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Gateway to Europe

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2. **L**ifestyle of business, sports and event pleasure ***together.*** This is a place to live, work and play. You might have other centres that are dominated by business, but perhaps not as blessed as we are with a sustainable lifestyle, sporting events and sense of pleasure. You might have other places that dominate on lifestyle and pleasure, but don't have a huge business side to them in terms of manufacturing or infrastructure profile. The emphasis for us is on the word 'together', it's the two complementary halves, the business or career half and the social, sporting and lifestyle-family side.

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7. **S**ubstantial, successful, sustainable business base already in place across the primary, secondary and tertiary sectors. It's a case of functional magnetism – companies like to be located synergistically, with more than 65% of the Province's GGP produced in Durban, along with the Durban Chamber of Commerce being the largest Metro Chamber nationally. Business is clustered around the manufacturing, tourism, services, maritime, logistics and agricultural industries. Having the second largest business and industrial base in SA provides many options for suppliers, support services, customers and employees, which are all important factors of production.

These are the 'ALL HITS' Super 7 key reasons that make Durban attractive to both residents and visitors alike.

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A painful holiday's end

It is three years since the start of the financial crisis. Since then we have experienced a financial sector meltdown, a collapse in economic activity and an unprecedented monetary and fiscal response - the worst global slump for more than 70 years.

The financial crisis revealed faults within the global economy, particularly in the western economies. The world is currently divided into two groups of countries: those that are recovering strongly and those that lagging behind. The BRIC countries – Brazil, Russia, India, and China – are in the first group. Even Russia, where the upswing was difficult and hesitant, is expected to grow by over 4% this year.

The second group consists of countries with debt problems, above all the United States. While the US is expected to grow by some 3% this year and next year, this is with a fiscal deficit that is expected to reach 11% of GDP this year, before easing to around 8% in 2011.

Financial reforms have failed to address the fundamental problems. The four factors that resulted in the financial crisis have been partially addressed. Unfortunately, international agreement is not forthcoming, particularly now that governments have to temper their fiscal and monetary stimuli. Global economic imbalances remain, the financial system is still opaque, moral hazard can only be dealt with when governments refuse to guarantee 'casino banking', and more regulation is not the answer to ignorance.

A sustainable and balanced global recovery can be achieved with the successful conclusion to the Doha Round. Doha is vital because the friction on the free flow of goods is holding the world economy back. The amount of wealth generated from a successful Doha conclusion would be huge. The surge in world trade over the past decade was in large part due to the slashing of barriers under Doha's predecessor, the Uruguay Round, which was completed in the early 1990s.

Figures released by the World Trade Organisation show that during the second quarter of 2010 the value of world trade in merchandise rose 25% year-on-year. The WTO numbers show the recovery in world trade is happening not in the West but among particularly the BRIC countries. The West's slow recovery is not holding back global recovery as many predicted. Brazil's largest trading partner is no longer the US, but China. Intra-Asian trade is the fastest-growing component of global trade.

Protectionist sentiments are rising. All sides, the Americans, EU, the Chinese and the Indians, need to compromise. But the West should be leading the charge when it comes to freeing-up world trade. The Western world now needs the boost to investment, growth and jobs that Doha would deliver far more than the fast-growing emerging markets. ■

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US-China relations: storm clouds gathering

Stanley Crossick is a Senior Fellow at the Brussels Institute of Contemporary China Studies (BICCS). BICCS is part of the Vrije Universiteit Brussel and aims to increase European political, economic, social and cultural understanding of contemporary China; and to be an academic hub between Europe and China. It has 12 experts working on China and also an extensive teaching resource. See www.vub.ac.be/biccs

President Hu Jintao's long-planned visit to the United States is not likely to take place soon, as Beijing has postponed the preparatory talks as tensions mount between the two countries. Their relationship has global reach and influences the stability and prosperity of the Asia-Pacific region.

Rising rhetoric

The Chinese Communist Party's *People's Daily* carried an editorial at the end of July asking: *"Is the US ready for China's ascent as a great power?"* It warned that that the two countries are on a collision course if Uncle Sam does not give way. The editorial rejected any expectation that China would become more tolerant with growing global influence. *"When it comes to our national interests, China has no room to manoeuvre."*

During the drill organized by the South China Sea Fleet in July, Chen Bingde (Chief of the PLA General Staff) stressed that (the military) *"should pay close attention to changes in the situation and tasks, and get well prepared for military conflicts."*

The *Washington Post* reported on 30 July that the Obama administration has adopted a tougher tone with China in recent weeks as part of a diplomatic balancing act in which the US welcomes China's rise in some areas but also confronts Beijing when it butts up against American interests.

"... the South China Sea has become a public issue of major tension between the US and China"

The US rejects China's claims to sovereignty over the whole South China Sea and Chinese demands that the US stop conducting military exercises in the Yellow Sea. *"The United States has a national interest in freedom of navigation, open access to Asia's maritime commons and respect for international law in the South China Sea,"* Secretary of State Hillary Clinton said.

Suddenly the South China Sea has become a public issue of major tension between the US and China. Underlying it is the fact that the two powers are geopolitical, and increasingly military, rivals.

Political tensions

Beyond trade, there is a list of discords: Beijing objects to the arms sales to Taiwan, President Obama's meeting the Dalai Lama, pressure on human rights and the joint US-South Korea military exercises in the Yellow Sea (which prompted Beijing to cut off high level military relations).

Washington regrets the 'Google affair', the uncomfortable Obama visit, the Chinese behaviour at the Copenhagen Climate change conference, China's non-intervention with North Korea and its failure to denounce the sinking of the South Korean ship, it's watering down sanctions against Iran and its continuing to trade with and investment in Iran. Missile defence and cyberwarfare concern both countries.

Relations had deteriorated during 2009 but a joint declaration issued during the visit of President Obama to China in November was supposed to herald a "new era" in the relationship. The two parties promised to *"nurture and deepen bilateral strategic trust"*. However, neither side actually trusts the other.

The Strategic Economic Dialogue brought to Beijing in May, US Secretary of State Hillary Clinton, Treasury Secretary Timothy Geithner and 16 cabinet secretaries or agency heads, leading a group of 200 Americans. The meeting was atmospherically successful but without substantive achievement.

Disputes are an intrinsic factor in international trade. The US and EU always have ongoing battles (eg. Boeing vs. Airbus and state aids) but these battles are confined to the trade sphere without political spill over. It is doubtful if this can also be achieved between China and the US, because of the different cultures.

Military dimension

The US and ROK have announced that the two sides will *"present a joint military exercise every month until the end of the year."* The move has drawn strong criticism from Beijing. The exercises placed the Chinese capital within striking distance of the aircraft carrier USS George Washington, which was involved in the drill, Chinese military analysts said.

At a meeting on Asian security in Hanoi on 23 July, US Secretary of State Hillary Clinton pressured Beijing on issues in the South China Sea, over which China has overlapping territorial claims with some neighbours. However Chinese Foreign Minister Yang Jiechi characterized Clinton's comments as *"an attack on China"*. He unusually issued a statement charging that the US was ganging up with other countries against China. Beijing has always opposed any effort to *"internationalize"* the issue.

Xinhua, the official news agency, reported on 29 July that Washington has strengthened its military cooperation in the region, stealthily instigated and supported some local countries to scramble for the Nansha Islands, and has dispatched naval vessels to China's exclusive economic zone to conduct illegal surveys. The agency opined that full control over the waters is necessary for the Chinese navy to better protect its seas and maintain security in the Asia-Pacific region. By trying to internationalize the South China Sea issue, the US wants to put off its resolution so as to contain China's rise. Strategically, Washington wants Southeast Asia to form the centre of an "Asian strategic alliance" (political and economic) that includes Northeast Asia, Southeast Asia and India.

The US, Xinhua says, wants to set up more military bases and positively interfere in security affairs in the Asia-Pacific region. The US covets the comparatively rich oil and gas reserves in the South China Sea, especially as it is keen to control world energy resources, for which it never hesitates to launch a war. Therefore, the US has made great efforts to complicate, extend and internationalize the South China Sea issue and it assiduously attempts to make the sea declared as international waters so that it can wantonly participate in oil exploitation in the region.

In addition, through cooperation with oil companies of Vietnam, Malaysia and the Philippines, American oil giants have participated in exploiting oil and gas in the South China Sea and the US military claims that it is responsible for providing security for these companies.

The US has a national interest in navigation in the South China Sea. In order to secure its control on important sea lanes the US doesn't want to see China cooperating with other concerned countries to resolve the issue. China has persisted in resolving the dispute through peaceful negotiations with neighbouring countries. China never bullies the weak. At the same time, Beijing will never allow external forces, like the US, to interfere in the matter. These are tough words from the official news agency.

Washington continues to worry about the growing military strength and the power of the People's Liberation Army (PLA) – the largest

army in the world, notwithstanding that the gap between the US and Chinese militaries is considerable with the US probably outspending China 10 times. The US, for example, has 11 carrier groups and China none.

Trade tensions

Unfortunately, the increase in South China Sea tensions is happening at the same time as trade tensions increase. Geoff Immelt, GE's CEO, said at a dinner in Rome in June that, *"I am not sure that in the end they want any of us to win, or any of us to be successful."* China is GE's fifth biggest market.

Immelt went further, warning that GE (the world's largest manufacturing company) was exploring better prospects elsewhere in resource-rich countries, which did not want to be *"colonised"* by Chinese investors. *"I really worry about China"*, he told an audience of top Italian executives in Rome, accusing the Chinese government of becoming increasingly protectionist.

"Unfortunately, the increase in South China Sea tensions is happening at the same time as trade tensions increase"

"China and India remain important for GE but I am thinking about what is next," he said, mentioning what he called *"most interesting resource-rich countries"* in the Middle East, Africa, Latin America plus Indonesia. *"They don't all want to be colonised by the Chinese. They want to develop themselves,"* he said. The comments echo a rising chorus of complaints from foreign business groups in China about the regulatory environment they face.

Coca Cola, GE, Goldman Sachs and Google have all come up against difficulties around the same time, which suggests a trend. US trade officials have been concerned for some time that Chinese economic and trade policy is becoming increasingly nationalistic and that, after three decades of extraordinary economic growth, Beijing believes it can now be less welcoming to foreign investment in order to focus on promoting national champions.

Wen Jiabao was told directly by the CEOs of BASF and Siemens that Beijing's current approach to foreign companies *"does not exactly correspond to our views of a partnership"*. BASF and Siemens had combined sales in greater China of more than €9bn ($11.6bn) last year and employ over 36,000 people in China. They complained about foreign companies being compelled to transfer technological and business know-how to Chinese companies in return for market access. They also told Wen that foreign companies *"expect a level playing field in public procurement"*.

The businessmen called for the rapid removal of trade and investment barriers in sectors such as automobiles and financial services. Premier Wen insisted that China remained open to foreign investment and did not discriminate against foreign companies. *"Currently there is an allegation that China's investment environment is worsening. I think it is untrue."*

These American views have been increasingly held but complaints were made privately with silence maintained in public. US and European multinationals appear to be revising their views on doing business in China. The strategy has been that short-term losses would be compensated with long-term gains in a rapidly expanding market. However, there is an increasing worry that foreign companies will be less welcome after the benefits of their technology have been absorbed n China.

Indigenous innovation

China's drive for *"indigenous innovation"* as set out as set out in the *"Long-term Plan for the Development of Science & Technology (2006-2020)"* (MLP) is the root of foreign concerns. The MLP defines indigenous innovation as *"enhancing original innovation through co-innovation and re-innovation based on the assimilation of imported technologies"*. Apparently, many international technology companies see this as a blueprint for massive technology theft. The Chinese are able to build national champions with western technology and a closed market, which then become world leaders, eg. in wind energy.

Both the American and European Chambers of Commerce (Amcham and EUCCC) report deteriorating conditions for foreign companies in China.

President Obama argues that China is posing as a developing country but needs to be treated as the economic powerhouse it is. US Democrats tend to be protectionist and not necessarily believe in free trade. There are many interests against close Sino-American relations, including US trade unionists, Chinese nationalists and both the military establishments.

US multinationals have been the main advocates that a stronger and more prosperous China could be good for America. Thus, this change in attitude of corporate America is ominous.

The danger of protectionist forces having their way increases. The US continues to complain about *"currency manipulation"* and jobs lost to China. Obama is indebted to protectionist trade unions for his election and mid-term elections will be held in November. China increasingly alienates and frustrates western multinationals, thereby weakening the strongest pro-China lobbies in both Washington and Brussels. There is a bill before Congress to exclude China from US government procurement if it does not reciprocate.

Conclusion

We are witnessing at the same time a deterioration in Sino-American political, military and trade relations. This is reflected in unusually vociferous public rhetoric with some aggression being detected on both sides. Deng Xiaoping's axiom *"Keep a cool head and maintain a low profile. Never take the lead - but aim to do something big"*, is no longer the rule.

There is a serious danger of growing protectionism which would be an all-round disaster. The unprecedented decline in US self-confidence can have negative consequences. Due to the financial and economic crisis, China has been catapulted unexpectedly early into a global leadership role, for which it is not yet fully prepared. Chinese leadership sometimes seems to be overconfident and sometimes unsure of itself.

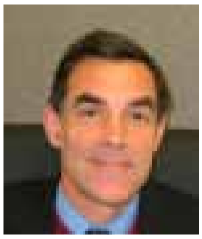
In the past, Washington has kept firmly to the sidelines of tensions in the South China Sea. This has now changed. Washington has declared it a *"national interest"* and Beijing a *"core interest"*, Thus bringing them head to head on the issue of sovereignty.

There is a risk of an intensifying cycle of recrimination, which could take on a life of its own, and become uncontainable. Hopefully both governments appreciate the need to tone down the rhetoric and narrow their differences. In fact, underlying US policy has not changed, merely its public advocacy.

This paper does not suggest that armed clashes are likely or that there will be an early crisis, but the circumstances are such that there are several flashpoints that can result in accidental miscalculation. There is a balance of power game, with the US seeking to prevent China becoming the hegemon of much of the eastern hemisphere.

The current leadership ends in 2012. The major policy decisions governing foreign policy and China's international role will be determined by the fifth and sixth generations of leadership. The sixth generation leaders will come from a generation not scarred in the same way as the present ones by the Mao époque and the Cultural Revolution. They are much more likely to have travelled abroad, even studied abroad, and be able to speak a foreign language. These factors will substantially influence their thinking, but it is premature to forecast in what way. It is hoped that they will be more internationalist and comfortable with the West. And both countries need each other. ■

Brazil: finally on the yellow BRIC road?



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Brazil has risen in international prominence in recent years. The country's rapid rebound after the financial crisis of 2008, its activist foreign policy, its winning of the right to host the 2014 World Cup and 2016 Olympics, and its discovery of vast oil deposits off the coast of Rio de Janeiro, as well as its steady economic growth and sheer economic potential, have captured the imagination of investors, politicians, and other observers. This rising interest has led to a certain amount of triumphalism with regard to Brazil's future, and the country is frequently hailed as one of the world's most important "rising powers", together with China, India, and Russia (the so-called BRICs), as well as other contenders for such a title. But is the optimism justified?

Few people are aware of the long and difficult journey the country has travelled to achieve its current stability and growth. The last twenty-five years have seen many false starts, crises, and failures as the country's political system, economic policies, and role in the world economy have been transformed. These changes have contributed to Brazil's current position as one of the world's most important emerging markets, a position enhanced by some genuinely unique advantages. Nevertheless, potential bottlenecks and pitfalls also exist, and these have to be recognized in any thorough evaluation of the country's prospects. This article will survey important recent developments in Brazilian political economy, highlight the country's strengths as an economic powerhouse, and critically review the challenges it faces. It will conclude by arguing that there are good grounds for being cautiously optimistic about a country that already has the world's 5th largest population and its 8th largest economy.

> **"Few people are aware of the long and difficult journey the country has travelled to achieve its current stability and growth"**

A path to prominence

Twenty-five years ago Brazil was emerging from 21 years of military dictatorship. It was a politically polarized country undergoing a debt crisis, with a distressed public sector, high inequality, and widespread poverty most noticeable in urban slums filled with tens of millions of recent migrants from the countryside. Although long a home for transnational corporations, Brazil had many protectionist barriers to imports and foreign investment. It also was enduring chronic and rising inflation, which exacerbated income inequality and led to serious economic inefficiencies and distortions. A series of failed economic plans had been unsuccessful in stabilizing the economy. While the new constitution, ratified by Congress in 1988, raised hopes for an era of democratic stability, the first popular election for president since 1960 only took place in 1989.

In 1994 the introduction of the *Real Plan* changed the trajectory of Brazil's economy. Chronic annual inflation rates of three digits were replaced by a rate under 7 percent. It has remained roughly at that rate ever since, ushering in an era of unprecedented stability and growth for the country. The success of the *Real Plan* led to the election of one of its promoters, former Finance Minister Fernando Henrique Cardoso, who served as president for two four-year terms, from 1995 to 2003. Under Cardoso, Brazil's political economy experienced major changes. Tariff barriers were lowered, and many state-owned enterprises in sectors such as aviation, telecommunications, electricity, banking, and mining were privatized. Foreign direct investment surged. A regional free trade agreement, MERCOSUR, consisting of Argentina, Brazil, Paraguay, and Uruguay, was consolidated, spurring a rise in regional trade that complemented increasing exports to countries outside the region.

