no sensible person would disagree. But instead, they make a dangerous leap in faith, a non sequitur that, while politically correct, makes no sense scientifically. At Hibbing, Sanders said:

"And what they [scientists] tell us is, if we do not get our act together, if we do not transform our energy system away from fossil fuel into energy efficiency and sustainable energy, the planet that we're going to be leaving our children and our grandchildren is a planet that will not be healthy or particularly habitable. We have a moral responsibility to transform our energy system away from fossil fuel."

For it to be rational to spent trillions of dollars to 'transform our energy system away from fossil fuel' because of climate concerns, several conditions would have to be met.

We would have to know, with a reasonable degree of confidence, that future global warming, if it occurs, will be dangerous. To date, nothing untoward has happened to the climate despite a supposed 40% rise in atmospheric CO₂ levels in the past 150 years. In this period the global temperature statistic has risen only about 0.8 degrees Celsius, an amount that has been highly beneficial as we emerged from the Little Ice Age. So, it is only *future* rise that could be of concern. And for it to be worthy of being a public policy issue at all, that rise would have to be expected to be dangerous.

Predicting future climate is fraught with uncertainty. We don't really know whether warming or cooling lies ahead, let alone the extent of such change. *"Climate is one of the most challenging open problems in modern science,"* according to University of Western Ontario applied mathematician Dr Chris Essex, an expert in the mathematical models that are the basis of climate concerns. *"Some knowledgeable scientists believe that the climate problem can never be solved."*

If future global warming actually occurs, the probability that it will be dangerous is about 2%, according to Dr Tim Ball, former climatology professor at the University of Winnipeg. Dr Ball's conclusion is supported by *Why Scientists Disagree About Global Warming*², the November 23, 2015 report of the Nongovernmental International Panel on Climate Change (NIPCC). This report stated: *"No evidence exists that... [a future warming of 2°C, the figure the United Nations says we must avoid] would be net harmful to the global environment or to human well-being."*

For sake of argument, let's be generous to Sanders and his allies and say that there is a 10% chance that future global warming, if it happens, will be dangerous.

However, for Sanders' prescription to make sense, we would also have to know, again with a reasonable degree of certainty, that the cause of this threatening change would be an increase in the concentrations of carbon dioxide (CO₂) in the atmosphere. CO₂ rise is not a concern otherwise since it is essential to plant photosynthesis and so not a pollutant.

"Western politicians are unwittingly encouraging one of the greatest ethical tragedies of our time"

As shown in Figure 2 below, there is little empirical support for the hypothesis of CO₂-driven global warming. During a multi-million-year period about 450 million years ago, CO₂ concentrations were about 11 times today's level, but the Earth was stuck in one of the coldest period of the last half-billion years. At other times, it was hot when CO₂ levels were high. At still other times, it was neither unusually hot nor cold. There is no consistent correlation between CO₂ levels and temperatures in the geologic record, let alone a meaningful cause and effect relationship.

The same is true in more recent times. According to the November NIPCC report, *"No close correlation exists between temperature variation over the past 150 years and human-related carbon dioxide (CO₂) emissions."*

And, of course, we are 19 years into the 'global warming hiatus,' a period of no overall temperature rise despite a supposed 10% increase in CO₂ concentration in the atmosphere. This slowdown was just confirmed in *Making sense of the early 2000s warming slowdown*³, a paper published in the March 2006 edition of the journal *Nature Climate Change*.

Ball suggests that, if dangerous global warming were to occur, the odds of it being caused by increasing levels of CO₂ are essentially zero. Other factors, such as changes in the output of the sun, play a far more prominent role, he believes. However, again for the sake of discussion, let's assume that there is a 10% chance that the cause of dangerous global warming would be an increase in CO₂ levels in the atmosphere.

But that is still not enough for the senator's strategy of moving away from fossil fuels to be a rational approach to climate change. We would also have to know that CO₂ levels in the atmosphere will indeed rise in the decades to come as a result of increasing CO₂ emissions from industrial activity.

While it is popular to assert that CO₂ levels have risen steadily in the past century and a half, some scientists dispute this. Ball, says, *"The CO₂ level from pre-industrial times was completely manipulated to show a steady rise from 270 ppm to the current 400 ppm. Scientifically valid chemical measurements of 19th century CO₂ levels in excess of those of today were simply ignored."* (See Figure 3).

Not surprisingly, Ball is also sceptical about future CO₂ increases asserting, *"there is no sound reason to assume CO₂ levels will necessarily rise. Indeed, there could be a drop as global cooling results in CO₂ absorption by a cooling ocean."*

Ball concludes that there is only a 20% probability that CO₂ levels will rise in the foreseeable future. For the sake of this discussion, let's be charitable to Sanders' perspective and assume that the odds of future CO₂ rise are quite high, say 75%.

But is this rise, if indeed it occurs, likely to be caused by human activities? Or it could be caused mainly by natural

factors such as outgassing from the oceans due to a possible gradual warming caused by solar changes. Ball says there is a 2% chance that, if CO₂ rises in the foreseeable future, it will have been caused by human industrial activity. Giving the Sanders' team another break, we will say that there is 50% chance that any possible future CO₂ rise will be caused by human industrial activity.

Summarizing our concessions to Sanders et al, we have a:

- 10% chance that global warming will occur in the foreseeable future and will be dangerous
- 10% chance that the cause of future dangerous change will be an increase in CO₂ levels
- 75% chance of future CO₂ rise
- 50% chance that future CO₂ rise will be caused by human industrial activity.

Calculating the product of these probabilities yields the likelihood that future global warming, if it occurs, will be dangerous, that such warming will be caused by an increase in CO₂ content of the atmosphere and that such a rise will be as a result of emissions from human activities. The product is 0.38%, or about one chance in 260. Picking more realistic likelihoods at each step in the chain yields even lower probabilities that Sanders' fears are justified. Using Ball's estimates, the probability is zero, of course.

Many will argue for higher probabilities for each of the above four factors. Yet to generate even a 50:50 likelihood that Sanders' is correct would require that, on average, each of the aforementioned probabilities be 84% or higher. No sensible scientist could be this confident about future climate states and their causes.

In addition to the low probability that Sanders' concerns about climate are justified, there is yet another factor that must be accounted for. We would have to know that, were a man-made global warming disaster in the cards, it is more cost effective to reduce CO₂ emissions (mitigation) than to simply prepare for and adapt to future change.

Ball believes that there is only a 1% chance that mitigation is more cost effective than adaptation. Several studies support this conclusion. For example, Rannoch, Scotland-based Christopher Monckton, Viscount of Brenchley⁴, an expert in the quantification of climate sensitivity, conducted an analysis⁵ that demonstrated that, assuming the data of the UN Intergovernmental Panel on Climate Change is correct, it is fifty times more expensive to try to stop climate change than to adapt to it. The study, as it applies to Australia, for example, may be seen here⁶.

Regardless of the final probability we chose for the likelihood that mitigation is more effective than adaptation, the overall odds that Sanders' solution is reasonable become vanishingly small.

Contrast this against the probability that quickly moving away from fossil fuels will cause great hardship for humanity, a likelihood that Ball places at 100%. To get an idea of the future impact of such a huge transition, we must examine the effects of the mitigation policies to date.

In an effort to set a climate mitigation example to the world, the European Union have advanced the most expensive

forms of energy (primarily wind and solar power) at the expense of the least expensive forms (fossil fuels). Bloomberg New Energy Finance asserted that, between 2005 and 2013, EU member states spent approximately €600 billion (\$882 billion) on renewable energy projects. The results have been catastrophic. The *Washington Post* explained that the EU "has become a green-energy basket case. Instead of a model for the world to emulate, Europe has become a model of what not to do."

In his December 2, 2014 testimony⁷ before the US Senate Committee on Environment and Public Works, Dr Benny Peiser of the London-based Global Warming Policy Foundation⁸ explained the impact of EU climate policy on the average person:

"Since the introduction of the levy [Germany's renewable energy levy, which subsidises green energy production] in 2000, the electricity bill of the typical German consumer has doubled. As wealthy homeowners and business owners install wind turbines on their land and solar panels on their homes and commercial buildings, low-income families all over Europe have had to foot the skyrocketing electric bills.

Many can no longer afford to pay, so the utilities are cutting off their power. The German Association of Energy Consumers estimates that up to 800,000 Germans have had their power cut off because they were unable to pay the country's rising electricity bills."

The situation is equally disturbing in the United Kingdom. In *To Heat or Eat: Europe's Climate Policy Fiasco*⁹, Peiser's Friends of Science presentation in Calgary on May 14, 2013, he said, "In the UK, we have currently about 7 million families in what is called fuel poverty, that is, at least 10% of your disposable income has to be spent on energy." Largely as a result of soaring energy costs, Peiser explained¹⁰, the Office of National Statistics in England and Wales shows predicts that one million Brits are expected to die from cold in their homes by 2050.

Climate change mitigation efforts are also causing serious problems in the United States, where, according to some estimates, \$4 billion is spent every day by government on global warming-related activities: carbon trading, biofuels, renewable energy (primarily wind and solar) and administration.

Especially hard hit is the coal sector which provides the nation's least expensive and most reliable electricity: over 50% of the mines and miners in Central Appalachia are now idle and forty-nine US coal companies are currently bankrupt. Over the past five years, the coal industry has lost 94% of its market value, dropping from \$68.8 billion to \$4.02 billion.

As a result of the Obama's administration's Clean Power Plan (the CPP, which is misnamed; it only restricts CO₂ emissions), 49,000 megawatts of coal-fired electricity will be eliminated, at an increased wholesale power cost of \$214 billion between 2022 and 2030. This is forecast to result in power rate increases of up to 31% in half of all US states. Electric power grid operators are very worried about the reliability of America's power supplies if the CPP proceeds as planned. Incredibly, 115 million Americans currently qualify for energy assistance. Without coal in the mix, the situation will worsen still.

The situation will not improve if Hillary Clinton becomes president. CNN reported¹¹, "By the end of her hypothetical first term as president, Clinton promised that the United States would

Primary energy world consumption

Million tonnes oil equivalent

Figure 1. Coal, oil and natural gas provide the vast majority of world primary energy consumption