Under Cardoso and his party the PSDB (*Partido da Social Democracia do Brasil*, or Social Democratic Party), which forged an alliance with conservative parties, the Brazilian economy was liberalized, but new forms of state intervention were also implemented. A major land reform took place, involving the expropriation of unproductive land and its distribution to millions of poor rural Brazilians. Social spending increased. An innovative programme called *Bolsa Escola* (School Allowance) transferred small amounts of money to low-income families who kept their children in school, boosting both aggregate demand and school enrolments. Federal-state relations were also altered. A fiscal responsibility law, passed in 2000, tied federal transfers to the states to caps in state governments' spending, thus reining in the proclivity of state governors to over-borrow and overspend.

The Cardoso administration did not experience eight uninterrupted years of smooth sailing. In late 1998 and early 1999 the Russian debt default triggered capital flight and a precipitous devaluation of Brazil's currency, the real. This, in turn, engendered a mild recession in 1999. Cardoso's enthusiastic embrace of neo-liberalism was also controversial, and not entirely popular. However, the main legacy of the Cardoso administration was that of unprecedented macroeconomic stability and enhanced social spending. It was this legacy that Cardoso's successor, Luís Inácio "Lula" da Silva, built upon in his eight years as president, from 2003 to 2010.

President Lula is a very different personality from former President Fernando Henrique Cardoso. Cardoso, the son of a general and an influential sociologist who had taught at the University of São Paulo, Brazil's top university, is a member of the traditional ruling class. He is cosmopolitan, has lived in Chile, France, and the United States, and speaks English and French fluently. President Lula is a person of much more humble origins. He was born in the countryside outside of the town of Garanhuns, in the interior of Pernambuco, a poor north-eastern state. He speaks no foreign languages, and is criticized for his errors of Portuguese grammar. He migrated to São Paulo with his family as a child. With only five years of formal education, Lula worked as a shoeshine boy before landing a job as a lathe operator in an automobile factory in one of the industrial suburbs of São Paulo. He later became a trade union leader and in the late 1970s emerged as an iconic figure of opposition to the military regime of 1964-1985. A founding member of the Workers' Party (*Partido dos Trabalhadores*, or PT), Lula ran for president unsuccessfully in 1989, 1994, and 1998, before winning the 2002 election with 61 percent of the valid vote.

While President Cardoso opened up the Brazilian economy, President Lula democratized access to the fruits of that economy. President Lula retained the orthodox economic policies of his predecessor, paying off an IMF loan early and maintaining good relations with the business community, especially key financial and business interests based in São Paulo. However, this economic continuity was complemented by a major commitment to boost the living standards and opportunities of the poor. His government adapted *Bolsa Escola* to create *Bolsa Familia* (Family Allowance), a conditional cash transfer programme that now covers 11 million families, or more than 40 million people. *Bolsa Familia* requires recipient families to keep children in school and have them receive immunizations in return for small monthly stipends. The Lula administration also increased the real value of the minimum wage, and introduced a subsidized mortgage programme (*Minha Casa Minha Vida*, or My House, My Life) that made home

ownership affordable to many low-income Brazilians. Another programme, *ProUni*, provided scholarships to private universities for low-income students. And from 2004 to 2008, Brazilians' access to credit also expanded dramatically. Credit available to individual consumers rose from R$139 billion (roughly £54 billion at current exchange rates) to R$394 billion (or £152 billion), an increase of almost 300 percent. Partly as a result of these developments, poverty has fallen significantly under the Lula administration. Whereas 49.5 million or 28.5 percent of the total population in 2003 lived under the poverty line, this figure was only 29 million, or 16 percent of the population, in 2008. Equally important, income inequality, while still very high, has begun to fall.

The commodities boom, spurred in part by increasing demand from China, helped the Brazilian economy over the last eight years. Last year China replaced the United States as Brazil's leading export market, and Brazil exports iron ore, soy, and other products to China. While its average annual GDP growth has been slower than that of other BRICs in the last decade, the rate jumped to 9 percent in the first quarter of 2010, and the country's recovery from the 2008 financial crisis has been remarkable. Its international reserves ballooned to $250 billion, the budget deficit is only 2.1 percent of GDP (compared to the average of 10.2 percent in the G20 countries) and its country risk rating declined from 677 in October of 2008 to 234 in May of 2010. Formal sector employment has increased steadily during the Lula administration's two terms in office, fuelling the expansion of the domestic market, and foreign direct investment in the country, buoyed by a wave of mergers and acquisitions, remained robust in 2009 at $25.9 billion.

"It is expected that at the end of 2010 there will have been more Brazilian investment abroad that year than foreign investment in Brazil. This is a significant change in Brazil's relationship with the world economy, and implies a growing global presence of Brazilian multinationals"

In recent years, Brazil's export performance has been impressive. In 2008, its exports were almost $200 billion, with a trade surplus of $25 billion. Significantly, Brazil's exports are roughly evenly divided between manufactured goods (44 percent of total exports in 2009), on one hand, and agricultural and mineral primary products (40.5 percent) on the other. It is a major exporter of automobiles, steel, and aeroplanes, but also sugar, coffee, soy, orange juice, iron ore, poultry, beef, and cotton. This provides some stability that may not be available to Russia, which principally exports energy, or China, which relies almost exclusively on the export of manufactured goods. Furthermore, Brazil does not over-rely on one region of the world in its commercial relations, with a rough balance between the United States, the European Union, and Asia as the principal destinations for its exports. Brazil's well-regarded diplomatic corps has also worked hard to diversify the country's trade links, especially with developing countries, in recent years.

It is expected that at the end of 2010 there will have been more Brazilian investment abroad that year than foreign investment in Brazil. This is a significant change in Brazil's relationship with the world economy, and implies a growing global presence of Brazilian multinationals. The Brazilian development bank the BNDES (*Banco Nacional do Desenvolvimento*) provides subsidized loans to companies wanting to engage in joint ventures, acquire technology, or otherwise expand their activities abroad. It could be that in the coming years Brazilian multinationals such as Petrobras, Compania Vale do Rio Doce, Oderbrecht, Gerdau, Embraer, Perdigão, Sadia, and Votorantim will become as well known abroad as they are in Brazil.

Business opportunities will abound in Brazil in the coming years as the disposable income of its population of 190 million rises. Brazil's capital markets have deepened, and some of the world's largest share offerings are taking place there. Foreigners buy about two thirds of those shares, and account for roughly one-third of the daily trading volume in the São Paulo stock exchange. The Brazilian government is also planning to invest $6.4 billion in infrastructural improvements prior to the 2014 World Cup.

The Lula administration's foreign policy has also been adventurous, as well as somewhat controversial. Adopting positions independently of the United States, the Brazilian government tried to broker a compromise after the 2009 coup d'état in Honduras, was recognized as a major player at the Copenhagen climate change summit at the end of 2009, and, together with Iran and Turkey, tried to engineer a compromise agreement about Iran's nuclear programme in early 2010. These initiatives, together with the opening of many new embassies in Africa, a broader emphasis on South-South relations, and a persistent pursuit of a permanent seat at the United Nations Security Council, have won Brazil recognition as a mid-level, moderate power on the global stage. Brazil also continues to manage the United Nations relief operation in Haiti, MINUSTAH.

Is God Brazilian?

Brazil has three remarkable advantages that augur well for its growth prospects. First, it is self-sufficient in energy (unlike China and India, for example, which are energy importers) and almost half of the energy it uses (47 percent) is renewable (mainly hydroelectric and ethanol made from sugar cane). This contrasts with an average of only 7 percent among OECD countries. In addition, once production from the deep-water oil fields begins, Brazil is likely to become a major petroleum exporter. Second, Brazil has an enormous frontier of arable land, more than that of any other country at 300 million hectares, according to one estimate. Therefore its highly productive agricultural sector, already a major contributor to Brazil's trade surplus, has room to expand and increase production without needing to encroach on the Amazon rain forest. Third, Brazil has an abundance of fresh water, or more than 8,000 billion cubic kilometres per year, according to the United Nations. Given that shortages of fresh water are thought to be a potential source of conflict in the future, this gives Brazil an enviably self-sufficient position when it comes to three vital natural resources.

In addition to these key factors, there are complementary characteristics that should make Brazil an attractive site for investment in the future. South America is a nuclear-free zone with no major border disputes and relatively peaceful relations between neighbouring countries, with the possible exception of ongoing tensions between Colombia and Venezuela. This contrasts with other BRICs who face the possibility of serious conflicts with neighbours (for example, between India and China, or India and Pakistan) or who have major internal conflicts (for example, Naxalite rebels in India, or Chechen separatists in Russia). In addition, Brazil has the best university system in Latin America, with considerable capacity for research and development and burgeoning links with private sector companies. Finally, 60 percent of the Amazon rain forest is in Brazilian territory, which makes Brazil responsible for about one third of the remaining tropical rain forest in the world. If properly maintained, the rain forest's biodiversity represents an important future asset. It also gives Brazil a pivotal position in international efforts to deal with climate change.

The dark side

Brazil is not without its problems, however. Challenges to its continued growth and emergence as a mid-level global power exist. The very slowness of the country's emergence as a politically stable and economically developing country suggests the possibility that various barriers could continue to impede social and economic progress. Some of these barriers are technical, while others are more deeply rooted in society and thus more intractable.

Within the business community, the barriers to continued development most frequently identified are infrastructure, taxation, pensions, and the party system. Poor infrastructure, especially roads, airports, and ports, drive up the cost of business and deter investors.

According to Welbar Barral, of Brazil's Ministry of Development, Industry, and Foreign Trade, the cost of transporting soy from Matto Grosso, a state in the western part of the country, to a Brazilian port is as high as the cost of shipping the same product from the port all the way to China. Because of the precariousness of its infrastructure, Brazil cannot continue growing at 9% per year, according to Barral. Existing infrastructural bottlenecks drive up transportations costs for businesses and deter foreign investors. A complex and onerous system of taxation poses an additional barrier to economic expansion. The percentage of the Brazilian GDP taken up by tax revenue – around 40 percent - is very high by Latin American standards, and is comparable to that of a social democratic country such as the United Kingdom. Few Brazilians, however, would claim that they receive state services comparable in quality to those provided in the UK. High rates of taxation inhibit formal-sector business activity and induce some people and firms to engage in informal economic activities. In addition, the federal government's pension system is underfunded and quite inegalitarian, skewed towards the payment of very high pensions to a few top civil servants.

Electoral laws are also very permissive, with low barriers to the creation of new political parties. This has resulted in the presence of dozens of different parties in the national Congress, with no recent president able to count on a majority of his own party in either the Senate or the lower house (*Camara dos Deputados*). The transaction costs of passing legislation tends to be high in this system, which has been called one of coalitional presidentialism. Critics repeatedly call for its reform, by which they usually mean a change of rules that would diminish the number of political parties. Some observers also link the high number of parties to the problem of political corruption. While the investigation of corruption has improved in recent years, it is still very rare for a politician to be punished for the theft of public money. This climate of impunity undermines the vitality of Brazilian democracy and the quality of political representation.

Brazil has still not fully escaped the legacy of its nineteenth century past, when it was the largest slave-holding society in the world. While recent decades have seen the growth of civil society organizations, and a fuller realization of citizenship rights on the part of the socially excluded, crime, violence and human rights violations are a fact of life for many Brazilians. An illustration of this problem came in August 2010, when gang members from the Rocinha slum in Rio de Janeiro temporarily held several guests hostage in the up market Inter-Continental Hotel. This incident revived concerns about the ability of the Brazilian government to maintain security during the 2014 World Cup and 2016 Olympics. More broadly, it highlights the desperate conditions under which millions of inhabitants of *favelas* (slums) live. In 1960, 70 percent of Brazil's population was rural; today, about 84 percent is urban. In several decades millions of people migrated to cities, where they lack access to basic urban amenities and live in overcrowded, hand-built communities that are often dominated by drug-traffickers or militias.

The crime problem is linked to this pattern of inequality and social exclusion. Poorly trained and underpaid police forces often react to perceived threats with violence, directed with impunity at the poor. The courts are overwhelmed with criminal cases. Brazil's prisons are in poor condition, because the population of inmates has been increased without any corresponding increase in spending, and many prisons have seen serious incidents of violence and criminal activity. It is unlikely that these problems of public insecurity can be solved except in the long-term, as slum housing is gradually replaced by better structures and *favelados* are gradually integrated into the cities' political and social networks.

Another problem in Brazil is the poor provision of elementary and secondary education. This is a challenge that successive Brazilian administrations have been unable to address. Members of the middle class, who once sent their children to state schools, have long migrated to private schools. A similar development has occurred in the health care system, where private insurance companies provide care for those who can afford it, while the public health care system attends to the poor.

Many of these problems will not necessarily be addressed within the political system. The 2010 presidential election, in which President Lula is constitutionally barred from running, features more continuity than change. On one hand Dilma Rousseff, President Lula's former chief of staff and hand-picked successor, is likely to win because of the strong economy. On the other hand Jose Serra, from President Cardoso's PSDB, offers policies that differ little from that of the current government, except perhaps in the area of foreign policy. However, a third candidate, the former Minister of the Environment Marina Silva, has raised another problematic issue only partially addressed by the Lula administration. In some instances the Lula administration seemed to see environmental issues as obstacles to, rather than facilitators of, economic development. This zero-sum mentality does not square with contemporary notions of sustainability nor the scientific consensus about climate change, and leads some foreign observers to worry about Brazil's capacity to manage the Amazon rain forest. Twenty percent of the forest in Brazil has been destroyed in the last four decades, a rapid rate of destruction. Ninety-three percent of the coastal rain forest, the Mata Atlantica, was destroyed from 1500 to the present, but few people would like to see the same pattern repeated with the Amazon forest. While Brazil has made progress in slowing the rate of rainforest destruction, its responsibilities in this area remain a concern to outside observers.

Other concerns about Brazil are more specific. Interest rates remain stubbornly high at over 10 percent per year, some of the highest in the world, inhibiting productive investment. The exchange rate of 1.77 reais per dollar is too high for many exporters, who would like to see it decline to at least 2 reais per dollar. In addition, the bureaucratic and legal regulations surrounding the creation of new businesses are cumbersome and subject to discretionary interpretation, leading to complaints that the Brazilian government stifles innovation and employment generation, especially in the small business sector.

With regard to foreign policy, it does seem that Brazilian leadership is often more accepted globally than it is in its own region of influence, South America. Brazilian "soft power" is considerable outside of South America. Its reputation for peaceful negotiations and diplomatic problem-solving; its tolerant, multi-racial, multi-ethnic, and religiously pluralistic society, with the largest population of people of African descent outside of Africa; and its attractive devotion to music, dance, and football all make it a welcome interlocutor in many parts of the world. But neighbouring countries of its own region, such as Argentina and Peru, sometimes view its diplomacy with suspicion, and Brazil has not always been able to prevail in its own "backyard", despite the frequent negligence and lack of clear policy guidelines on many issues on the part of the United States. This is perhaps a paradox of Brazil's rising power in the world – it has been more effective as a mid-level global power than it has as a regional hegemon in South America.

Conclusion

The world seems to be entering a new era in which the emerging BRIC economies and their associates will become increasingly important to global production, trade, and investment. According to one study, by 2050 only two of the existing G-6 economies – the Japan and the United States – will still be in the G-6, while the other four places will be taken by Brazil, China, India, and Russia. Such long-term forecasts must be taken with a grain of salt, but it seems clear that the old hierarchies in the international division of labour are dissolving, leading some commentators to go so far as to declare the end of the "Third World".

Whichever way the global correlation of forces lines up, Brazil is likely to have a prominent place in the new global order. While the country long under-achieved in terms of economic development and punched below its weight on the global stage, it has achieved a level of political stability and economic maturity that makes its status as a mid-level global power more than chimerical. Of the BRICs, Brazil can probably claim the most robust democracy, the most peaceful foreign policy, and the best endowments in terms of energy, arable land, and water. These are important advantages in what is likely to be a tumultuous period. Problems persist, and complacency on the part of its leaders would be dangerous, but it does seem to be the case that the country of the future will come into its own in the 21st century. ■

The international economic crisis and the Cyprus economy – future prospects and competitive advantages

Charilaos Stavrakis is the Minister of Finance of the Republic of Cyprus

It is a fact that the Cyprus economy has not been directly affected by the financial crisis, due to the negligible degree of exposure of the Cypriot banks, insurance companies and provident funds to toxic products. However, the real economy has inevitably been affected in an indirect manner, due to its small size and open nature. Consequently, the rate of economic growth in 2009 decelerated to around -1.7%, a percentage which compares favourably to the EU average, which was -4%.

The impact of the crisis on the Cyprus real economy is mainly attributed to the deteriorating export demand, which mainly affected the sectors of manufacturing, construction, real estate and tourism. The significant economic deceleration that the UK faced in 2009 had a major impact in the tourism sector, since roughly half of the total number of tourists visiting Cyprus come from the UK. Similarly, a slowdown in the construction sector has been evident, as the external demand for housing in Cyprus stems mainly from UK citizens.

It is important to note that the crisis affected Cyprus with a time lag, henceforth 2010 is expected to be, at least, as challenging as the year 2009. However, some positive economic developments have been observed in the first half of 2010, showing that the Cyprus economy is slowly exiting from the economic crisis but there is still uncertainty.

As regards employment, while employment growth remained robust in some sectors, in other sectors, more directly exposed to the external slowdown, an increase in unemployment has been observed. The unemployment rate is expected to rise further in 2010, due to the time lag which takes place between growth and unemployment.