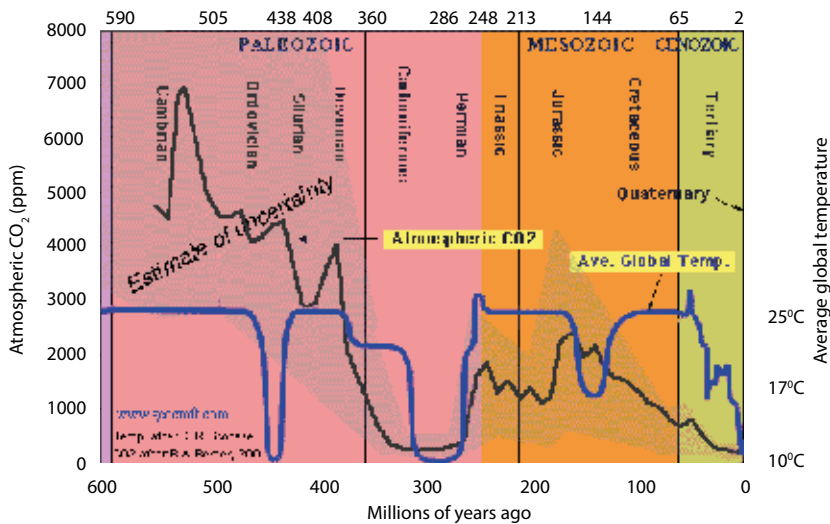
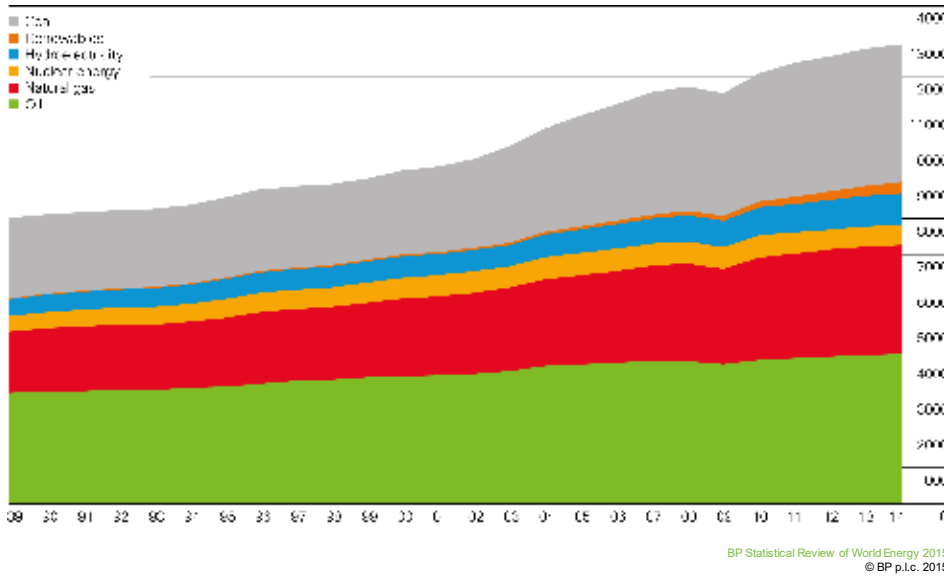


Figure 2. Geologic record does not support the idea that CO₂ changes drive temperature

Late Carboniferous to Early Permian time (315 mya-270 mya) is the only time period in the last 600 million years when both atmospheric CO₂ and temperatures were as low as they are today (Quaternary Period).

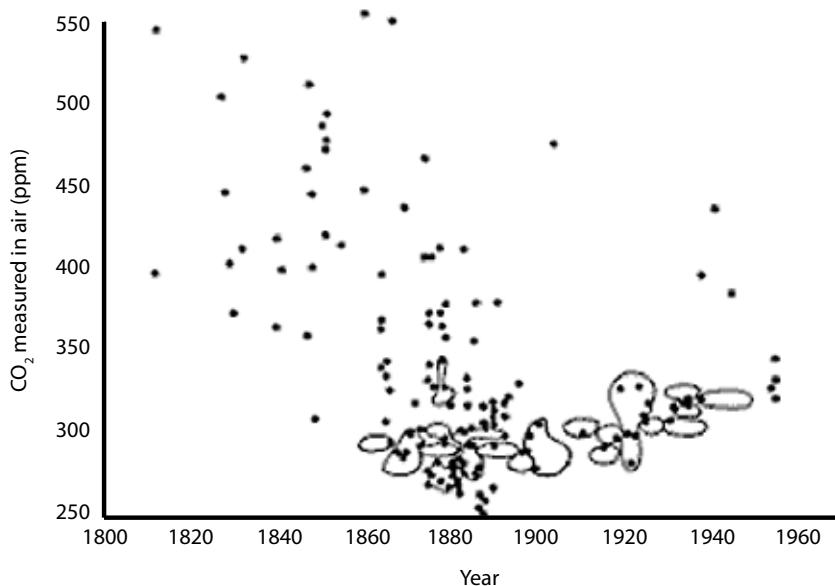


Figure 3. Dr Zbigniew Jaworowski included this graph in *Climate Change: Incorrect information on pre-industrial CO₂*, his March 19, 2004 written testimony¹² for the hearing before the US Senate Committee on Commerce, Science, and Transportation. Ball explains, "This plot demonstrates how GS Callendar selected only those CO₂ measurements that showed both low pre-industrial levels and a steady rise to the mid-20th century." Dr Jaworowski testified to Congress, "The modelers ignored the evidence from direct measurements of CO₂ in atmospheric air indicating that in 19th century its average concentration was 335 ppmv. ... encircled values show a biased selection of data used to demonstrate that in 19th century atmosphere the CO₂ level was 292 ppmv."

Source: www.mitosyfraudes.org/Calen5/JawoCO2-Eng.html

have more than 500 million solar panels installed across the country.”

Dr Jay Lehr¹³, science director at The Heartland Institute, an independent nonprofit organization based in Chicago sums up the costs of the climate scare in the western world, “If one were to add up Europe’s and the United States’ total investment in wind and solar energy along with their reduction in the use of fossil fuel power plants and efforts of all types to reduce CO₂ emissions in the name of stopping global warming over the past two decades, we are approaching one trillion dollars. This has dragged down every participating economy at a time they were attempting to recover from the great recession of 2008.”

As described in *Progressives should demand a reassessment of climate change concerns*¹⁴, my article published in the June 2015 issue of *World Commerce Review*¹⁵ other disastrous consequences of the worldwide focus on climate mitigation include:

- the lack of adequate funding for adaptation. The San Francisco-based Climate Policy Initiative has found that, of the over \$1 billion spent globally every day on ‘climate finance’ that they tracked only 6% of it is dedicated to adaptation.
- 6.5% of the world’s grain is diverted away from food to biofuels, causing food price spikes in poor countries.
- 1.2 billion people in developing nations lack access to electricity even though their countries have vast fossil fuel resources.
- millions of birds and bats die each year in collisions with industrial wind turbines (IWTs). Spain’s Ornithological Society estimates that the 18,000 wind turbines in that country could be killing six million or more birds and bats every year. Even more serious are the ruined lives¹⁶ of hundreds of thousands of people who live near IWTs.

Poor countries get it; we should too

Developing countries have always understood that their economic and social development is far more important than taking expensive actions to possibly influence future climate states. This prioritization has been imbedded in all UN climate negotiations since the start. Article 4 of the 1992 UN Framework Convention on Climate Change (UNFCCC)¹⁷ treaty on which all UN climate negotiations are based states:

“The extent to which developing country Parties will effectively implement their commitments under the Convention will depend on the effective implementation by developed country Parties of their commitments under the Convention related to financial resources and transfer of technology and will take fully into account that economic and social development and poverty eradication are the first and overriding priorities of the developing country Parties.”

So developing nations will keep their CO₂ emission reduction commitments only if we pay them enough, give them enough of our technology, and most importantly, as long as these commitments do not interfere with their ‘first and overriding priorities’ of ‘economic and social development and poverty eradication.’

Actions to significantly reduce CO₂ emissions in developing countries would involve dramatically cutting back the use of coal, the source of 71% of India’s electricity and 81% of China’s. As coal is by far the cheapest source of power in most of the world, reducing CO₂ emissions by restricting coal use would unquestionably interfere with development priorities. So, developing countries have repeatedly made it clear that they won’t do it, and have successfully resisted attempts to modify this part of the UNFCCC.

Currently, developed nations do not have this option. We must keep our emission commitments no matter how it impacts our economies.

This is a colossal mistake. Mitigation policies are clearly inflicting massive damage to developed countries. Yet, these actions have had essentially no effect on global climate and the odds that they will significantly influence climate in the foreseeable future are minute. By so strongly promoting the fantasy that we can control Earth’s climate as if we had a global thermostat, western politicians are unwittingly encouraging one of the greatest ethical tragedies of our time. ■

ABOUT THE AUTHOR

Tom Harris is Executive Director of the Ottawa, Canada-based International Climate Science Coalition¹⁸

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Examining the interplay between climate change and nuclear weapons

Rob van Riet is the Peace & Disarmament Coordinator at the World Future Council

Two principal threats of our time

While humanity faces a range of interconnected transnational threats and crises in the 21st Century—including extreme poverty, hunger, pandemic disease and demographic change—climate change and the continued existence of nuclear weapons stand out as the two principal threats to the survival of humanity. On the long arc of human existence, both threats are relatively new to the scene, having only appeared over the last century. Both threaten the survival of life on earth as we know it and both are of our making.

As the World Future Council has highlighted in a recent report¹, climate change and nuclear weapons interact with each other in a range of ways. Conflicts induced or exacerbated by climate change could contribute to global insecurity, which, in turn, could enhance the chance of a nuclear weapon being used, could create more fertile breeding grounds for terrorism, including nuclear terrorism, and could feed the ambitions among some states to acquire nuclear arms.

Furthermore, as evidenced by a series of incidents in recent years, extreme weather events, environmental degradation

and major seismic events can directly impact the safety and security of nuclear installations.

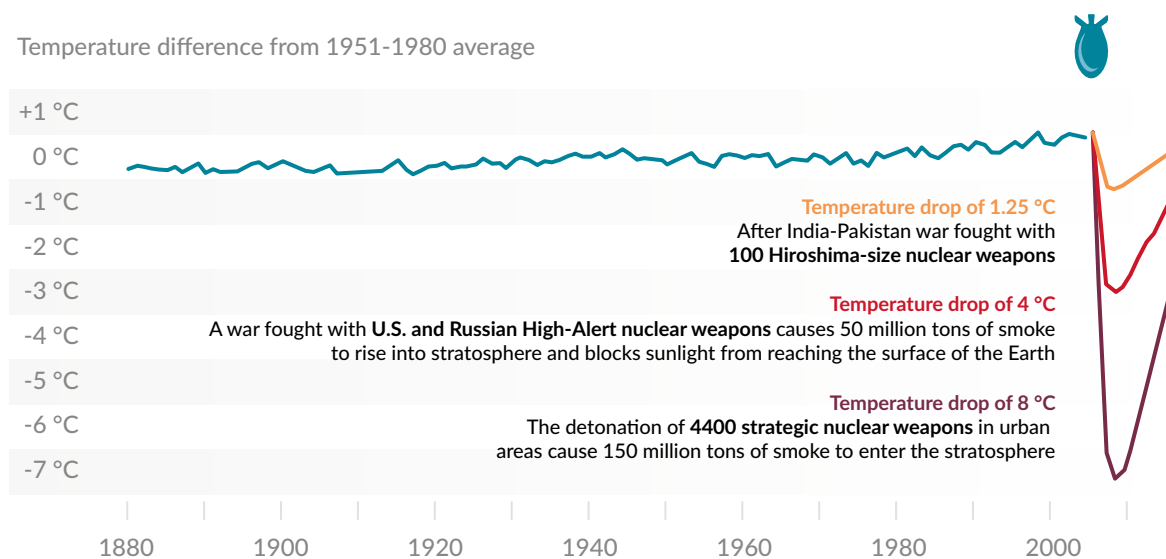
Moreover, a nuclear war could lead to a rapid and prolonged drop in average global temperatures and significantly disrupt the global climate for years to come, which would have disastrous implications for agriculture, threatening the food supply for most of the world (see Figure 1). Finally, climate change, nuclear weapons and nuclear energy pose threats of intergenerational harm, as evidenced by the trans-generational effects of nuclear testing and nuclear power accidents and the lasting impacts on the climate, environment and public health from carbon emissions.

The need for global action

Negotiations and initiatives for tackling the climate and nuclear threat are reaching a critical stage.

At the UN Climate Change Conference in Paris in December 2015 (COP 21), the global community reached an unprecedented agreement on climate change. The Paris Agreement sets out a

Figure 1. Global average surface temperature changes for small, moderate and large nuclear wars in the context of the change of climate since 1880



Source: nucleardarkness.org

“Climate change, nuclear weapons and nuclear energy pose threats of intergenerational harm, as evidenced by the trans-generational effects of nuclear testing and nuclear power accidents”

global action plan to peak greenhouse gas emissions as soon as possible and avoid dangerous climate change by limiting global warming to well below 2°C with the aim to limit the increase to 1.5°C, since this would significantly reduce the risks and impacts of climate change. However, there is some concern about whether this agreement can be enforced effectively. Countries are required to communicate Intended Nationally Determined Contributions (INDCs) to mitigation of and adaptation to climate change which will be regularly reviewed. However, meeting the goals set in the INDCs is not legally required.