In a table format, the main economic indicators are presented for the years 2007-2009

	2007	2008	2009
Rate of growth of GDP (%)	5.1	3.6	-1.7
Per capita GDP in PPS, (EU-27 = 100)	93	96	98
Rate of inflation HICP (%)	2.2	4.4	0.2
Unemployment rate (%)	3.9	3.7	5.3
Employment growth (%)	2.8	2.7	0.8
Fiscal position (% GDP)	3.4	0.9	-6.1
Public debt (% GDP)	58.3	48.4	56.2

Given the challenges provoked by the crisis the Government of the Republic of Cyprus, acting promptly and decisively, took timely measures which mitigated the repercussions from the global economic crisis. We made a conscious effort to adopt an expansionary fiscal policy, with the basic axes being the increase in investment and social expenditure, aiming at boosting investment and demand, as well as social cohesion. These measures concerned the two most important sectors of the economy, the construction sector and the tourist sector, which were hit the hardest.

At the same time, we adopted targeted measures to boost employment and to fight unemployment, in close cooperation with social partners. I would like to stress here, that the *Report of the European Commission for Cyprus*, evaluating the measures taken to confront the crisis, characterized them as timely and correct.

Due to the fiscal impact of the measures mentioned above and the deceleration of the economy caused by the international crisis, a marked deterioration of the public finances has occurred. In response to this negative development the Government has prepared a broad policy framework for fiscal consolidation, which has being intensively discussed with social partners and political parties in order to reach a broad consensus, which is essential for a successful reform. Notwithstanding the challenging economic environment which Cyprus is facing, the overriding aim of this fiscal consolidation strategy is to reduce the deficit to 6% in 2010 and to continue with the correction thereafter, bringing it to below 3% of GDP by 2012.

The strategy includes measures, inter alia, such as amnesty on the issuance of title deeds for buildings with minor irregularities, specific actions to tackle tax evasion and tax avoidance, a systematic attempt to curtail current expenditures, public sector reforms which will address the growing size of civil service and bring about a bridging of the benefit gap with the private sector, and a careful reform of the system of social transfers in order to target better benefits and help more those in greater need. Some of these measures are already being implemented, while others are and some are pending for discussion in the House of Representatives.

In the medium term, the general economic goal of this Government is to achieve high economic growth, which will result in the creation of more and better jobs. In combination with the implementation of a prudent social policy, the ultimate goal is to create a high level of prosperity for all citizens. However, it is true that the global economic crisis highlighted the fact that the Cyprus economy needs to be further diversified, in order to be able to compete well in a highly competitive environment. As a result, the Government is planning to implement a number of structural measures, as analysed in the National Reform Programme that Cyprus has to prepare every year, in the context of the Lisbon Strategy. The Government, among other, aims at upgrading and enriching the tourist product through the construction of new marinas, golf courses and a scheme for the creation of new and upgrading tourist accommodation units. It also aims at enhancing the competitiveness of the manufacturing sector.

Moreover, my vision for the Cyprus economy in the medium term is to be established as an international business, health and cultural centre, offering high quality services and attracting foreign investment from all over the world. I also envisage a greener and more sustainable economy, where the use of renewable energy resources will constitute the bulk of the energy mix, thus setting the Cyprus economy free from oil dependency.

As regards Cyprus as an international centre, the Cyprus economy exhibits a series of significant comparative advantages that attract a significant number of investors. Despite the economic crisis, Cyprus economy maintained its economic advantages, namely, low corporate and personal income tax (the uniform corporate tax rate of 10% is the lowest corporate tax rate in Europe). Cyprus also exhibits a well educated workforce, social cohesion which is based on a long tradition of co-operation between employers, unions and the government, modern infrastructure in transport, energy and telecommunications, high quality consultancy services such as legal, accounting, auditing, modern and transparent legal, financial and accounting systems modelled to that of Britain and a fully liberalised foreign investment policy. In addition, the adoption of the euro on the 1st of January 2008 has further strengthened economic growth and foreign investment, through the improvement of the overall business environment. Moreover, the taxation system is also friendly to non-residents and businesses, since, for example, it abolished withholding taxes on interest and dividends. Cyprus already disposes a wide network of agreements for double taxation avoidance with more than 40 countries and intends to expand it even more.

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In order to create a more favourable business climate so as to further exploit Cyprus` position as a European business hub, the Government of the Republic of Cyprus intends to implement the following:

- simplification of the regulatory framework and the reduction of the administrative burden for business;
- continuous upgrading of the infrastructure in transport, energy and communications;
- promotion of research and innovation;
- further development of human capital

Furthermore, the Government of the Republic of Cyprus has recently established the "Cyprus Investment Promotion Agency", in order to promote Cyprus more effectively in overseas markets, as an attractive foreign investment destination and a centre for international business operations. In addition, in order to facilitate and expedite the whole process of establishing operations in Cyprus, the Government has set up "One-Stop-Shop" under the auspices of the Ministry of Commerce, Industry and Tourism, for both local and foreign-based companies.

To conclude, I am confident that Cyprus will come out of the international crisis stronger and that the structural measures envisaged to be adopted by the Government in the short and medium term, will be sufficient to further establish the Cyprus economy as an ideal place for conducting business activities. ■

What future EU trade policy needs to deliver!

Philippe de Buck is the Director General of BUSINESSEUROPE

A competitive framework for the future EU trade policy

The economic crisis triggered a 9% decline in global trade in 2009 and created pressure for protectionist measures. Although the worst-case scenario of full blown protectionism has been avoided, more than 220 potentially trade-restrictive measures were adopted around the world, affecting around 5% of EU exports. To keep markets open, the EU should continue to monitor and push for the removal of protectionist measures, especially since high unemployment and budget deficits can increase pressure for restrictive or discriminatory measures. Europe should convince trading partners to abandon protectionist measures such as export taxes, tariff increases and "buy local" provisions in procurement rules.

In this context, the EU's Global Europe strategy has served Europe well since its launch in 2006. We believe that its economic orientation and main components must remain in place if the EU is to continue to be competitive in the future. Certainly, changes have taken place in recent years, not least the economic crisis, the drive towards greener growth and the adoption of the Lisbon Treaty. An updated trade policy will need to take these into account.

However, the EU must address these new realities while remaining fully aware of trade's primary purpose – to generate long-term growth and employment in the European economy. The EU's Common Commercial Policy must work to support EU competitiveness, and is therefore a crucial component of the EU's 2020 growth strategy. A first milestone for the future trade policy will be to define the EU's strategic objectives – mid-term and long-term, especially vis-à-vis the large emerging countries, but also towards its more traditional trading partners like the US, Japan or Canada. To reach the growth objective of the Europe 2020 Strategy, trade policy should deliver real market access for European companies, to enable them to growth and boost employment. There are five components to such a successful market access strategy:

- Avoiding and fighting protectionism.
- Advancing multilateral and bilateral negotiations.
- Arranging regulatory cooperation.
- Asserting EU interests when cooperating with strategic partners.
- Addressing enforcement needs.

Trade policy should also be coherent with the EU's internal market and industrial policies. For instance, the EU should aim at promoting a strong and stable intellectual property regime within and outside the EU to foster innovation and the commercial deployment of new technologies. In addition, support should be given to areas in which the EU has a competitive advantage over its main trading partners; as in innovative and low carbon technologies. Moreover, specific attention should be given to open public procurement markets which account for a significant share of global GDP.

Trade negotiations will prove meaningless without a strong EU enforcement policy to ensure that trade partners live up to their commitments. One way to improve the situation could be to make changes to the Trade Barriers Regulation that would create a stronger obligation on the European Commission to launch action through the WTO if trade violations are established. This would also increase uptake of this mechanism. The EU should take a firmer line against countries which do not respect their international trade commitments, including appropriate and credible enforcement measures when there are violations of WTO or other international trade agreements.

Advance multilateral and bilateral trade negotiations

BUSINESSEUROPE remains convinced that an ambitious and balanced WTO Doha Round deal is the best way to deliver trade liberalization for the world economy. The European Commission should make the WTO negotiations an immediate priority and press for a rapid, ambitious and balanced conclusion in its multilateral and bilateral contacts. Apart from ambitious tariff liberalisation in the field of goods, substantial and meaningful improvements in key services sectors and modes of supply are needed to create the new business opportunities essential for economic growth, development and job creation. Key emerging countries, in particular Brazil, India and China, will have to make contributions according to their economic and political weight. Specific sectoral agreements in goods – chemicals, renewable energy and energy efficient power equipment, machinery, gems and jewellery, footwear – as well as in services should be part of an ambitious Doha outcome.

The great benefit of the multilateral trading system is that it provides a system of rules to govern international commerce. As a way to strengthen the global rules-based trading system, the EU should continue to work in particular with Russia on its WTO accession, and with China to join the WTO Government Procurement Agreement.

While firmly committed to the Doha Round, bilateral free-trade agreements are essential to increase market access for European companies in fast-growing markets like South Korea, India, South East Asia and Latin America (MERCOSUR). The EU must strongly promote its export and investment interests in these negotiations in close cooperation with European business.

The EU-South Korea Free Trade Agreement will bring significant benefits to a majority of European firms and will be the first FTA concluded under the Global Europe trade strategy. BUSINESSEUROPE

supports its ratification, accompanied by strong implementing measures. These must address the concerns of parts of the business community by using all avenues provided under the terms of the agreement. The measures must ensure that both parties abide fully by their commitments – especially regulatory cooperation and in the removal of non-tariff barriers – and that safeguard procedures are enforceable and duly applied where justified. Under these conditions, the agreement needs to enter into force by the end of the year.

BUSINESSEUROPE will also advocate for the rapid adoption under Lisbon Treaty rules of the free trade agreements concluded with the Central American region, Colombia and Peru. These agreements will increase business opportunities on both sides of the Atlantic in a mutually beneficial way.

The EU needs to advance convincingly on the other major deals on the table according to the criteria that agreements need to deliver full access for European goods, services and investment. The full range of barriers faced by companies in these markets must be tackled, including tariffs, additional duties on imports, export duties, non-tariff barriers including regulatory measures, restrictions on trade in services, investment barriers, public procurement, intellectual property rights, access to raw materials, dual pricing and governance issues. BUSINESSEUROPE wishes to see high quality results in all cases, but will not support long drawn-out discussions that have little hope of conclusion. If no progress is being made, negotiations should be re-evaluated.

" … the EU must address these new realities … to generate long-term growth and employment in the European economy"

Looking forward, the EU will need to keep an open mind about future negotiations. Commercial interests and economic factors must continue to be the determinants of new discussions. Ultimately companies will benefit most from liberalisation with Europe's biggest trading partners, and fast growing but highly protected economies.

Address non-tariff barriers

Non-tariff or regulatory measures often create distortions to market entry for European companies around the world. They include everything from health and safety disciplines to technical standards, creating intentionally or unintentionally discrimination against foreign competition. In addition, Europe's own regulatory regime creates huge burdens for EU industry that make it very difficult for exporters to compete globally. The Global Europe strategy clearly recognises that the EU should take these effects into account when legislating internally, but this has not been fully implemented. Companies do not question the need for regulation to achieve important policy goals, but they seek transparent, proportional and science based regulation that minimises international trade and investment distortions. Both negative and positive changes in the regulatory environment which have effect on business should therefore be as predictable as possible by improving early warning mechanisms.

Regulatory divergences can also undermine trade and investment. The EU should use its bilateral dialogues, in particular with the US but also with China, Russia and Japan, to prevent damaging regulatory divergences and develop regulatory convergence on the basis of open and pro-competitive standards for industrial and services markets. In this context, BUSINESSEUROPE would like to see a more concrete strategy emerge. Supported by a thorough impact assessment of possible approaches and solutions, discussions should focus on selected economic sectors in which progress would seem most promising or where the EU has the biggest economic interests. More harmonization and mutual acceptance of products and services serve the interests of both sides involved in regulatory dialogues and will strengthen the competitiveness and growth of both economies. These common goals and perspectives should be better stressed throughout the relevant discussions.

Strengthen EU-China links

Over the last decade, there has been tremendous growth in EU-China trade and investments. With the aftermath of the global economic crisis, enhancing business between China and the EU will be one important path to accelerate global recovery. China is already the EU's 2nd largest trading partner after the US, and Europe's fastest growing export market. However, there is still a lot of room for improvement. For example, in 2008 the EU still exported more goods to Switzerland than to China (€97.6 billion compared with €78.4 billion). Clearly, the scope for increased trade is great and the relationship with China should be a priority for EU trade policy.

European companies are very keen to do business with and in China. But recently, they have expressed concerns over deteriorating business conditions in China. China will continue to raise important challenges for EU's trade policy, for example in relation to government procurement, intellectual property rights, access to raw materials, government subsidies, or more generally China's full respect of its international obligations. In order to secure European companies' economic interests, this development requires a much more proactive European approach.

The EU-China High-Level Economic Dialogue (HED) is the right tool to tackle the numerous barriers to trade and investment. A strong economic dialogue that removes trade and investment impediments is central to the EU-China relationship. European business should be closely involved in this exercise in order to focus on the most pressing business concerns. This approach should lead to an EU-China Action Plan which should set and implement objectives and milestones to be reached within clear established deadlines. The Action Plan should be agreed jointly by the two sides and evolution reviewed at the annual meetings of the High-Level Economic Dialogue.

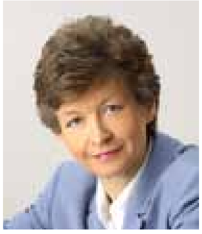
A modern European investment policy

Foreign direct investment is an important driver of global trade. With the new authority granted by the Lisbon Treaty, the EU will need to develop a coherent policy to safeguard and enhance European investments abroad. The first step is to provide legal security to companies availing of existing member state bilateral investment treaties (BITs). Legislation must clarify that existing treaties are compatible with the new Lisbon arrangements and the conditions under which new member state agreements are possible. The EU should outline a framework for the negotiation of new agreements and the renegotiation of existing BITs by individual member states. This framework should enable such negotiations, provided these do not generate a serious competitive disadvantage for the investments of other member states.

Following that, the EU should seek a robust outward-looking investment policy, securing the highest level of protection for its investors in key markets. Investment provisions should be of the highest standard and include a broad definition of investment, covering all sectors of business. Negotiations should start from the assumption that all sectors are included, listing only the exceptions rather than a detailed account of what is covered. This negative list approach will give companies legal certainty that new business models they may develop, which might not be foreseen today, will also be protected. Furthermore, investment provisions should provide for full market access, fair and equitable treatment and full protection of European investments.

The focus of EU investment policy should be on partners with high economic growth potential, such as China or Russia, which present real value-added in terms of investment opportunities and protection. Preference should be given to countries that have agreed on a limited number of BITs or market access commitments with the EU or its member states. As the Global Europe Strategy correctly pointed out, the ability to invest freely in third country markets has become more important as supply chains become increasingly globalised. Establishing a physical presence in a foreign country helps EU companies take advantage of new business opportunities and makes the flow of trade more predictable. Consequently, access to markets and the protection of investment will remain crucial for European companies' future competitiveness. ■

The euro crisis: putting off the day of reckoning



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Introduction

In the first week of May the eurozone came extremely close to breakdown, totally eclipsing what interest the financial markets had in the British General Election. As worries escalated over the possibility that Greece, or indeed other weak eurozone countries, could default, a sovereign debt crisis blew up in the markets. Oil had been poured on the flames in late April when the Credit Ratings Agencies, flawed but still hugely influential, had downgraded the sovereign debt of Greece, Spain and Portugal. Moreover, this debt crisis morphed into fears about a more generalized Lehmans-style banking crisis. The European banking sector has substantial holdings of Greek sovereign debt and a Greek default would be hugely damaging to their balance sheets.

So in early May a reluctant German Chancellor, torn between a domestic electorate hostile to Greek bail-outs and eurozone meltdown, finally agreed, firstly, to a €110bn bailout for Greece which effectively covered Greek credit needs for the next three years at rates of 5% or less and, secondly, a "shock and awe" stabilisation package amounting to €750bn for other eurozone countries faced with funding problems. The €750bn consisted of a loan facility of up to €440bn backed by the more creditworthy eurozone members operational for the next three years, €60bn of EU27 bonds and up to €250bn of support from the IMF.

These rescue packages have certainly bought the eurozone time. They were designed to protect the weak links in the eurozone for the next three years so that these countries could be given the breathing space to try and shore up their public finances, strengthen their banks and instigate economic reform packages to improve the competitiveness of their economies. The moves have certainly reduced the probability of a collapse of the currency bloc within the next three years – though it would be unwise to discount further eurozone crises erupting during this period. But these packages, along with the policy responses on offer to date, will almost certainly fail to address the problems of the economically fractured eurozone. And there remain serious questions over the longer-term sustainability of the eurozone in its current format, with its current membership.

The economically fractured eurozone

The recent economic crisis has highlighted the fundamental structural differences between the eurozone economies. It is worth spending some time on these differences because the future of the euro depends crucially on how the individual economies will prosper – or otherwise – in the near-medium term. Often, too often in my judgement, the debate about the euro's prospects focuses on the short-term financial stability of the currency union. But the focus should be on economic prospects, which are vitally concerned with people's livelihoods, prosperity and homes, and are the very underpinnings of social cohesion and stability. These central issues ultimately drive political decisions. Of course there is a political will within the EU to maintain the eurozone with its current membership at the moment, but the question is for how long.

During the 1990s the euro was planned and launched as part of the vision of a unified Europe – irrespective of the economic wisdom of trying to meld such disparate economies together. That vision has been severely impaired. The EU's politicians now have the face-saving task, given the political capital sunk into the project, of expensively bailing the system out. But at some point, surely, they will balk at the costs involved, both financial and economic, and actively push for a slimmer, more economically coherent currency union.

The eurozone is patently not an economically coherent currency union at present. On the one hand there are the "core" members, principally Germany and the Netherlands. On the other hand are the peripheral "Club Med" members: Italy, Spain, Portugal, Greece and Ireland. There are, of course, differences within these groups as well as between them. Italy is better placed than Spain, Portugal, Ireland and especially Greece. France is customarily added to the "core" group though in some ways it displays aspects of the "Club Med" group.

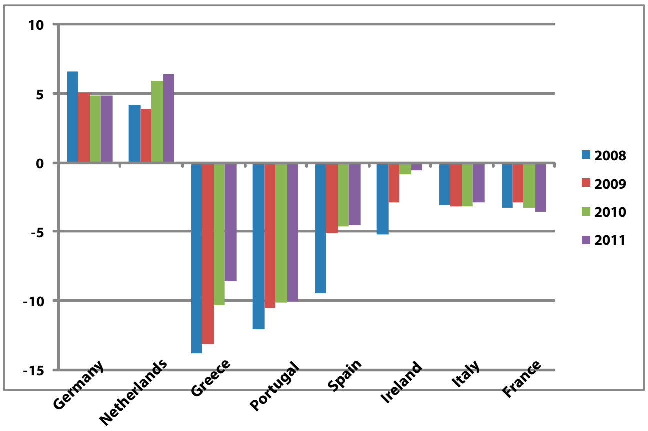
The first point to note, concerns the way in which the ECB's policy decisions have exposed the economic compatibilities of the member states. In the early 2000s Germany's economy showed very weak growth. German GDP actually fell 0.2% in 2003. The ECB kept rates low during this period partly in response to Germany's difficulties. The ECB's main refinancing rate was 2.00% to 2.50% for much of the period 2003 to 2006. This was the appropriate interest rate policy for Germany. But these rates were significantly too low for Ireland, Greece, Spain and Portugal. To generalize, they were a major contributory factor to their unsustainable credit-fuelled private spending and property booms, since turned to bust, which exacerbated the subsequent recessions and will damage their recovery prospects. In currency unions there is only one interest rate and if there is to be optimal performance members need similar interest rates. In the run up to the 2008 economic crisis this was demonstrably not the case in the eurozone.

Secondly, there are fundamental disparities between the two groups concerning the external balances. This is unsustainable. Germany and the Netherlands ran large current account surpluses in the run-up to the economic crisis in 2008 (chart 1). Significant proportions of these surpluses were with the Club Med countries. Much of the demand for German exports came from the peripheral countries. Spain, the largest and most important of these countries, ran huge external deficits though in percentage of GDP terms Greece and Portugal were in worse positions.

Boom-times in the peripheral economies are over – maybe permanently. The $64,000 question now is whether Germany will stoke up domestic demand, some of which could be met by exports from the beleaguered "Club Med", and reduce the trade imbalances. The jury is out.

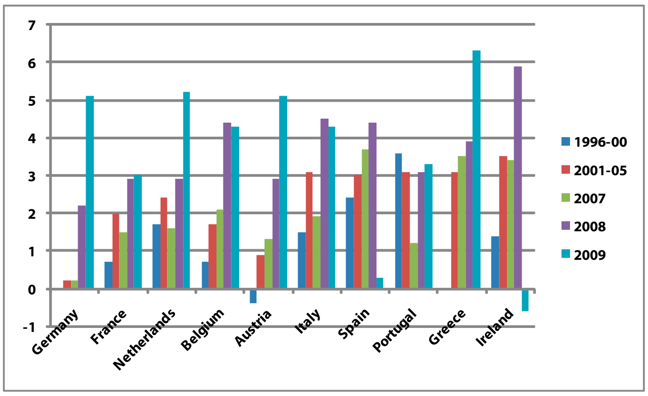
Thirdly, the boom years for the peripheral economies did not just mean higher private spending and booming property markets. They also experienced some wage inflation, driven by powerful trade unions. The result was that their unit labour costs rose faster than in the "core"

Chart 1. Selected EU countries: current account balance, % of GDP



Source: The European Commission, European Economic Forecast – Spring 2010, May 2010.

Chart 2. Eurozone, selected countries: unit labour costs, annual % changes, 1996-2009



Source: European Central Bank, Statistics Pocket Book, August 2010. Unit labour costs are for whole economy, annual % changes. 1995-2000 data for Greece are not available.

countries (chart 2), which reduced their relative competitiveness within the eurozone. Moreover these cost increases occurred in countries already noted for long-term economic weaknesses - Greece, Italy, Spain and Portugal. Arguably these economies are over-dependent on low-tech industries where they are in competition with Asia, but increasingly struggle to compete.

Additionally, the strength of the euro has affected the competitiveness of all of the eurozone but, whilst Germany's high valued industries can cope with this development, the industries of the weaker countries are less well placed. Arguably they require a depreciating currency, but cannot unilaterally achieve this within the eurozone. The alternative route to improved price competitiveness is painful deflation.

"... the weaker eurozone countries... are trapped and the option of leaving the eurozone... will surely become an increasingly tempting option"

There were big increases in unit labour costs in several eurozone countries in 2009, not least of all in Germany, but these reflected the depth of the recession. The rises should be largely reversed when the economies recover. The exceptions were Ireland and Spain where austerity was beginning to bite.

Fourthly, the European Commission's most recent forecasts (May) underlined the truly parlous fiscal positions of the weak peripheral economics. Despite the austerity packages announced earlier this year, and factored into the forecasts, government borrowing is forecast to remain high in Greece, Portugal, Spain and Ireland as weak growth bears down on revenues (chart 3). Perhaps surprisingly Italy's borrowing outlook was better than France's. But the French government's package of austerity measures, announced in June, should ameliorate France's deficits.

These high deficits have led to a rapid build-up of total public sector debt. This is especially the case in Greece, where the debt to GDP ratio is around 120%. The country is flirting with insolvency. In addition to their high public sector indebtedness, Spain and Portugal have substantial levels of private sector indebtedness, which can only act drag on their recoveries.

Finally, growth prospects look poor in the eurozone's weaker economies. They are unlikely to show any year-on-year growth for this year, whilst Germany should recover according to Commission's May forecast (chart 4). Recent German GDP data have confirmed a better-than-expected recovery, GDP could rise by 3% this year, whilst the figures for the weaker economies have tended to be anaemic. The ECB was faced with a policy dilemma in the early 2000s when it kept rates low for Germany. Their policy dilemma in the near-medium future will be to agree an appropriate monetary stance when Germany is growing strongly but several other eurozone economies are not.

Reflecting the recession and continuing weak economic performance, unemployment rates have rocketed in Spain (to 20%) and Ireland (over 13%). Germany's unemployment rate is now falling.

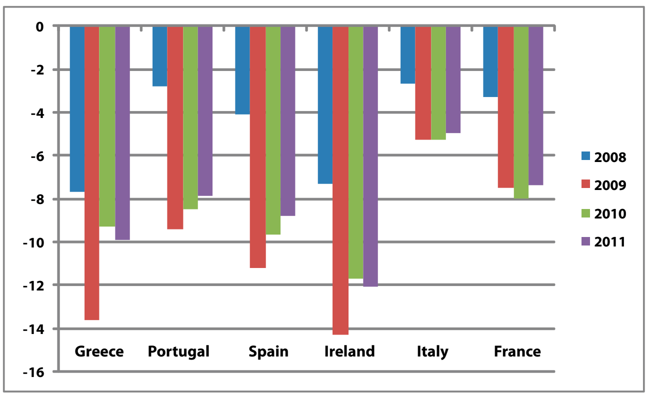
Austerity packages and the weaker economies

The eurozone's peripheral economies are therefore in trouble. No-one should have been surprised when the markets panicked about Greece's fiscal predicament earlier this year, with contagion rapidly spreading to the other weaker eurozone members.

This panic was assuaged by the May rescue packages. But there is a very nasty sting in the tail. The Greek bailout and the "shock and awe" rescue package are both contingent on recipient countries imposing vigorous austerity packages, which the Commission had been urging for many months. Spain and Portugal have 2013 as their target for reaching the EU budget deficit guideline of 3% of GDP and Ireland and Greece have 2014. Ireland has already imposed cuts in public sector pay of up to 20%, with reductions in child and unemployment benefit. Portugal took additional consolidation measures in April Spain announced additional budget cuts in May. Further tightening measures are part of the EU-IMF bailout package for Greece. Tough austerity measures can only undermine further the feeble growth prospects for these countries.

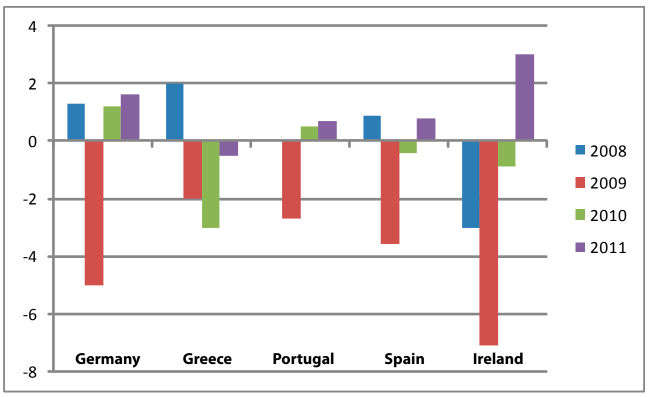
Apart from the threat to social cohesion of high unemployment and falling living standards, it has to be questioned whether these countries are in any position to vigorously grow out of their debts, given the size of their deficits and debts. Resolving large fiscal deficits is very difficult without growth. Under these circumstances the eventual will of Greece and to a lesser extent Spain and Portugal to administer the required fiscal pain has to be questioned.

Chart 3. General government borrowing, % of GDP



Source: The European Commission, European Economic Forecast – Spring 2010, May 2010.

Chart 4. GDP annual growth rates (%)



Source: The European Commission, European Economic Forecast – Spring 2010, May 2010.

One age-old solution to high indebtedness is of course rampant inflation associated with a depreciating currency. But given the straightjacket of the eurozone and the tough anti-inflationary stance of the ECB, this is not an option. The question then has to be whether the growth prospects can be improved. There are two suggestions. The first is to impress on the countries the need to raise their competitiveness and in the case of Spain and Portugal grasp the need for politically unpopular labour and product market reforms. And the second is to address the imbalances, as discussed above, between the strong surplus countries and the weak deficit countries.

The future of the eurozone

The Greek bailout package and the stabilisation package have been accompanied by a vigorous debate about the future of the eurozone and its governance. Though it is generally agreed closer cooperation and greater fiscal control are required, there are major differences between France's and Germany's ambitions. For France, the crisis has proved the need for decisive steps in the direction of common eurozone economic governance – nothing less than a "gouvernement économique" with wide powers over taxation and monetary policy. The Germans, however, want a different sort of centralisation built on rules to impose fiscal discipline and punish the profligate in order to achieve a "harmonisation of rigour". But they resist the notion of a comprehensive "fiscal union" with even more transfers going from the rich north (principally Germany) to the poorer southern peripheral countries.

The Commission released its own proposals in May for coordinating economic policy. They included proposals for the better functioning of the Stability and Growth Pact which is intended to keep eurozone members on the fiscal straight and narrow but, even before the recession, was regularly flouted. And the newly convened special "economic taskforce", which includes the ECB and the EU finance ministers, will make its recommendations in October.

The debates surrounding the economic governance of the EU27 in general and the EU16 in particular are already proving contentious. One proposal is that all EU countries, and not just the EU16 countries, should have their budget plans scrutinised by the Commission. The UK has already stated that this would be unacceptable. Another set of proposals relate to possible treaty changes – including Mrs Merkel's suggestion that treaty law should be changed to expel countries that repeatedly violate fiscal rules from the eurozone.

There is therefore no shortage of proposals for patching up the eurozone. But whatever is finally implemented, two conclusions can be safely drawn. The first is that there will be more centralisation of economic and fiscal policies in the wake of this crisis. And the second is that tighter fiscal rules, though dominating the debate to date, will do nothing to help the weaker eurozone countries trapped in the eurozone with crippling indebtedness and poor growth prospects. They are trapped and the option of leaving the eurozone, possibly defaulting on debt, will surely become an increasingly tempting option.

The prospect of currencies leaving the eurozone was, until the May crisis, considered unthinkable. But it is now has to actively thought about. Indeed the question is no longer whether a country could leave the euro, but which one might want to (or be forced to), and how it could pick a way through a financial and legal minefield to the exit. The candidates discussed so far include Greece and Portugal (on the grounds of weakness) and Germany (on the grounds of strength). Germany's departure is politically unthinkable – but Greece's isn't. ■

International Chamber of Commerce
The world business organization

Incoterms® 2010: revised trade rules for an inter-connected world

Continuing a long tradition of providing the global trading community with the most up-to-date trade tools, the International Chamber of Commerce (ICC) is preparing the official September launch of the Incoterms® 2010 rules that will come into effect on 1 January 2011.

First created by ICC in 1936, the Incoterms® rules - short for "international commercial terms" – help traders avoid misunderstandings by clarifying the costs, risks, and responsibilities of both buyers and sellers in the delivery of goods.

When ICC first introduced the Incoterms® rules they caused a sensation in the international business world. Representing a radically new concept in an industry regulated by local rules of law, the new rules were the first real attempt to bring coherence to a commercial and judicial system that diverged widely from one country to another.

"The global rules developed by ICC and used by companies in countless business transactions all over the world are an essential part of ICC's work and set us apart from most other international business organizations," said ICC Chairman Rajat K Gupta. *"Before ICC developed the Incoterms® rules, the different terms were often subject to varying interpretations in different countries, often giving rise to disputes and litigation. Today the Incoterms® rules for the usage of terms such as Ex Works (EXW), Cost and Freight (CFR) and Cost, Insurance and Freight (CIF) are part of the recognized canon defining the responsibilities of buyers and sellers in transactions for the sale of goods worldwide."*

The Incoterms® 2010 rules take account of a number of important developments that have occurred in global trade since the 2000 revision. These include first, changes in cargo security, which, since 9/11, has been at the forefront of the transportation agenda for many countries; second, the continuing spread of custom-free zones; and third, the increased use of electronic communications in business transactions. Incoterms® 2010 reflects all of these developments.

The present revision is the seventh since Incoterms® were first created 75 years ago. The changes in the rules through the years have been made to adapt the terms to new developments in world trade. The 1980 revision, for example, introduced the term Free Carrier (FCA) to deal with the frequent case where the reception point in maritime trade was no longer the traditional FOB-point (passing of the ship's rail) but rather a point on land. The 2000 revision made substantive changes with regard to customs clearance and the payment of duty obligations under Free Alongside Ship (FAS) and Delivered Ex Quay (DEQ).

In all cases, revisions have been made to ensure that the wording of the Incoterms® rules clearly and accurately reflect trade practice.

With regard to cargo security, the Incoterms® 2010 rules, for the first time, assign cargo security information obligations to both buyers and sellers. Because of different and ever-shifting security regimes, the revised rules inform the parties that these regulations have to be taken into account and that they must consult to ensure compliance.

In addition to the changes related to cargo security, customs and electronic trade, there are other important features in the latest revision:

- The number of the rules has been reduced from 13 to 11, and two new rules have been created: Delivered at Terminal (DAT) and Delivered At Place (DAP);
- Guidance related to the meaning of key words as used in

the Incoterms® rules, such as "delivery", "carrier" and "packaging", are now included in the Introduction. This reflects similar modifications made to other ICC rules of practice;

- Guidance notes have been added at the beginning of each of the rules to help clearly steer the user to the correct Incoterms® rule, and the Introduction has been stripped down to its bare essentials;

- There is no longer any reference to "ship's rail" in the FOB, CFR and CIF rules. This changes the delivery point to "on board" for these rules; and

- Insurance is covered in greater detail, with revisions to the LMA/IUA War and Strike Clauses noted as possible additions to "minimum cover" C clauses.

Commenting on the rules, Emmanuel Jolivet, General Counsel of the ICC International Court of Arbitration, said: *"The Incoterms® rules are a perfect example of an efficient standardization of an international business tool. Their day-to-day use in international sales contracts brings legal certainty to business transactions while simplifying the drafting of international contracts."*

ICC has a long history of developing rules of practice for business. The UCP, ICC's universally accepted rules on documentary credits, date back to the 1930s. Their latest revision, UCP 600, came into effect in 2007. ICC rules on demand guarantees, the URDG, were first issued in 1991 and their recent revision, URDG 758, came into effect on July 1st of this year.

Gupta concluded: *"Because our rules are developed by experts and practitioners brought together by ICC in a thorough consultative process, they are globally accepted and have become the standard in international business rules-setting."*

Incoterms® 2010, the latest revision of the International Chamber of Commerce's internationally recognized trade terms, will be officially launched with a conference at ICC's international headquarters in Paris on 27 September. A series of masterclasses on the new rules will also take place in 2010 on 28-29 October and 29-30 November, with another to follow in 2011 on 31 January-1 February. The revision will come into effect on 1 January 2011. ■

Incoterms® is a trademark of the International Chamber of Commerce registered in several countries.

Incoterms® 2010 can be purchased on the ICC bookstore website, www.iccbooks.com. For information on upcoming Incoterms® 2010 conferences and master classes, contact Jennie Irving at jennie.irving@iccwbo.org or telephone +33 (0) 1 49 53 28 70

Incoterms® 2010
by the International Chamber of Commerce (ICC)

The Foreign Manufacturers Liability and Accountability Act: a major concern for Indian exporters to the US

Pritam Banerjee is the Head of Trade and International Policy at the Confederation of Indian Industry

The proposed Foreign Manufacturers Legal Accountability Act of 2010 (FMLAA) currently being debated in the US requires all foreign manufacturers and producers exporting 'covered products' to establish a registered agent in the US who would be in a position to accept service of process ie. legal responsibility for the liabilities arising out of these products. Covered products include drugs, cosmetics, biological products, consumer products, devices, chemical substances, and pesticides. Through the act of accepting the service of process on his behalf by the registered agent a foreign manufacturer or producer would be deemed to have consented to the jurisdiction in US courts.