Meanwhile, calls from a majority of states for a legally binding instrument or package of measures to achieve the universal prohibition and elimination of nuclear weapons—a goal as old as the nuclear age—have languished. Despite a recent series of interventions setting out the vision of a world free of nuclear weapons by high-level statesmen—including from the nuclear armed-states—concrete action toward its achievement has lagged, although this has the possibility to change with a new process for nuclear disarmament deliberations and negotiations² currently taking place at the United Nations in Geneva.

This lack of progress on nuclear disarmament has been starkly contrasted by a renewed focus on the catastrophic consequences of nuclear weapons and recent revelations on the kaleidoscope of risks inherent to nuclear policies and postures. The sobering conclusions are that:

- a) as long as nuclear weapons exist, their use, whether accidental or intentional, will be a matter of when, not if;
- b) any use of nuclear weapons in a populated area would have catastrophic consequences on human health, the environment, infrastructure and political stability; and
- c) the use of just a small percentage of the global nuclear arsenal would create climatic consequences that dwarf the current and projected impact of carbon emissions.

The availability of solutions

Overall, the discrepancy between long-term goals and concrete steps undermines the conditions for international cooperation in security and climate policies. Despite growing awareness of the urgency of tackling the climate and nuclear threat among policy-makers, academics and civil society, concrete action is lagging behind.

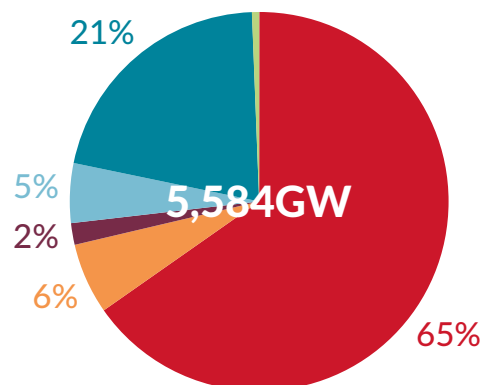
Why is this so, when considering that renewable energy technologies provide viable alternatives? (see Figure 2) By harnessing local renewable energy sources, jurisdictions increase their political and energy independency, while the degree of local and international cooperation needed to

transition to 100% renewable energy can act as a catalyst for cooperation in tackling other transnational security threats. This helps solving geopolitical crises, avoid future armed conflicts triggered by climate instability and resource scarcity, and build cooperative security mechanisms. Similarly, regional initiatives could attempt to tackle both climatic and security threats.

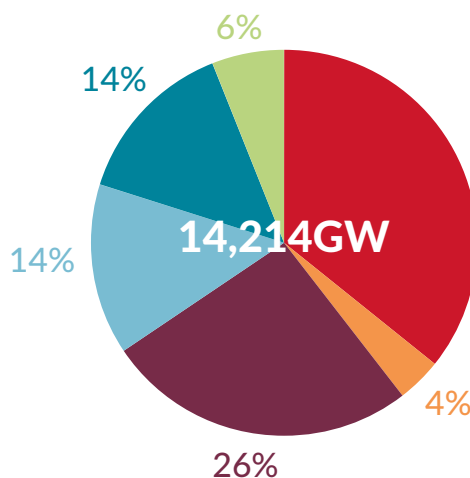
For example, Nuclear Weapon-Free Zones (which already cover the entire Southern Hemisphere – see Figure 3) can, in turn, promote regional environmental and climate protection policies, as exemplified by the Antarctic Treaty System. Such action could also be sought in the Arctic, where the effects of climate change and the dangers of nuclear weapons come together as increased competition over resources and the opening up of routes for military maneuvering and posturing, including with nuclear weapons, can heighten tensions between the region’s powers.