This proposed law has raised serious concern within Indian industry and could prove to be very expensive to small and medium scale manufacturers and producers. If this law comes into force, it will effectively become a non-tariff barrier to accessing the US market. The FMLAA adds to the costs of exporting in two specific ways. First, there is the cost of hiring registered agents for receiving service of process. Many Indian exporters to do not export to US market the whole year, a few consignments a year is often the common practice. Many do not even export to US customers every year, doing so periodically once every two or three years. However, exporters would have to maintain a registered agent in the US all year round as it would not be feasible to search and contract a registered agent on a consignment by consignment basis. The cost of maintaining such a registered agent would be significant, especially for some of the smaller exporters.

Second the law applies to intermediate goods and not just finished products. This brings a large number of Indian exports to the US under the ambit of the law. Product liability issues related to finished product would potentially make intermediate suppliers also liable in case something is wrong with the finished product and causation is difficult to pin-point. This greatly increases the likelihood of many intermediate goods exporters having to shoulder more risk from litigation related to product liability. Preliminary CII estimates are that the additional cost for compliance with this new American law for the Indian industries could be anywhere between US$300 to US$500 million.

The need for the proposed FMLAA is difficult to understand as the Consumer Product Safety Improvement Act (CPSIA) already provides more than adequate protection to the US consumer by requiring producers to test and verify that products entering the United States conform to US standards before they are imported into the country. Thus, many see the FMLAA as an attempt by US lawmakers to satisfy the more protectionist elements among their supporters before crucial mid-term elections in November.

One can argue that the FMLAA violates WTO principles (GATT, Article XI.1) that states that *"No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party".* While the US is certain to dispute the interpretation of the above stated principle, what cannot be argued is that the FMLAA violates the spirit of the WTO in that it fails to meet the stated ambition of this agreement (Article VIII.1C) that *"the contracting parties also recognize the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirements".*

Implicit in this stated ambition for freer and less complicated flow of goods across borders is the understanding that greater the incidence of formalities required for cross-border trade higher is the cost to meet compliance requirements for them. Several studies undertaken by the World Bank and UNCTAD have repeatedly pointed out that high transaction costs are often bigger barriers than tariffs for exporters. It is entirely possible that increasing transaction costs from such protectionist regulation might eliminate any gains from reduction in tariffs that are likely to be achieved in the Doha Round.

> **"... the US needs global markets just as much as rest of the world needs US markets. Many US jobs are directly or indirectly dependent on US exports"**

This is a major concern for industry in emerging countries like India that are at one hand being asked to bear the burden of substantial tariff reduction, while at the same time see some of their more important markets raise protectionist barriers in the form of regulatory requirements.

It is no secret that the FMLAA was born out of the 'Making it in America' initiative in the US House of Representatives with the explicit goal of protecting the US manufacturing sector. The US is expected to put national priorities over principles such as free trade like any other country. But the US itself is a major exporter, and if one takes out China from the US trade portfolio and includes the trade in services along with goods, than US exports and imports are fairly balanced. As a matter of fact China accounts for almost 2/3rd of the total deficit in goods and services trade for the US.

In other words, the US needs global markets just as much as rest of the world needs US markets. Many US jobs are directly or indirectly dependent on US exports. A downward spiral towards protectionism using regulatory means is not conducive for US economic recovery and employment generation. Policy makers in the US government and House of Representatives, and stakeholders such as the AFL-CIO need to understand the complexity and inter-dependence in the web of global economic relations today and be more supportive of the idea of free and more transparent trade. ■

Digital Agenda for Europe – the road to our better future

Neelie Kroes is a Vice President of the European Commission and the EU Commissioner for the Digital Agenda

What sort of business can succeed when its competitors have got access to infrastructure 100 times better? It's an interesting question – and a challenge faced by many European businesses every day as they compete against businesses in OECD member countries with faster internet.

And with more services and conversations moving online – how can we keep a cohesive society if 30% have *never* gone online? It would be very hard indeed.

The bottom line in today's world is that Information and Communication Technologies (ICTs) are no longer luxuries or hobbies or items that are merely 'interesting'. Today, ICT investments are the backbone of wealth creation - contributing to half of Europe's productivity growth. The ICT sector itself is directly responsible for 5% of European GDP, with a market value of €660 billion annually.

Whether you think of it as evolution or revolution; whether you like it or not – the pervasiveness of ICT is here to stay. We can anchor these technologies and networks in our values – but we certainly can't ignore them. And that is why I am so excited to be in this newly created and strategic role of European Commissioner for the Digital Agenda. Because of my portfolio's pivotal role in economic success, in many ways I am acting as a Commissioner for Growth and Jobs. And nothing is more important to the European economy than these outcomes. The Digital Agenda for Europe is a comprehensive strategy to help Europe plan its long-term digital success. We need actions at all levels to take advantage of the full potential of the ICT. To set about building the partnerships and delivering the funding necessary to achieve this, we have framed our action plan around seven priority areas.

Digital single market

While we have a single market for some goods and services and the internet is borderless, the European market for electronic content and services is currently a patchwork of 27 different digital markets. As a result, the 250 million Europeans who use the internet daily cannot access pan-European telecoms and digital services and content.

Transactions fail. Popular services are not available where they could be and so on. If three out of four internet users in the UK buy online in their home country, only one out of eight buys from another EU member state – they may be impeded by different laws or simply lack of trust.

Such barriers need to be abolished. To achieve a true digital market, the Commission intends to open up access to legal online content by simplifying copyright clearance for example. By the end of 2010, the Commission will propose a framework Directive on collective rights management to enhance the governance, transparency and pan European licensing for (online) rights management. A Green Paper addressing the opportunities and challenges of on-line distribution of audiovisual works will be issued by 2010. The whole situation will be re-visited by 2012 to see whether additional measures are needed. Other actions include making electronic payments and invoicing easier, completing existing projects like the Single European Payment Area, and creating an EU-wide online dispute resolution system for e-commerce transactions, so that consumers and providers know where to go if things go wrong.

ICT standards and interoperability

The internet is a great example of the power of technical interoperability. We should make sure that all future ICT products and services have these advantages built-in. This is the most effective way to encourage people to create, combine and innovate. It will save ordinary individual users and small businesses in particular from a lot of needless frustration.

We will therefore encourage the development and application of standards which can be implemented by different companies, allowing for more competition. Users and consumers will then be less constrained in their technical choices. But setting the standards is not enough on its own.

We need to enhance the interoperability between devices, applications, data repositories, services and networks. The Commission will propose new rules for implementing ICT standards to improve public procurement and legislative practices for interoperability.

Trust and security

In Scandinavian countries more than 80% of the population use online banking whereas only 13% of Greeks and 4% of Bulgarians do

so. One third of all Europeans think that their payment is not secure and that prevents them from buying online. These are not statistics we can be happy with.

All Europeans need to feel confident and safe online to embrace technology and the possibilities that it offers. Higher security also encourages the increased use of online banking and shopping, which would create more opportunities for businesses.

The Commission will work to coordinate the European response to cyber-attacks by setting up a European rapid response system to cyber-attacks, including a network of Computer Emergency Response Teams (CERTs). We will also strengthen the rules for individuals' privacy and personal data protection. The Commission will boost its efforts against offensive and harmful content online to make sure that children are safe when on the internet.

Fast and ultra-fast internet

Access to the internet can create more educational and employment opportunities, can improve living standards for older people and increase access to public information and services. Broadband internet access is becoming critical to economic growth and development in Europe – it is the platform for new markets, the key means of delivering masses of information and a great medium for innovation. Yet today only 1% of Europeans have a fast fibre-based internet connection (FTTH), compared to 12% of Japanese and 15% of South Koreans. Around half of the rural population has no internet access at all.

"Whether you think of it as evolution or revolution; whether you like it or not – the pervasiveness of ICT is here to stay. We can anchor these technologies and networks in our values – but we certainly can't ignore them"

The Commission is committed to working with national and regional authorities and businesses to ensure that by 2013 all European citizens can have basic broadband access to the internet, and that by 2020 everyone can have access to high speed internet of 30 Mbps or above. By 2020 we are also aiming to have 50% or more of European households subscribing to ultra-fast internet of above 100 Mbps. Rolling out next generation access (NGA) networks will be key to this and we will encourage this deployment through better use of EU funds and strengthening cooperation between public and private actors. For example, we will make sure that civil engineering works involve potential investors to make sure that utilities' infrastructure is suitable for cabling. The Digital Agenda will also encourage EU coordination in radio spectrum management in order to boost the growth of innovative wireless broadband services.

Research and innovation in ICT

ICTs have completely changed the way we live – from using computers to mobile phones – and they have the potential to deliver many more improvements. But delivering that potential will require us to invest more in ICT-related research and development (R&D). Currently, R&D spending on ICT in Europe is just 40% of that in the US, making us lag behind our biggest competitors. This is not a sustainable approach to our economic and social challenges.

Given that ICT contributes to a large proportion of the total value-added in European industrial strengths such as automobile (25%), consumer appliances (41%) or health and medical (33%), the lack of investment in ICT R&D threatens the entire EU manufacturing and service sectors. We need to solve this problem and make sure that our brightest ideas reach the markets. The Commission is allocating the biggest portion of funds under its seventh framework programme for research (FP7), or about €9 billion, to support R&D in ICT.

In addition, we will work closely with EU countries to attract more private funds into ICT research (in fields like Future Internet, Factories of the Future, Energy-efficient Buildings or Green Cars) with total EU funding of €1 billion and leveraging around €2 billion of private spending. We will seek maintaining the pace of yearly increases by 20% of the ICT R&D budget, at least until 2013. We invite the member states to double its annual total public spending on ICT R&D by 2020 to €11 billion. Last but not least, we will simplify bureaucratic procedures to make it easier for young researchers and small and medium-sized businesses to access R&D funding.

Digital skills and accessible online services for all Europeans

As more essential tasks are carried out online, from applying for a job to paying taxes or booking tickets, using the internet has become an integral part of the daily lives of many Europeans. Research shows that people with ICT skills earn more than people without such skills.

The internet is a weapon against poverty. About a third of European citizens have never used the internet. I want these 150 million people to have the skills and competences they need to be part of the digital era. In addition, Europe is suffering from a growing professional ICT skills shortage and could lack the competent practitioners to fill as many as 700,000 IT jobs by 2015. I would also like more Europeans and women in particular to choose an ICT career so that we can meet the demand for ICT professionals coming from the private and public spheres. There are 30 million women aged 15 to 24 in Europe that could be motivated to become professionally involved in the ICT sector.

The Digital Agenda proposes a series of actions to increase the ICT skills and competences of Europeans. In this way, everybody will be able to enjoy the benefits of the digital world. We will try to attract the young people and women of all ages who are regular ICT users to a job in the ICT sector. Finally, for the people already using ICT skills and working in the technology sector, the Digital Agenda will help recognise the competences of ICT practitioners EU-wide. In this way, the industry in need of employees with particular ICT skills will be able to easily identify them.

Using the potential of ICT to benefit society

We need to invest in the smart use of technology to find solutions to some of Europe's biggest problems: high energy consumption, pollution, ageing citizens. In healthcare, Europeans must have access to their online medical records wherever they are in the EU. The Digital Agenda for Europe also aims at boosting energy saving ICT technologies, for example highly efficient lighting systems, to help Europe meet its 2020 climate and energy goals and reduce greenhouse gas emissions by 50% by 2050.

Only half of EU citizens have used online e-government services (such as company registration or tax filling) and the services themselves are rarely available across borders. We want to encourage the use of e-government and to have more cross border services online.

Achieving progress in the priority areas of the Digital Agenda for Europe would benefit everyone – citizens, governments and businesses. Small and medium-size enterprises (SMEs), for instance, will be able to conduct electronic payments and invoicing across national borders based on safe and efficient payment methods once the Single European Payment Area (SEPA) has been completed. The improved e-government services will enable SMEs to spend less time on administrative procedures and gain new business opportunities. The higher implementation of ICT in the manufacturing process will increase its efficiency, which will contribute to the greater competitiveness of the European production firms. The ICT industry itself will gain from the implementation of the Digital Agenda for Europe's objective to improve ICT education. As a result, the sector will be able to employ the highly-qualified specialists it needs to continue its successful performance.

Achieving the goals of the ambitious Digital Agenda for Europe cannot happen without the joint efforts of all of us – citizens, businesses and public authorities. We need to work together to achieve the results that we want, thus contributing to the competitiveness of our economy and brighter future for all of us. ■

Bavaria - Europe's leading ICT hub

Bavaria: high-quality automobiles, the fairytale castle of Neuschwanstein, Lake Constance, the majestic Alps, countless beer breweries, Wagner, Lederhosen and the Oktoberfest. That's what most people around the globe associate with this state in the south of Germany. Yes, Bavaria truly holds superlatives as a destination full of amazing landscapes, culture, tradition, history and art. However, a lesser-known fact is that Bavaria is also the 8th largest economy in Europe, with a € 430 billion GDP.

Bavaria is traditionally an economically powerful region with a state government that provides businesses with an extensive number of support measures. It also has excellent research institutions and a wide range of cluster networks and innovation initiatives, which make it attractive to a variety of enterprises and especially to ITC companies who will find a large client base and top-notch communication infrastructures. These are only some of the reasons why Bavaria enjoys a superb reputation as the perfect site for ICT companies and has attracted so many internationally renowned corporations.

Right in the heart of Europe with a market of some 500 million consumers, Bavaria is also strategically positioned next to the important markets Switzerland and Austria and the manufacturing commerce of Eastern Europe. Easily connected to the rest of the world by four airports, it is a major hub of international trade. One of the biggest in Europe is located here, the Munich Airport, which was given the award "Best Airport Europe 2010". It transported a resounding 32.7 million passengers in 2009. Bavaria is thus in a perfect location to develop business relations into any imaginable direction.

Today, the worst of the global financial crisis and the following economic downturn seems to be behind the ICT industry in Germany. Those companies, especially software developers and providers of IT services, are optimistic and expect to see growth in the current business year. The ITC sector expects a turnover of €140 billion in 2010 and the BITCOM-Index, which is the Federal Association for Information Technology, Telecommunications and New Media's rating, reached an even higher level than before the crisis.

Within Germany it is definitely Bavaria that excels. From the very beginnings of growth in the ICT sector, Bavaria has been a driving force for IT advancements and application. This branch looks back on fifty years of growth, making it one of the largest and most diverse in the world. In Bavaria the global players are just the tip of the iceberg, with the biggest mass of companies belonging to the *Mittelstand*, small and medium-sized enterprises (SMEs) that act both locally and internationally are well connected and very specialised. Bavaria has thus proven itself to be attractive for companies of all sizes and is home to some 650,000 SMEs.

The list of large, internationally renowned IT corporations in Bavaria read like a *"Who's Who"* for business. These include Adobe, BT, Cisco Systems, Fujitsu, Google, Hewlett Packard, IBM, Infor, Intel, Microsoft, Nokia, NTT, DoCoMo, Olympus, Oracle, Siemens Networks, Sun, Tata, Texas Instruments and VMware. Many have set up their European or German headquarters in Bavaria or have located their R&D centres in the state. Google has said that it chose Munich in order to be able to work together with Bavaria's highly innovative ICT companies. All in all there are 24,000 ICT companies in the Munich area alone, which makes Munich the number two as an ICT hub in Europe and leaves the area with the highest spending on ICT in Germany. Along the value chain the sector employs 380,000 people. It all adds up to *"Europe's high-tech mecca"*, in the words of Bill Gates.

However, it is not only the ICT sector that finds Bavaria the place to be. The top players in other branches such as logistics, automotive, aerospace industries, mechatronics, medical technology, financial services, mechanical engineering, service centres, energy and environmental technology, carbon industries and telematics make Bavaria the wealthiest of all the 16 German states. Here are the Adidas Group, Allianz, Audi BMW Group, EADS, DATEV, MAN, Siemens and many more.

All those enterprises produce and research in Bavaria, where they can take advantage of infrastructures enabling them to use those synergies to the fullest. This adds up to a location providing numerous potential customers to the ICT industry. More and more industry innovations, especially in the automobile, health, financial services and communications fields depend and are based on ICT technologies and so have been major advocates for the its use and development. ICT provides the core enabling technology for an ever more knowledge-oriented society and industry. It has been stated that in Germany almost 40% of macroeconomic growth can be traced back to the use of ICT innovations and that more than half of industrial production, most modern services and about 80% of exports depend on ICT technologies and microelectronics. Thus ICT is the backbone of the economy and an engine for all of the aforementioned industries.

The demands, needs and ideas of those industries, which utilise ICT naturally, have a strong influence on developments in ICT technologies. In Bavaria both sides find platforms to easily come into contact, communicate, exchange ideas and find solutions. This is true for all of Bavaria's key areas in ICT technologies, such as embedded systems, geodata, IT-security, media and IT convergence and IT supported processes.

Especially at NürnbergMesse leading trade fairs are held, such as the *"Embedded World"* for embedded systems and *"it-sa"* for IT-security.

These shows are supplemented by many other international and national trade fairs as well as top-class and well-attended congresses, conferences and corporate events. In this way, Bavaria has been able to write a story of mutual success for the ICT companies themselves as well as for their client industries.

Moreover there are a great number of regional ICT networks and technology centres in Bavaria, in which local and highly specialised companies as well as the local chambers of industry and commerce form strong networks to support one another by building yet new platforms to share knowledge between neighbours. Large regional ICT companies assist smaller entities in building up their own network, which makes those regional technology centres efficient business incubators.

This close and successful cooperation within both state and international business communities is not at all a coincidence. Rather it is largely due to the many policies enacted by Bavaria's government. Those governments, over the years, have fostered and encouraged the organisation of events as well as the association of some 19 so called 'clusters' in recognition of the need of businesses in the state to build relationships. This stems from the realisation that no company can 'go it alone' due to ongoing specialisation in all fields.

The Bavarian political landscape understands that the competitiveness of companies acting on a globalised market relies on numerous factors: geographical proximity, personal connection and informal meetings. Companies that organise themselves in clusters are more innovative and more productive, because they have direct access to dedicated suppliers, research institutions and specialised working forces within driving distance. This cluster initiative is designed to provide Bavaria's businesses with a distinctive edge over competitors.

The biggest aim of cluster organisations is to be available to small and medium-sized enterprises, the *Mittelstand*, thus enhancing their ability to compete. The cluster management teams, set up by the Bavarian state, strive to strengthen and enlarge the network between businesses, research institutions, investors and other service providers. With the support of these teams, ideas are turned into marketable products even faster than ever. Within the clusters, business contacts can be established and working relationships plotted between ICT companies and potential suppliers, partners and customers. This strengthens the competitiveness of ICT companies, their suppliers and also their customers.

One of those clusters deserves a special mention: BICC^{NET} (Bavarian Information and Communication Technologies) cluster. Here the state's government provides valuable links between its ICT business enterprises, the academic community and public sector institutions. This cluster gathers all actors on the stage of ICT: the biggest to the smallest companies, research institutions and public authorities. The range of activities is equally all-embracing. It ranges from the development and launching of R&D projects, consortia and platforms, to interfacing with industries that use ICT.

Convergence with other sectors especially open up various possibilities for economic growth in the ICT industries. Thus the BICC^{NET} cluster pays special attention to the topics of this promising field. It actively links ICT companies with each other as well as with enterprises of the client or user industries – and it fosters capacity building within the companies. Main points of the cluster are:

- Embedded systems (convergence of IT and electronics/electrical engineering)
- Geodata based applications
- Multi Format Contents (convergence of audiovisual media, telecommunication and IT)
- Finance-IT (convergence of financial services and information technology)
- IT-supported processes and business operations (capacity building and convergence with all sectors of industries and economy)

ICT as a cross-sectional technology can only be brought to fruition by interdisciplinary and international cooperation. It needs the brightest and best employees and the brightest and the best researchers. Indeed, Bavaria's academic landscape is top-notch and one of the world's engines for technological development. Actually within driving distance of each other are 11 universities, 17 schools of applied technologies, 9 Max Planck Institutes, 7 Fraunhofer Society facilities and 3 Helmholtz research centres. These institutions turn out some 4,000 computer scientists per year.

Bavaria's academic institutions of international reputation are equipped with state-of-the-art facilities for the development of ground breaking innovations. The IT research infrastructure includes Munich's top-ranked University of Technology, which was the alma mater of six Nobel Prize winners. Universities of applied sciences are located in Regensburg, Amberg-Weiden, Augsburg, Kempten and Neu-Ulm as well as Passau, Landshut und Deggendorf.

As for research institutes, the Fraunhofer Institut for Integrated Circuits especially stands out. It also specialises in ICT and forms Europe's largest combined research unit in the field. The Fraunhofer ICT Group with its 18 member institutes is an ideal first contact point for clients from the industry looking for a strong workforce as well as networking connectivity.

The member institutes are combined and can thus bring forth targeted and application oriented, integrated solutions for each specific industrial area along the value chain. Regular business summits provide the perfect interface for the right partners from industry and research.

Thus it is not a matter of happenstance that each year more patents are registered within Germany than in any other country of the European Union. And each year there are more patents registered in Bavaria than in any other German state. It comes as a stroke of luck that the German Patent and Trade Mark Office (DPMA) is located in Munich. Every application for a German patent or a utility model needs to be filed with the DPMA. Through its statutes the DPMA is obliged to grant and administer industrial property rights and to provide information on industrial property rights effective in Germany. Also the German Federal Patent Court that controls the decisions of the DPMA has its seat in the Bavarian capital. Since the two most important decision makers for German industrial property rights are in Bavaria, it follows that the density of specialised and highly competent lawyers in the field can also be found right here.

Bavaria truly offers ICT enterprises the best of all worlds. The economic policy thrust forward by the Bavarian government provides businesses with support in many vital areas and has attracted numerous important delivery markets. Invest in Bavaria is also worth noting as a business promotion agency of the Bavarian Ministry of economic affairs, which offers cost-free support in setting up a new business or expanding existing business operations.

The number of different branches, from logistics to automobile and financial services, provides a large client base for ICT companies. Those companies enjoy Bavaria's state-of-the-art transportation, telecommunications and energy infrastructures. Through the regional networks, cluster initiatives, and potential for a highly-qualified workforce owing to its many universities and technical schools, this southern German state has definitely come to deserve the title: *"Bavaria - Europe's leading ICT hub"*. ■

To find out more about doing business in Bavaria please visit:

http://www.invest-in-bavaria.com

Bermuda - the wired island

Telecommunications is more than important to Bermuda: lying almost 800 miles from the nearest land mass, the island's economic fortunes rise or fall depending on how well its corporate citizens are able to communicate with their colleagues, clients, suppliers and the outside world in general.

The Minister of Telecommunications, whose portfolio includes e-commerce and energy, is a senior member of Cabinet, reflecting Government's understanding of the central role that telecoms plays in Bermuda's future. *"The largest economic contribution to Bermuda's economic well-being is made by the financial services sector, primarily insurance, banking and trust services"* says the Minister of Energy, Telecommunications and E-Commerce, the Hon. Michael J Scott, JP, MP *"Part of our brief is to ensure that the environment for the sector is professionally managed, up-to-date with the latest international developments, and operated in such a way as to enhance Bermuda's international reputation for integrity in its financial dealings."*

To maintain its leading position in such keenly competitive markets, Bermuda must always be as up-to-date as anywhere else in the world. Capital flows most freely to those jurisdictions where its activities can be the most efficient, and it is no coincidence that Bermuda's highly modernised telecoms profile and its financial services providers are equally world class.

Bermuda now has three marine cable systems (composed of five marine cables) coming into and then out of Bermuda. These systems are separately owned by Cable & Wireless, Brasil Telecom GlobeNet and Cable Co, a KeyTech subsidiary. All three provide a quite staggering amount of capacity and a significant element of redundancy, thus securing Bermuda's links with the world.

State of the art

Bermuda is known as the *"wired island"*. With the largest number of cell phones per capita in the world and internet penetration rates of 89%, the telecoms industry is robust. There are 6 ISPs, 3 mobile operators and two long distance voice providers. However, the goalpost is always shifting in the telecoms landscape and so in order to get a better understanding of how telecoms services in Bermuda are changing, we sat down with a few of the providers.

The participants

BTC is Bermuda's gateway to the world. The company provides the network infrastructure that families and businesses throughout Bermuda depend on for local voice, data, and broadband access. The company was founded in February 1887 by an Act of Parliament that established The Bermuda Telephone Company Limited, at the start of Bermuda's romance with telecommunications.

The Hon Michael Scott JP, MP, Minister of Energy, Telecommunications and E-Commerce

Logic is a premier communications and information technology consulting company in Bermuda. The company provides hardware, software, communications, professional services and strategic consulting, and is the only company in Bermuda that provides all of these solutions under one roof. Logic is a Microsoft Gold Partner, a Cisco Premier Partner and an HP Gold Business Partner. Logic also offers a suite of residential services, including long distance calling, broadband internet, calling cards and technical support. The company operates an internet café and store in the heart of Hamilton, Bermuda's capital.

M3 Wireless, a leading provider of 3G wireless voice and data services, was the first company to introduce wireless voice service to Bermuda in 1987, as a division of BTC. M3 offers customised solutions tailored for businesses large or small, including BlackBerry service and worldwide roaming. In addition, M3 offers easyConnect, providing affordable wireless internet access for the home.

North Rock Communications was incorporated in 1997 as Bermuda's second ISP. The company has a significant market share of the internet market in Bermuda. In the long distance telephony market, North Rock carries a significant portion of Bermuda's outbound traffic. In 2003, North Rock became Bermuda's second residential provider of local dial tone services. The company deployed the first next generation Softswitch in Bermuda. North Rock was selected as Bermuda's "Best Internet Service Provider" for three of the past four years.

Q: What services does your company offer?

North Rock: Our product and services portfolio has more than 400 items today, including:

- Residential and commercial ISP services;
- Wireless broadband service;
- International and local voice services;
- Ancillary services, such as consulting and value-added offerings.

M3: We offer 3G wireless voice and data solutions, including BlackBerry and iPhone plans. Our 2G GSM network provides full redundancy to our 3G network. We are currently implementing 3G+, which will be operational in the fall. For business customers, M3 offers BlackBerry service, worldwide roaming, in-building solutions and 24/7 customer support. In addition, we offer a residential fixed wireless Internet access service called easyConnect and for business customers we offer a VPN service using easyConnect.

Logic: Our distinct advantage is our full-service offering, coordinated by industry-certified consultants and network engineers who design, implement, and monitor comprehensive solutions, based on clients' business requirements and industry best practices. Our services include:

- Data connectivity (MPLS, dedicated international private leased lines and dedicated internet access);
- Voice services (long distance telephony, VOIP telephone solutions);
- Managed services (data centre services and virtual hosting); and
- Network and professional services.

BTC: We provide business customers with voice and data services from T-1 through ethernet speeds, up to 1,000 megabits per second. BTC recently installed a Next Generation Network (NGN) switching platform that enables find-me, follow-me services and multimedia applications like unified messaging, presence, and audio and video conferencing — cutting-edge services that are available in other major commercial centres around the world.

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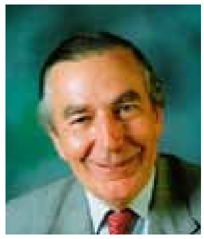
MENA Supplement

The Middle East Association – promoting business and good relations between the UK and the MENA (Middle East and North Africa) region

THE GLOBAL TRADE PLATFORM

Leading the way



Michael Thomas, Director General of the Middle East Association, underlines the importance of the Middle East and North Africa region for British business, and explains how the Association can help British companies take advantage of the opportunities

The Middle East and North Africa region is enormously important for UK plc. It has continued to provide a reliable market for British goods and services in a time of global economic turbulence; UK visible exports to the Middle East and North Africa continued to rise in 2009 to more than £12.7 billion, in contrast to the fall in our exports worldwide. Add to this several billion of invisible (services) exports, underpinned by the strong relations between the City of London and the countries of the region.

On the whole, the region has been less affected by the global economic downturn than most other regions of the world, and with growth picking up in 2010, prospects for British business are very positive – in fact UK exports to the region in the first six months of 2010 are up 17% over the corresponding period of 2009. The countries of the region continue to invest massively in infrastructure, diversify their economies, and improve their business environments in the drive to provide employment, attract investment and meet the needs of their growing populations.

"... the region has been less affected by the global economic downturn than most other regions of the world"

Take, for example, the transport sector – the region is now a major global transport hub with almost every country developing new ports and airports, and railways a new focus of development. New industries and centres of excellence are developing - Qatar for instance aims to become a centre of excellence for healthcare technology and scientific research, while the UAE is developing a focus on avionics and biotechnology. The region offers a wide range of opportunities in sectors ranging from oil, gas and petrochemicals, construction and infrastructure, education, healthcare and financial services, to emerging areas such as research and development, renewable energy, aero technology, ICT and offshoring.

MEA trade missions provide plenty of opportunities to meet with local business representatives

The UK enjoys strong traditional links with the region and British products, expertise and innovation are held in high regard. But competition, particularly from China and other Asian countries, is increasing, so British companies cannot afford to sit on their laurels!

The Gulf states and Iraq

It is encouraging that the UK's new Coalition Government is attaching priority to developing business relations with the Gulf Cooperation Council (GCC) states in recognition of their role as a major market for British companies, as well as their contribution to the UK economy through their investments here. The oil rich Gulf states, their coffers boosted by several years of high oil revenues, have been able to launch public spending programmes to boost their economies and to push ahead with their investment plans in the face of the global economic crisis.

The UAE, which has one of the world's largest GNPs per capita as a result of Abu Dhabi's enormous oil wealth, is the UK's largest market in the region, accounting for almost £3.6 billion of UK exports in 2009. Abu Dhabi is making massive investments in education, healthcare, oil and gas, infrastructure and industry, such as the Shah field gas project and Khalifa port and industrial zone. It is playing a leading global role in the development of sustainable energy technology through its Masdar initiative and is focusing on high end and cultural tourism – the Saadiyat Island development will house a number of world class museums including offshoots of the Louvre and the Guggenheim. Dubai with its diversified economy, business friendly environment, excellent infrastructure (including the GCC's first metro system) and numerous free zones, continues to attract high levels of foreign investment and remains a core trade, services and logistics hub for the region. The $10 billion Al Maktoum International airport currently under construction at Jebel Ali is set to be the largest airport in the world.

Saudi Arabia, the largest economy in the Middle East, possesses 21% of world oil reserves, and is the UK's second largest market in the region, offering opportunities across the board. The Kingdom is looking to spend around $80 billion a year on infrastructure up to 2013 and its 2010 budget has a big focus on education and healthcare. Six new economic cities, three new railways, 4 million new housing units, 1,500 new schools, a giant $26 billion petrochemicals complex at Ras Tanura, the development of the mining sector and the recent opening of King Abdullah University of Science and Technology (KAUST) are just some of the examples of the tremendous economic and cultural expansion underway in the Kingdom, which has dramatically improved its business environment in recent years in its bid to become one of the world's top ten most competitive economies by 2010.

Qatar is one of the richest and fastest growing economies in the world as a result of the exploitation of its massive gas reserves, the proceeds of which are funding major infrastructure and economic diversification projects, and is now the world's leading supplier of liquid natural gas (LNG). The financial, healthcare, tourism and education sectors have seen impressive development, with many international financial companies now established in the Qatar Financial Centre.

Oman, which has particularly strong traditional links with the UK, has had considerable success in attracting investment into large scale gas based and industrial projects at Sohar and Salalah where free zones are being developed, and in developing niche and high end tourism. Demand for British expertise, particularly consultancy, project management and financial services, continues apace. Business friendly Bahrain and oil rich Kuwait also provide good opportunities.

Iraq has the potential to become one of the leading oil producers, and to become once again a major market for British companies; it is hoped that once a new government is formed the pace of development will accelerate. The country's infrastructure requirement is estimated at up to $400 billion. In the meantime, the relatively secure and stable Kurdistan region in the north is forging ahead and there is a tremendous amount of construction and infrastructure development taking place. Expertise and consultancy are required in all areas and there is much goodwill towards the UK.

The Mediterranean countries

It is not just the oil rich countries that provide opportunities – the countries around the Mediterranean, with their diversified economies, strong manufacturing, tourism and agriculture sectors, regional links and trade agreements with the EU and other trading partners, also provide good business potential. Egypt, with its population of 82 million, strong industrial base and fast reforming economy is in fact the UK's third largest market in the Middle East and bilateral trade is at record levels – UK exports to Egypt in 2009 amounted to nearly £1 billion and the UK is the largest foreign investor in the market, largely as a result of BG's involvement in the gas sector. There is substantial investment in infrastructure through public/private partnerships, and the country is fast developing as a low cost manufacturing and outsourcing base for Europe. Manufacturing, tourism, construction and real estate and ICT have grown particularly strongly.

Morocco, with its strong agriculture, tourism, textiles and mining sectors and growth of new areas such as offshoring, the automotive industry, aerospace and electronics, provides a wide spread of opportunities. Tangiers port, the largest container port in the Mediterranean, is set to become a regional hub, and construction and infrastructure development are moving ahead strongly. Along with its neighbour Tunisia, Morocco is keen to develop its business relations with the UK and bilateral trade and investment has grown significantly.

Libya, with its massive oil wealth, offers great opportunities as it seeks to diversify its economy, although the business environment can be challenging. Massive expenditure on infrastructure and public services has fuelled a construction boom, and financial services, health and education, real estate and infrastructure, and tourism are growth areas. While the economy remains state dominated, a process of economic reform and liberalisation is underway. There are strong historical links with the UK and English is widely used in business. British exports to the market rose by over 50% in 2009 to £423 million.

Jordan, despite its scarce natural resources, continues to experience growth and attract investment, its free zone at Aqaba being a major success. Jordan has developed as a hub for doing business with Iraq and current focuses of development include renewable and nuclear energy and the exploitation of its oil shale resources as well as tourism and ICT. Syria continues to open up, while Lebanon, with its open economy and strong and resilient private sector, provides an attractive business environment.

How the Middle East Association (MEA) can help you

I hope that little snapshot has convinced you that the MENA region should be viewed as a priority for business development. If so, The Middle East Association (MEA) is here to help you! The MEA, with its unrivalled regional knowledge and business experience, as well as its network of high level government and private sector contacts, is uniquely placed to keep abreast of the changing priorities and developments in the region and to assist British companies to take advantage of the opportunities. The UK's foremost private sector organisation for promoting trade and good relations with the broader Middle East and North Africa, the MEA is an independent and non-profit making association which represents some 400 large and small companies from all business and industry sectors who together account for an estimated 70% of UK trade with the region.