Figure 2. Global installed capacity in 2014 and projected capacity in 2040

Global installed capacity in 2014

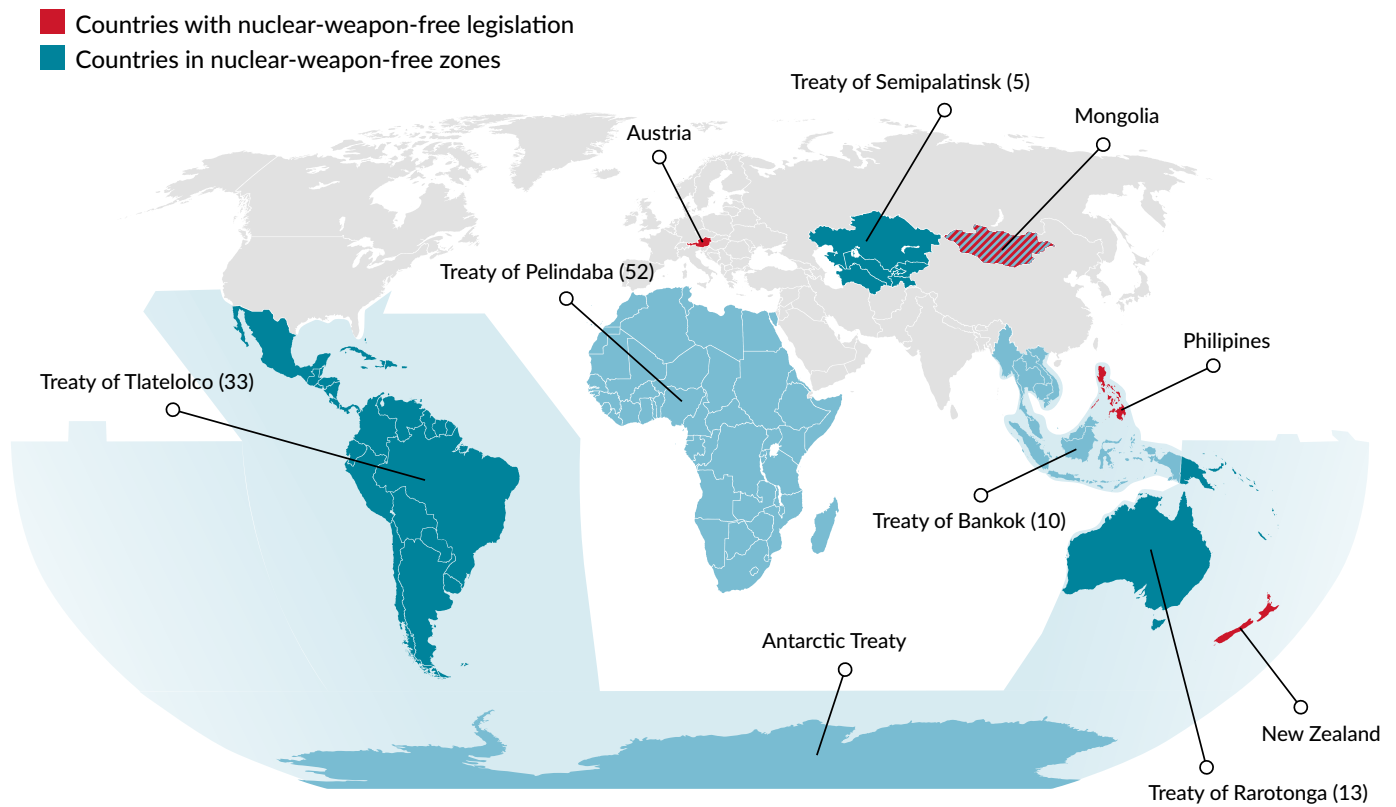


Global projected capacity in 2040



Source: *New Energy Outlook 2015, Bloomberg New Energy Finance*

Figure 3. An overview of existing Nuclear Weapon-Free Zones and countries with national nuclear prohibition legislation



The legal imperative

Finally, there exist international legal obligations both with regard to curbing climate change and achieving universal nuclear disarmament. It is thus not surprising that on both fronts, litigation has been pursued to ensure these obligations are implemented. Climate cases have been filed in several countries, including in the Netherlands, where the Court ruled in favour of the plaintiffs, noting that the State has a legal obligation to protect its citizens, ordering the Dutch government to reduce its CO₂ emissions by a minimum of 25% (compared to 1990) by 2020.

On the nuclear front, the Republic of the Marshall Islands filed applications in 2014 in the International Court of Justice against the nine nuclear-armed states (US, UK, France, Russia, China, India, Pakistan, Israel, North Korea), claiming that they are in breach of obligations relating to nuclear disarmament under the NPT and under customary international law. Cases are proceeding in March 2016 against the three of the nuclear-armed states that have accepted the compulsory jurisdiction of the ICJ—the UK, India, and Pakistan.

A cautionary tale

For the people of the Marshall Islands, and a rising number of people in other parts of the world, the effects of these two threats are not a theoretical, future issue of concern. Behind

the facts and figures are stories of real suffering from climate change and nuclear weapons programmes.

The plight of one group in particular is illustrative of the human impact of the nuclear enterprise and climate change. The inhabitants of the remote Pacific island chain of Bikini Atoll were forced from their homes in the 1940s so that the United States could test its atomic bombs there, bringing with it a legacy of trans-generational effects of radiation exposure, including high cancer rates, birth deformities and environmental poisoning. The lands they had called home were declared uninhabitable.

Now, the tiny patches of earth they were relocated to in the Marshall Islands are at risk of suffering the same fate, as rising sea levels are breaching sea walls, washing over their islands, killing crops and forcing the Bikini Atoll refugees to consider relocating again—this time to foreign continents thousands of miles away.

As if to underline the potentially catastrophic convergence of both perils, there is even the danger that rising sea levels could spill the radioactive waste from testing, which has been stored on the islands, into the ocean. Their experience should serve as a cautionary tale. If we don't seize the opportunities soon to rid the world of these threats, we will drift toward a similar fate. ■

1. <http://www.worldfuturecouncil.org/2015/11/27/the-climate-nuclear-nexus/>
 2. <http://www.unog.ch/oewg-ndn>



The Paris Agreement: built to last

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As the dust begins to settle following the euphoric sense of achievement and relief of UNFCCC delegates during the closing plenary of COP 21 in December¹, the time has come for a reality check.

The outcome of COP 21 certainly gives us reason to celebrate. After a decade of negotiations, research and advocacy, the Paris Agreement represents a turning point in our collective effort to tackle climate change. In many ways, it embodies a fresh start and provides a new foundation for climate policy.

Ambition, with many dimensions

The Paris Agreement is legally binding, making its provisions mandatory for Parties under international law. It is virtuous in establishing an aspirational goal that sets a clear direction and a facilitative framework to guide countries.

The Agreement is ambitious in that it sets a global goal to keep the increase in global temperature well below 2°C by 2100 and to pursue efforts to limit it to 1.5°C. This really is a breakthrough, as it is the most ambitious target ever formalized, and was, for the first time, supported by many developed countries. Parties made the goal more specific by adding a target to achieve global peaking of greenhouse gas emissions as soon as possible, and to reach greenhouse gas emissions neutrality in the second half of this century.

To achieve these goals, countries committed to submit, maintain and frequently review Nationally Determined Contributions (NDCs), which reflect countries' highest possible ambitions. They have also adopted a resilience goal and agreed to a mechanism to address losses and damages from climate change impacts, giving much more prominence to the need of developing countries to deal with the impacts of climate change than ever before.