Working in close co-operation with UK Trade & Investment and the FCO, we run a full programme of events for the benefit of British companies, which include major conferences, seminars, trade missions, business briefings, VIP lunches and receptions with visiting Ministers from the region and Arab and UK Ambassadors.

For companies new to the region, there is no better way of evaluating the market potential and establishing those all important personal relationships that are the key to business success in the Middle East, than taking part in an MEA trade mission. We take more companies out to the region on our trade missions than any other organisation – most of them new to the markets - and we are continually opening up new markets for British firms – we were the first organisation to take British companies out to Iraqi Kurdistan, for example. We take twice yearly missions out to Saudi Arabia, Libya and Iraqi Kurdistan and our forthcoming programme includes missions to Turkey, Algeria, Kuwait and Jordan, Morocco, Syria and Lebanon, and Azerbaijan.

Our conferences and other events offer participants the opportunity to obtain up to date market information as well as excellent high level networking opportunities. Our forthcoming major events include our annual Opportunity Arabia conference on Saudi Arabia on 23 September, and our Oman Trade & Investment Forum to take place at the Mansion House on 21 October. This event is being organised in celebration of the 40th anniversary of the succession of HM Sultan Qaboos bin Said, and will be attended by a forty strong Omani delegation including Omani ministers. There are many other smaller events planned, including business briefings on Turkey and Dubai, and VIP lunches with Arab Ambassadors and British Ambassadors to the region.

Our sector priorities reflect the priorities of the region and the strengths of British companies. Financial services, where the City of London is a world leader, is one. Our annual City & GCC Financial Services Summit, which has the support of the Lord Mayor and the City of London Corporation, is acknowledged as the leading event for promoting collaboration between the City of London and the Gulf Cooperation Countries. Education and skills is also a priority, as the countries of the region invest massively to raise standards and equip their young populations with relevant skills, as well as to develop knowledge based economies. There is tremendous scope for partnerships in this area, and we have set up a working group to pursue initiatives, which include an annual conference and education and training sector trade missions.

Membership of the MEA

Membership of the MEA offers a range of benefits, from preferential rates at our events to advice and assistance from our expert staff. Why not get in touch? ■

For further information about membership and an up to date programme of events, contact Feride Alp, tel: 020 7839 2137, email: feride@the-mea.co.uk, or visit our website, www.the-mea.co.uk. We look forward to hearing from you!

The Middle East Association

Middle East Association

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Libya - a land of opportunities

The Middle East Association's Libya IV – Trade & Investment Forum held on Tuesday 6 July at One Great George Street, London SW1, was attended by around 175 business representatives including a 35 strong delegation from Libya. Sponsored by Europe Arab Bank and Denton Wilde Sapte, the Forum highlighted the strong relations between the UK and Libya and the prospects for the expansion of UK/Libyan trade and investment as a result of Libya's efforts to diversify its economy, massive investments in infrastructure, the encouragement of the private sector and improvements in the business environment.

Introducing the conference, Michael Thomas, Director General MEA, commented that UK exports to Libya have grown strongly in recent years. The MEA has played a leading role in developing British trade with Libya, taking at least two missions a year to the market.

In a keynote speech Dr Alsedieg Alshaibi, General Manager of Social and Economic Planning Management, Ministry of Planning and Finance, Libya, highlighted Libya's strong growth rate since 2004 and the potential for UK/Libya business, with UK involvement and expertise sought in BOT, BOO and other infrastructure projects. Antoine Sreih, CEO, Europe Arab Bank, highlighted the strength of Libya's economy, its role as an important future source of world energy, recent economic and banking reforms, and the increase in FDI since the lifting of sanctions. He also highlighted the potential for the growth of the non-oil sector in areas such as tourism, the finance sector, healthcare, education and training, real estate and infrastructure. As far as business is concerned Libya is a 'land of opportunities', he concluded.

"There is massive expansion in the construction and infrastructure sector with Tripoli experiencing a construction boom"

Baroness Symons of Vernham Dean, Vice President MEA commented that Libya is investing not only in its physical infrastructure but also in its intellectual capacity building infrastructure and noted the increasing openness and 'real indications of change'.

Open for business

Mr Abdulmagid El-Mansuri, Chairman, Foreign Investment Advisory Committee, Ministry of Industry, Economy & Commerce, Libya, commented that Libya is open for business and is seeking further cooperation with the UK, saying *"Libya is looking to the UK for investment".* There is currently around £1.5 billion of UK investment in Libya, he said. He suggested establishing a mutual fund to encourage UK industries to invest in Libya and highlighted the potential for UK/Libyan business cooperation in Africa given Libya's strong role in Africa.

There was much discussion of the political, economic and business environment. While Libya's enormous foreign exchange reserves ($140 billion), low levels of sovereign debt and progress on privatisation were noted, continuing dependence on hydrocarbons and income disparities were also mentioned, and some concerns were raised about the pace of reform and diversification.

The conference also heard about the consolidation and simplification of the laws relating to business and foreign investment, which will improve the environment for foreign investors. Corporation tax is being reduced to a fixed rate of 20% and the door is being opened for foreign participation in all types of companies. There is also provision for the establishment of the Zwara free zone, which could have its own judicial system, ports and airports. Progress on banking reform was also noted, with HSBC a strong candidate to win one of the two new joint venture banking licenses expected to be awarded shortly. However, constraints to business remain.

Opportunities

The conference discussed developments and opportunities in the oil and gas; education and training; real estate and infrastructure; and healthcare sectors. In the oil sector, a number of IOCs have left due to the lack of discoveries and unfavourable commercial terms. But BP and Shell remain and have massive programmes. In the medium term major gas developments are more likely than oil.

The UK is the partner of choice for education, and there are huge opportunities in this area. There continues to be a huge demand for English language training and it was suggested that businesses should pay attention to the English language needs of their partners. Quality assurance and raising standards are priorities; the CfBT Education Trust is working with the Ministry of Education to set up a schools inspectorate and train head teachers. Many training institutes are looking for partners to operate in Libya. The focus has tended to be on the higher education sector – there needs to be more focus on the primary, secondary and vocational sectors. Much investment is going into education with 500 new schools being built and others being refurbished.

There is also potential for cooperation on healthcare – per capita expenditure on healthcare has risen significantly although medical infrastructure and standards are still immature. There has been growth in private healthcare facilities, particularly diagnostics and secondary healthcare facilities. A recent development has been the establishment of Allibya health insurance company (www.amic.com.ly).

There is massive expansion in the construction and infrastructure sector with Tripoli experiencing a construction boom. Low cost housing projects, office developments and other major projects are underway. $36 billion is due to be spent this year on new infrastructure and housing projects on top of the $66 billion allocated for 2009. Real estate development is at the emerging stage and together with tourism is seen as a means to diversify the economy. There is tremendous potential for tourism development on the east coast – Albirdi Development & Tourism Investment Company is planning major new resort projects here. International real estate companies are moving in but more needs to be done to promote accessibility and encourage real estate developers – Chestertons is working with the Libyans to move the real estate market forward.

There is also massive expansion of utilities – in the electricity sector per capita consumption growth almost doubled between 2000-2007 and load is forecast to double over the next fifteen years. 4,600 mw is currently under construction. There are plans for interconnections between Libyan and its Mediterranean neighbours, and renewables is an emerging market, with the aim for renewables to account for 10% of total electricity supply. There is also the potential for strategic partnerships with Europe for the generation of energy in Libya for consumption in Europe.

Plenty of advice

There was plenty of advice for British companies looking to expand their business with Libya – the importance of personal relationships, patience and persistence, choosing the right partner, and maintaining a presence were highlighted. ■

The Middle East Association is taking a trade mission to Libya from 19-24 February 2011. Contact Feride Alp (feride@the-mea.co.uk) for details.

Conference highlights potential for City of London/GCC collaboration

The Middle East Association's (MEA's) 5th City & GCC Financial Services Summit took place on 19 July at the Merchant Taylors Hall in the City of London. It was organised in co-operation with the City of London Corporation and attended by over 250 senior financial services representatives from the UK and the MENA region. The premier London event promoting financial co-operation between the UK and the Gulf Co-operation Council (GCC) states, it was sponsored this year by Europe Arab Bank, HSBC, Qatar Financial Centre Authority (lead sponsors); The Bahrain Centre for Alternative Dispute Resolution, and the National Bank of Abu Dhabi. The Summit provided a valuable forum to explore the evolving synergies between the City and the GCC in the context of the aftermath of the global financial crisis and the shift eastwards in the focus of global economic influence. It highlighted the growing economic power of the GCC states and their importance to the UK, the pivotal role played by the City of London, and the strong potential for further cooperation in areas ranging from sovereign debt market development to financial sector reform and professional training.

Opening the conference Michael Thomas, Director General, MEA commented, *"The GCC countries are playing an ever more important role in investing in projects across the MENA region and beyond. This is evidenced by the fact that with us today we have five top business representatives from Palestine who are involved with major projects, one of which, a construction project valued at $800 million, is being financed by Qatari Diar."*

Baroness Symons of Vernham Dean highlighted the diversity of the Gulf markets, while HE Mr Khaled Al Duwaisan, Kuwaiti Ambassador, underlined the close relations between the UK and the GCC countries but urged UK companies to be more proactive in pursuing opportunities in the face of increasing competition.

In a keynote speech Alderman Nick Anstee, Lord Mayor of the City of London, highlighted the pivotal role of the City of London in global trade and development and discussed the challenges and opportunities created by the key drivers of diversification, demographics and the eastward shift in the global economy. *"GCC countries are tourist, cultural and educational centres – IT and processing centres - producers of petrochemicals – transport hubs – the list goes on...Gulf companies are international players; Gulf centres are global business hubs. London can flourish if it continues to be effective and competitive – in delivering business services, and mobilising capital for them and with them,"* he commented. He highlighted in particular the scope for British based training, higher education and professional qualifications; and the opportunities arising from massive infrastructural development including mobilising capital and providing expertise through conventional and Sharia-compliant routes, and through PPP and related methods. He underlined the significance of the major shift in global economic influence. *"The GCC countries are no longer just passive strategic investors – though that remains an element of their approach. They are also venture capitalists, deal-makers, suppliers of private equity to world business. The flow of capital and expertise is firmly two-way."* He ended by urging the government to provide a favourable tax and regulatory environment to attract overseas investors and to avoid overregulation, issues which were raised by subsequent speakers.

The Lord Mayor of the City of London, Alderman Nick Anstee, addressing the Conference

Did you know?

In 2010 the UK was the leading foreign investor on the Abu Dhabi Securities Exchange, accounting for more than 20% of total trade

Four of the eight top banks in the GCC are British

The Abu Dhabi National Exhibitions Company expansion of the ExCel conference centre is forecast to bring £1.6 billion of economic benefit to London in 2011

The Qatar Investment Authority (QIA) bought Harrods for £1.5 billion in May 2010

There are 26 sukuk listed in London with a combined value of £9.4 billion

The MENA region controls 35% of global Sovereign Wealth Fund (SWF) assets of $3.51 trillion

The Islamic finance market is expected to grow by between 10 and 20% year on year in 2010, driven by sukuk issuance

The Gulf insurance market is forecast to grow at a rate of around 25% until 2013

Lord Sassoon, Commercial Secretary to HM Treasury, highlighted the strong relations between the UK and its partners in the Gulf and the priority attached by the new UK Coalition Government to developing commercial relations with the region. Pointing out that trade growth is central to the Coalition Government's strategy, he said *"It is for this reason that, as we look across the globe, the Gulf stands out as an extremely significant region to be working with. The Gulf is the UK's 7th largest export market and has a growing consumer market. And the Gulf states are critical to the inward investment that the UK vitally needs."* Treasury ministers will be making regular visits to the Gulf starting this autumn as part of the Government's wider Gulf initiative, he said.

"As well as directly providing financial services to the Gulf it is in our interests for the UK to provide expertise to support financial services reform," he went on. *"Events such as the Dubai World debt restructuring serve as a warning that it is vital to make progress in this area."* He highlighted the opportunity for increasing technical cooperation between regulatory authorities, noting the MOU between the International Centre for

MEA events provide high level networking opportunities

Financial Regulation and the Emirates Securities and Commodities Authority. He highlighted opportunities for providing expertise and services to support Gulf infrastructure development, from bringing together investment consortia to supporting the development of sovereign debt markets, noting the establishment of the new Treasury unit Infrastructure UK. He concluded by saying that the UK and the Gulf need to look beyond the recent global crisis and constantly search for new areas of mutual interest to develop.

Shashank Srivastava, Acting CEO, Qatar Financial Centre Authority, discussed the increasing role of the GCC, and Qatar in particular, as a destination for international capital. *"The global financial crisis in some ways provides the context for the GCC's and Qatar's emergence as a capital destination,"* he said. Noting Qatar's economic strength he said *"We believe that Qatar will be a key part of the global trend which is seeing a shift in the economic balance of power towards the emerging world, especially the BRICS, but also towards the Middle East and Africa."* QFCA is looking to build a world class financial services marketplace focusing on the creation of a global business hub for three core markets – asset management, re-insurance and captive insurance, he said.

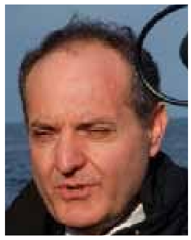
Michael Tomalin Chief Executive, National Bank of Abu Dhabi, highlighted the strength of the UK/GCC relationship, referring to London as the 'eighth emirate'. *"London is the first port of call for investment, property, business, education and holidays,"* he said, *"but other centres are vying for attention."* British financial institutions play a leading role in the GCC – London banks dominate cross border syndicated loans, four of the top 8 banks in the GCC are British and much of GCC insurance is reinsured in the London market. He noted the shift in the GCC countries from being exporters of capital to importers of capital, and the potential for using the GCC as a platform for doing business with the wider region.

Other speakers at the conference included James MacPherson, CEO, Bahrain Chamber for Dispute Resolution; Howard Gooder, Head of Project Finance, Europe Arab Bank; Robert Gray, Chairman, Debt Finance and Advisory Group, HSBC Bank; Andrew Altman, CEO, Olympic Legacy; Sir Anthony Evans, Chairman, Dubai World Special Tribunal; and Xavier Rolet, CEO, London Stock Exchange. Issues debated in lively panel sessions included project finance and infrastructure development in the MENA region; asset management in the GCC and the role of the City of London; rebuilding and restructuring Gulf capital markets following the global downturn; and improving the business environment through greater transparency and recourse to arbitration. ■

The conference is followed by the MEA's City of London Annual Luncheon at the Mansion House on Wednesday 6 October 2010, which will be addressed by Alderman Nick Anstee, Lord Mayor of the City of London and Stuart Popham, Chairman of TheCityUK. For further information email: jacqui@the-mea.co.uk.

Middle East Association

Stock markets in major oil exporting Middle East countries: risk analysis and vulnerability to change in S&P 500



Ibrahim A Onour is Associate Professor of International Finance at the Arab Planning Institute, Kuwait, and Bruno S Sergi is Professor of International Economics at the University of Messina, and Principal Research Fellow & Member of Advisory Board of the Centre for EMEA Banking, Finance and Economics at the London Metropolitan Business School

As stock markets in Gulf Cooperation Council (GCC) countries, which include Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Sultanate Oman, and Bahrain, have become increasingly open to foreign investors in recent years, they have become more vulnerable to shocks in international markets, and thus more volatile. The increasing integration among GCC markets increased the spill over effect of regional shocks, which in turn contributed towards increasing volatility. It is also to be noted that due to lack of sound regulatory policy in some of these markets, hyping, dumping, and rumours become the main driving force behind the frequent changes in stock prices. In addition, as GCC economies depend largely on crude oil revenue, volatility in oil prices has fuelled extreme stock price changes.

As a result of these changes in GCC capital markets it is important to assess risk in these markets using estimation techniques that take into account some of the empirical regularities, such as high volatility, that characterize asset markets in emerging economies. We employ three different techniques to estimate risk in GCC capital markets. The risk methods include VaR; expected shortfall, and systematic risk.

The value-at-risk (VaR) and the expected shortfall methods capture the likelihood of extreme losses that arise from extreme shocks that influence stock returns, whereas the systematic risk approach reflect the sensitivity of a security or a portfolio to shocks to the overall economy. The theoretical justification of the systematic risk approach is grounded into the Capital Asset Pricing Model (CAPM), which decomposes risk into risk premium and systematic risk, often known as beta factor. Since previous empirical findings the assumption of constant beta has been invalidated; as a result research efforts have been directed towards time-varying beta estimates. On the other hand, value-at-risk (VaR) also gained momentum in the past few years and has become the standard tool of risk analysis in stock markets. VaR is defined as the maximum possible loss to a portfolio with a given probability over a certain time horizon.

In other words, VaR reflects the likelihood of incurring a loss from investing in a portfolio over a certain period of time. The major challenge in using the VaR approach in risk estimates constitutes modelling the assets return distribution which is, according to the empirical research, characterized as fat-tailed and skewed distribution. In this paper, following recent research papers, we estimate VaR and the expected shortfall values using a fat-tail distribution, which is the Generalized Pareto Distribution.

Estimations

Here we include estimation of risk in GCC stock markets using a number of empirical techniques. Table 1 present several descriptive statistics on stock returns. The stock returns defined here represent successive daily closing price differences. The sample period covers from January 1 2004 to June 7 2008. After excluding the weekend holiday periods the sample size constitutes 1,116 observations. This sample period excludes the sharp downfall of GCC stock markets due to the international financial crisis which impacted on them from mid-September 2009.