Developed countries have also reiterated their commitment to provide support to developing countries. The collective goal of mobilizing USD 100 billion a year in support by 2020 was extended through 2025, with a new, higher goal to be set for the period after 2025. Parties adopted a long-term vision for technology transfer, as well as a new Technology Framework and a Paris Committee for Capacity Building.

All of these achievements demonstrate the fact that Paris represents an ambitious and comprehensive framework for decades to come.

Built to last

The high ambition of the collective global goal, combined with the long-lasting, durable nature of the agreement, sends a strong signal to economic actors that the rules of the game will change. And that chances those changes will be irreversible.



In 1997 in Kyoto, countries also agreed to a legally-binding agreement, but they had agreed to come back to the table eight years later to start negotiating a second round of commitments. By then, the world had changed, as many developed countries have claimed over the past decade and the geopolitics were not right to secure a new set of meaningful and impactful commitments by the Parties.

The Paris Agreement is different; it has been built to last. For instance, it formalizes the role of all countries in reducing emissions and in mobilizing climate finance—in a way that the UN Framework Convention on Climate Change (UNFCCC) did not capture—while also recognizing that developed countries must continue to take the lead. In this sense, the clear division between developed and developing countries that had prevailed is now something of the past.

The Agreement has a number of mechanisms built into it that will ensure it will remain relevant and effective, as realities and circumstances of countries change.

First, countries commit to review NDCs every five years with a commitment that there be a progression in each party's successive NDC.

Second, mechanisms for all countries to regularly report, review and update emissions information and progress made in implementing their NDCs will allow countries to both keep each other in check and ensure that pathways are consistent with our collective climate goals.

“Paris sets a clear bearing. It is built to last, but its real impact will depend on political will and governments’ abilities to stay on course”

Third, the Agreement also mandates that countries report on and take stock of adaptation efforts as well as of financial support provided every five years. This is a significant recognition that support is needed for developing countries to mitigate emissions and that their needs for support in adaptation are linked to the global level of ambition. In short, the lower the ambition in mitigation is, the higher the needs for adaptation will be.

These three mechanisms will enable us to collectively get our bearings and to ensure not only that countries’ mitigation actions are enhanced over time for emissions to stay on a pathway to emissions neutrality, but also that developing countries receive adequate support to contribute to mitigation and to adapt to climate change.

In a nutshell, Paris sets a clear bearing. It is built to last, but its real impact will depend on political will and governments’ abilities to stay on course. ■

1. <http://www.iisd.ca/climate/cop21/>



Barriers to implementing sustainable development goals

Deepanshu Mohan and Arun Kumar Kaushik ponder over a range of challenges that developing countries are going to face in fulfilling the ambitious targets set by the UN

The twenty first session of the Conference of the Parties (COP) and the eleventh session of the Conference of Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) took place in Paris last year. As one of the biggest symposiums to discuss climate challenges, organized by the United Nations Framework Convention on Climate Change (UNFCCC), it hosted 147 heads of states and governments. The goal was to establish a 'Paris agreement' as a charter for long term strategy in combating climate change.

The Conference was vital for the future of the whole world, but especially for the developing countries in designing policies on achieving social and economic development while sustainably managing their natural resource endowments and efficiently financing for environmental security. The UN General Assembly's recent resolution¹ on the Sustainable Development Goals (SDGs- adopted on the 25th September as *Transforming our world: the 2030 Agenda for Sustainable Development*) also emphasizes the importance of the 21st session of the COP in reaching an ambitious, universal climate agreement.

It would be pertinent to analyze some of the probable challenges that are likely to crop up from the designed path to sustainable development, as laid down by the UN Declaration on SDGs. In this article, we ponder over a range of challenges that developing countries are going to face in fulfilling the ambitious targets set by the UN.

The resolution on SDGs puts 17 major goals and 169 targets in "building on the Millennium Development Goals (MDGs) and complete what they did not achieve". The MDGs hailed as the 'world's greatest promise'² back in 2000 were part of a first universally designed 'to do list' for developing economies in tackling challenges pertaining to global poverty, hunger, health, education etc. A total of 8 goals and 21 targets were cited by the UN Millennium Declaration (2000)³ "to create an environment - at the national and global levels alike - which is conducive to development and to the elimination of poverty".

Critics of the MDGs strongly advocated against a hem-in design, used in defining most of these goals. According to



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“The two defining challenges in accomplishing this ‘supremely ambitious and transformational vision’ for developing nations lie on the financing and evaluation fronts”

some scholars, it promulgated an enforced consensus of the developed North on the developing South. The designing architecture of the MDGs did avoid

- a) a longer consultative process between those at the UN, the country representatives from developing countries, non-governmental organizations and other civil society members
- b) attaching equitable importance to issues on human rights, climate change, income inequality, peace and security in conjunction with poverty and hunger and more importantly failed to offer
- c) adequate monitoring and evaluative measures in achieving the goals and targets set forth.

The minutiae laid out by the resolution on SDGs attempts to overcome some of the aforementioned issues by allowing for an extensive participatory process between the UN team, the state and non-state representatives from developing member nations, involving diverse civil society groups too. The language of the preamble, albeit ambiguously defined, puts the 4Ps ie. People, Planet, Prosperity with Poverty, at the heart of any policy for attaining ‘inclusive’ sustainable development.

What does this universal declaration on SDGs mean for India, other developing and less developed countries (LDCs) in designing its own path to achieving ‘inclusive, sustainable, peaceful and prosperous’ development?

The two defining challenges in accomplishing this ‘supremely ambitious and transformational vision’ for developing nations lie on the financing and evaluation fronts. In a country like India, where over the last decade the gross expenditure on health as percentage of GDP (public and private expenditure combined) has been around 3-4%, government expenditure on education at around 4-5% of the GDP, it is arcane to imagine how the goals of prosperity and inclusiveness at a sustainable level can be met.

Only recently the Indian central government passed the seventh pay commission,⁴ raising the central government wages by approximately 23.5%, which is further likely to push the government’s total allocated revenue expenditure (on wages and salaries) from being approximately 17% of the GDP to be up by at least 2-3%.

While we do not wish to contest or undermine the importance of state/central expenditure on wages and salaries in pushing for a consumption driven growth, the financing priorities seem to be misplaced and one which warrants to be made more robust in areas of social sector as a precursor to the ‘inclusive, sustainable development’ process.

The resolution on SDGs emphasizes on the use of international public finance, through official development assistance (ODA) as a way to ‘catalyze additional resource mobilization from both public and private sources’. An ideal way for India, the other less developed countries (LDCs), the landlocked developing countries, and the African countries would be to rather push for greater domestic resource mobilization (eg. incentivizing development with more private sector participation) and financial inclusion (through wider access to credit and banking services) than depend on ODA and international financial institutions for financing developmental objectives that are endogenously identified by each economy.

Another major challenge in fulfilling the SDGs is on the monitoring and evaluation of targets, while accounting towards sustainable development. The global agenda on SDGs allows the national governments to have the ‘primary responsibility for follow-up and review, at the national, regional and global levels’ with respect to the progress made in implementing the SDGs and its targets by 2030.

‘Monitoring’ processes examine whether outlays are being rightly met, whereas ‘evaluation’ methods examine if the outcomes are being achieved. It is thus prudent to have a sturdy, independent monitoring and evaluative process that can effectively observe and study the national governments’ progress on policies towards sustainable development.

As a case the UN declaration does acknowledge the problem that baseline data for several of the targets remains unavailable and could be difficult to gather. However, no specific and definitive answers are provided on how such lacuna can be filled by effectively incorporating a mixed evaluative strategy between *qualitative* and *quantitative* methods for measuring targets like gender inequality.⁵

The need of the hour for Indian planners and other emerging economies requires them to think carefully about the methods, processes and policies that would effectively allow us to move towards sustaining development. Being cautiously optimistic, unless some proactive steps are taken to finance, monitor and evaluate the policies at the national, sub-national level, SDGs are likely to go the MDGs way. ■

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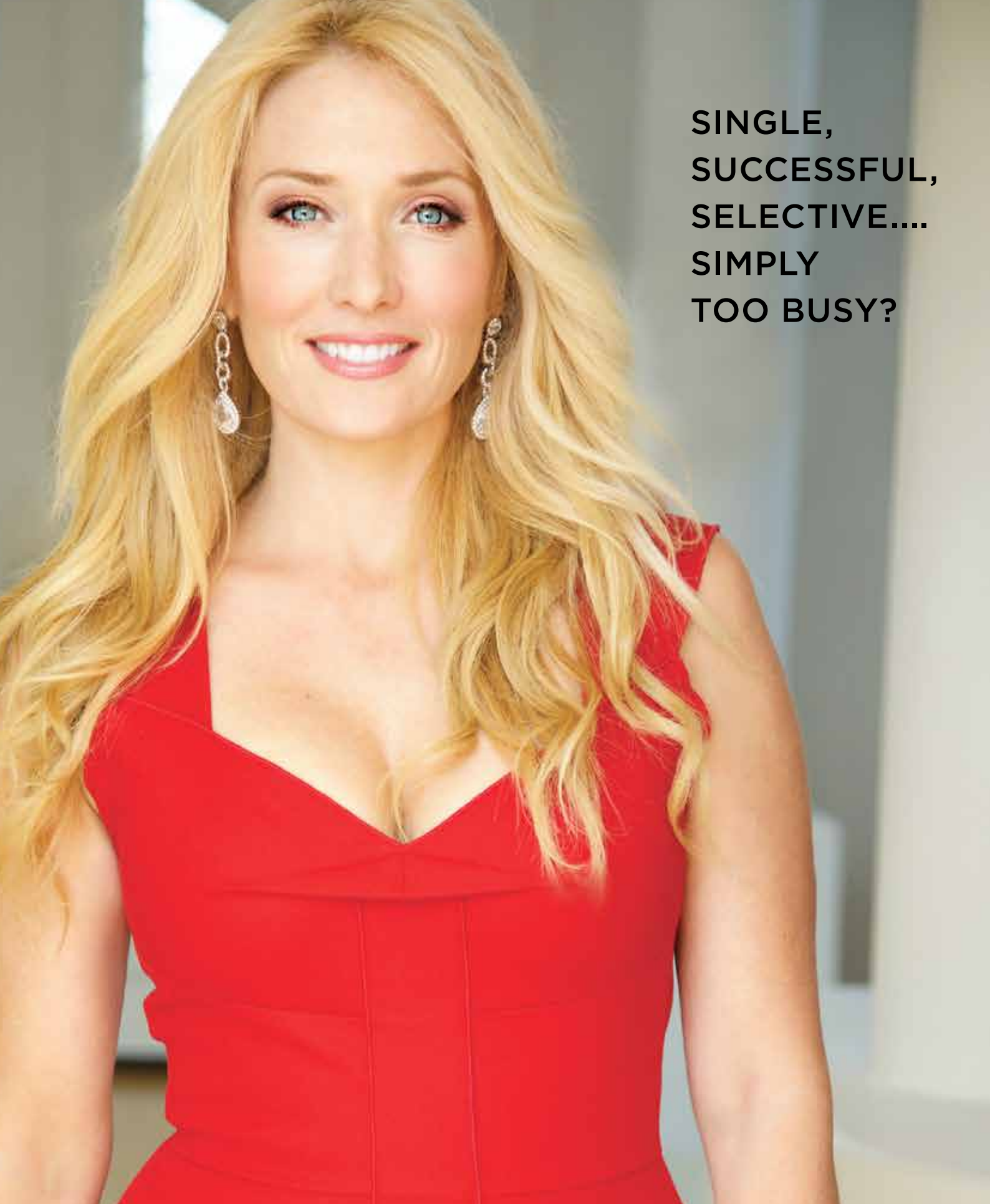
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