The analysis presented in the table display positive mean returns, but the negative skewness coefficients reflect the likelihood of negative investment returns in these markets. The maximum and minimum statistics show the Saudi market exhibiting the highest volatility of returns, as this can also be reflected in the highest standard deviation value. The excess kurtosis coefficient indicates the possibility of extreme gains and extreme losses in these markets.

Estimation of extreme loss and extreme gain parameters, which we refer to as the lower and upper tail index values respectively, a_L and a_U with corresponding standard errors, are presented in table 2. Estimation of the upper and lower tails parameters for the Kuwait, Saudi, and Dubai stock markets indicate extreme losses and extreme gains are equally possible in these markets. However, such equal chances of extreme losses and extreme gains are not apparent in the more mature S&P 500 stock returns, which indicate higher likelihood of extreme losses compared to chances of extreme gains. Unlike the other GCC markets, the Abu Dhabi stock market shows a higher probability of significant extreme losses but with smaller extreme gain prospects.

Table 3 present estimation results of risk values (VaR and ES), assuming holding period of the assets for a single day and one week. Estimated risk values of VaR and ES indicate the percentage of a portfolio value that can be lost after holding period. In general, estimation of risk values indicate that GCC markets exhibit higher risk than the S&P 500 stock returns. Among the four GCC markets, Saudi and Dubai markets are the most susceptible to extreme losses.

To verify the accuracy of estimated VaR values, an often employed criteria of back-testing is comparing k-period ahead VaR estimates with the actual loss values computed from the data. Given that VaR estimates risk level, with 95 per cent confidence in the result, we expect only around five failures (actual losses exceed estimated VaR values) in every 100 trading days. If the number of failures (or violations) exceed significantly such a limit, then the model underestimates VaR values, and the opposite is true when the number of violations is significantly smaller than the expected level.

In general, the ideal model yield estimates of failure rates close to stipulated significance level to pass the back-testing requirement. Table 4 reports results of back-testing for VaR and ES estimates, and indicate that at 95 per cent confidence level, the VaR and ES values yield violation rates, within the limits of 5 per cent tolerance level.

Since VaR stand for the maximum loss that is only exceeded on a small proportion of occasions, some authors have criticized VaR as a measure of risk on the basis that it fails to capture the potential losses that exceeds VaR value. It was proposed the use of Expected Shortfall (ES) as a measure of the expected size of a loss that exceeds VaR. It should be realized that ES complement VaR estimates as it answer the question: when VaR values underestimate risk, what is the size of the expected loss? Thus, ES is a measure of the likelihood of high unusual loss, or stock market crash.

While Saudi and Dubai markets are more risky in terms of extreme loss possibilities, the duration of investment period is an important factor in risk management strategy. This is because extreme loss exposure increases with the duration of asset holding period. Results in table 5 present the systematic risk estimates. Beta coefficients reflect the sensitivity of industry (or a market) to global shocks.

Therefore, a portfolio of beta greater than one is regarded more sensitive to change in global conditions, compared to a portfolio below this level. Since the average beta values for the Saudi market exceeds substantially the general composite index beta, which is a unit, it seems Saudi market is the most vulnerable, among the group, to external shocks. It can also be realized that the effect of US markets on risk in GCC markets, with exception of Saudi market, is very minimal as indicated by the last column in table 5.

Table 1. Descriptive Statistics

	Kuwait	Saudi	Abu Dhabi	Dubai
Mean (%)	0.10	0.07	0.09	0.18
St. deviation	0.01	0.02	0.01	0.02
Minimum	-0.04	-0.21	-0.12	-0.15
Maximum	0.06	0.16	0.11	0.09
Skewness	-0.064	-1.69	0.03	-0.49
Ex.kurtosis	8.6	18.4	11.8	9.2

Table 2. Extreme gain and extreme loss parameters

	1 day holding		1 week holding		5 weeks holding	
	$\hat{a}_L$	$\hat{a}_U$	$\hat{a}_L$	$\hat{a}_U$	$\hat{a}_L$	$\hat{a}_U$
Kuwait (std. error)	0.50* (0.09)	0.58* (0.08)	0.37* (0.21)	0.48* (0.19)	0.36* (0.21)	0.51* (0.14)
Saudi Arabia (std. error)	0.37* (0.36)	0.45* (0.13)	0.53* (0.18)	0.51* (0.17)	0.53* (0.18)	0.51* (0.17)
Dubai (std. error)	0.45* (0.20)	0.43* (0.19)	0.53* (0.14)	0.57* (0.12)	0.53* (0.14)	0.57* (0.12)
Abu Dhabi (std. error)	0.44* (0.17)	0.44* (0.12)	0.52* (0.21)	0.36 (5.25)	0.52* (0.21)	0.36 (5.2)
S&P 500 (std. error)	0.44* (0.17)	0.30 (17.7)	0.45* (0.20)	0.38 (0.40)	0.45* (0.20)	0.38 (0.40)

Note: $\hat{a}_L$ is lower tail (loss index), and $\hat{a}_U$ is the upper tail (gain index).

Table 3. Risk estimates

	VaR		Expected shortfall	
	1 day holding	5 days holding	1 day holding	5 days holding
Kuwait	0.082	0.22	0.13	0.30
Saudi Arabia	0.16	0.37	0.25	0.49
Dubai	0.178	0.38	0.26	0.49
Abu Dhabi	0.12	0.29	0.19	0.40

Note: VaR values represent the percentage of maximum portfolio losses during h-holding period of the assets under the normal situation, but ES values represent the possible losses under the worst market condition.

Table 4. Back-testing VaR values

	1 day holding	5 days holding
Kuwait	0.02	0.03
Saudi Arabia	0.02	0.02
Dubai	0.05	0.05
Abu Dhabi	0.02	0.04

Note: Number in each cell indicate the percentage number of days, in which actual loss exceeds estimated VaR values, at a given significance level of 0.05.

Table 5. Systematic risk estimates

	Average	S&P 500 effect
Kuwait with S&P 500 without	0.43E-3 0.32E-3	0.0001
Saudi Arabia with S&P 500 without	3.24 2.68	0.56
Dubai with S&P 500 without	0.37E-2 0.33E-2	0.0004
Abu Dhabi with S&P 500 without	0.26E-2 0.21E-2	0.0005

Note: With and without S&P 500 indicates Beta statistics when S&P index included and excluded from the general composite index. The S&P effect computed as the difference between the mean values of beta statistics.

Remarks

We employed three different methods of risk estimates for the Kuwait, Saudi, Dubai, and Abu-Dhabi stock markets. The three different methods include value-at-risk (VaR), expected shortfall (ES), and systematic risk estimates. Systematic risk estimates based on equal weighted average of the four GCC stock market indexes, beside S&P 500 and oil price indexes, to form a general composite index that reflect the internal and external factors affecting GCC economies. VaR and expected shortfall results indicate risk in the GCC markets rises with the length of holding period, and as indicated by the expected shortfall estimate, Saudi and Dubai markets are the most riskiest in the group as their portfolio losses can reach up to 25 per cent in any single trading day transaction.

To conclude, to assess the vulnerability of the GCC markets to shocks on US stock markets we computed systematic risk values with and without S&P 500 index in the general composite index. Findings indicate S&P 500 contributes with a very minimal effect on the GCC markets risk. This implies that substantial portion of volatility in GCC markets is attributable to internal factors rather than external spill over effects. ■

Figure 1. Risk measures

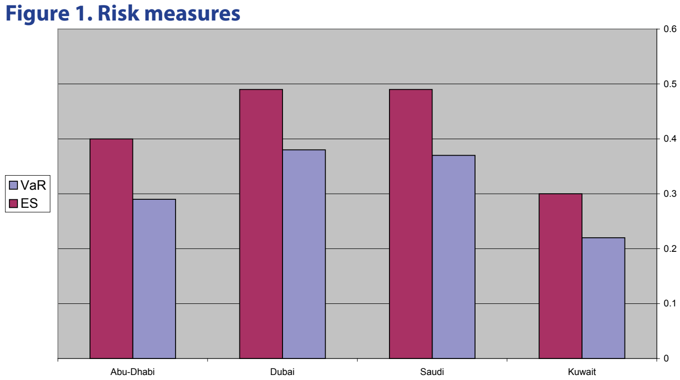
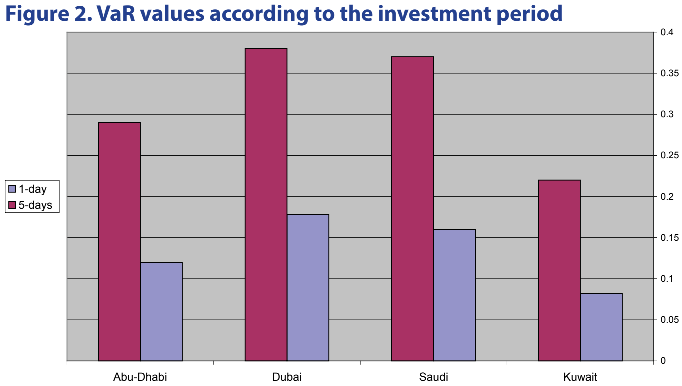


Figure 2. VaR values according to the investment period



Q: What online activities are most popular with your customers and how are you preparing for the next wave of such activities?

Logic: Social networking and online purchasing are the primary activities carried out by our customers. Naturally, as online applications evolve and users become more dependent on online applications, bandwidth requirements increase. Therefore, we must be prepared to meet this demand.

BTC: Our business customers are focused on the mission-critical applications that drive their individual businesses, which require BTC to develop networks and services that offer higher speeds and more robust capabilities. As a result, BTC is continuously implementing new projects and initiatives.

M3: Wireless device capabilities, especially tablets like the iPad, mean that our customers are able to do the same things online that they do on their laptops; however, the vast majority of customers use the internet on their phones for email, instant messaging and social networking (sites such as Facebook and MySpace). We are upgrading to 3G+ and bringing in devices capable of utilising the speed.

Q: What are your customers asking for?

BTC: We find that business customers typically want more bandwidth to accommodate increasing traffic, redundant networks to ensure reliable and robust communication, and audio, video and web conferencing capabilities — all of which result in "business as usual" for BTC.

North Rock: We have built a highly redundant network comprised of two NOC locations in Bermuda, connected to multiple international fibre cable systems. Bandwidth terminates at North Rock's POP in New York City. In New York, North Rock is connected to multiple voice and data carriers. On the wireless front, we have 200mHz of WiMAX spectrum — 3.4mHz to 3.6mHz. The capital investment in wireless is to capitalise on the next generation 4G WiMAX standard. With nine years of wireless experience and three utilising WiMAX, we are well positioned for the convergence of data, voice and video technologies. We anticipate that customers will want their content anywhere, anytime.

M3: There is a small segment that wants faster speed, but the primary concern for everyone is reliability. Wireless devices have become ubiquitous in everyday life. Of course, lower cost is something customers always want.

Logic: In what is currently a complex communications market, customers are seeking a seamless, affordable and reliable telecommunications experience. Services are developed to meet the specific needs of their business with emphasis on superior customer support.

Q: In what areas of telecommunications does Bermuda excel?

M3: Bermuda excels in wireless service. There are three providers, all offering 3G service. Bermuda's wireless penetration and BlackBerry usage rates are higher than those in most of the world. International businesses can set up in Bermuda, assured that they will be able to have consistently reliable wireless voice and data service locally and abroad.

Logic: Bermuda provides a vibrant telecommunications infrastructure from satellite to multiple undersea cables, offering diversity and reliability — the most recent addition being the new Challenger undersea cable connecting to the United States.

BTC: Bermuda has a wealth of telecommunications infrastructure and a wide variety of competitive providers that offer customers a choice of services and providers.

North Rock: Bermuda is unique, in that with a small population of 65,000 people in 21 square miles, we have more choice and fierce competition than large jurisdictions. International companies can choose from more than 12 licensed carriers. This choice ensures innovation, excellence in customer service, and value for their communication dollars spent.

Q: Are there particular areas of telecommunications that Bermuda could improve?

Logic: Presently, we are still unable to provide customers with "bundled services" (what is deemed as a seamless and unified communications offering) due to the current regulatory infrastructure.

BTC: Bermuda's business and residential customers would love lower prices. The small size of Bermuda's market, however, makes it difficult to realise the scale of economies that lead to lower prices.

M3: Bermuda's transport medium to the home is still not yet able to provide the highest speed services (example: fibre to the home)

Q: What advantages does Bermuda offer telecommunications companies?

BTC: Bermuda offers telecommunications providers a sophisticated business environment with critical communications needs and — as an island — critical global communications requirements.

M3: The Ministry of Telecommunications' reform of the current regulatory structure will provide greater transparency, as decisions will be made according to the regulations and processes that will be implemented.

North Rock: The Ministry's goal is to provide managed competition and ensure sustainability of the industry. This is a difficult challenge in a small jurisdiction with dominant carriers that are verticalized.

Q: What advantages do telecommunications companies offer international companies that are setting up on the island?

Logic: The deployment of a reliable, robust communications infrastructure in a short period of time.

BTC: Bermuda's telecommunications companies offer international businesses sound infrastructure, solid international connectivity, deep experience in dealing with international businesses and business requirements, competitive choice and excellent working relationships among and between local and international carriers.

Q: Can you find on the island everything you need to make your business work?

Logic: Telecommunications requires specific technical expertise and certifications. Finding the right resources in Bermuda is sometimes challenging. Equipment also needs to be shipped in.

BTC: Absolutely. We do not have any difficulty finding what we need to do business.

North Rock: Many companies comment on how much easier it is to do business in Bermuda due to the small size and the level of expertise. The intellectual capital in telecommunications is very high. Providers are very responsive and due to Bermuda's location they understand the critical need of uninterrupted service.

Q: Does being in a relatively small jurisdiction enable you to voice your concerns directly to regulators and politicians?

BTC: Yes, we have no difficulty expressing our concerns to regulators and politicians, most of whom are very well aware of the impact of telecommunications on economic growth and development.

North Rock: Yes. Since 2005, North Rock has been actively involved in the regulatory reform of the telecommunications market with the Ministry of Energy, Telecommunications and E-commerce. We have a positive working relationship with the Ministry. We are dedicated to ensuring that Bermuda is a foremost International jurisdiction with leading telecommunications infrastructure.

M3: Yes, METEC is accessible and you can gain access to the Minister to voice your concerns.

Q: How do you see the future of telecommunications unfolding in Bermuda?

M3: The new regulatory structure will benefit the consumer with better pricing as competition unfolds. We will see the number of players in the market shrink. Bermuda will continue to keep pace with the rest of the world in wireless services.

Logic: The new regulatory structure will not only provide consumers with greater choice but also allow us to finally provide them with the seamless communications experience they desire.

BTC: Telecommunications in Bermuda will continue to thrive as competitors continue to invest in new communications technologies.

North Rock: The continued need for increased internet bandwidth and the need for high-speed data on mobile devices is expected to drive telecommunications demand in Bermuda.

Q: How focused are Bermuda's service providers on security?
Logic: All providers are very focused on the security aspects for both customer information and communications privacy and adhere to all guidelines set forth by the Ministry of Telecommunications and law enforcement agencies.

BTC: As more users migrate to internet- and IP-based services, the requirements for network security are increased for all providers. So, security is definitely a focus for BTC, and we're investing heavily in hardware and software tools and security devices to protect our network and our customers' communications.

North Rock: Communications security is of utmost importance and the service providers in Bermuda deliver to this requirement. Our financial, insurance, reinsurance, and captive markets are attracted to and domicile in Bermuda due to our stringent security practices. ■

US export regulations would be simplified by proposed reforms, but not enough

Joan Koenig is Counsel in the Corporate and Securities Practice Group on the Customs and Trade and International teams at Drinker Biddle & Reath LLP, Chicago, IL

It is no secret that the current US system of export controls is cumbersome, complicated and unwieldy for US exporters and their customers. Trying to determine which of multiple sets of regulations applies can be mind-bending. Determining classifications and obtaining export licenses can take months. Even when a license is granted, restrictions on the license can place significant administrative burdens on down-stream customers. And, failing to invest the time and resources necessary to navigate the maze can result in substantial fines, penalties, and even a prison sentence in extreme cases.

For parties outside the United States who have to comply with the regulations – those who distribute US goods, use US parts or materials in their production, or those who purchase from smaller or less sophisticated US manufacturers who only sell ex-works, these regulations can be even more difficult to comply with. However, there may be a pinprick of light at the end of the tunnel.

The Department of Commerce's annual Update Conference was held August 31 – September 2 in Washington, DC, to brief US exporters on changes in US regulations. At this year's Update, the focus was clearly on President Obama's National Export Control Initiative, the goal of which is to alleviate some of the challenges mentioned above. Below is a brief overview of some of the challenges faced by US exporters and their customers, as well as the proposals the Obama Administration has set forth. For political reasons, some of the proposed reforms are, unfortunately, not very likely to occur. Further, there are additional problems the reform initiative does not even acknowledge. However, if they are enacted, some of these proposals will help to reduce the administrative costs and uncertainty of dealing with these regulations.

Overview

Although all industrialized countries have export control regimes, many of which are based on the same multilateral conventions such as the Wassenaar Arrangement and the Missile Technology Control Regime, the US system of export regulation has raised bureaucracy to a true art form. From the outset, US exporters are faced with competing control regimes. The Department of Commerce's Commerce Control List (CCL) identifies controlled 'dual-use' products by reference to specific technical parameters (eg. is the product accurate to within 6 microns, is it capable of operating with melting temperatures above 1,973K, etc.). Subject products fall under the licensing requirements of the Export Administration Regulations or EAR. The Department of State's International Traffic in Arms Regulations (ITAR), on the other hand, identify controlled 'defence articles' in general terms on its US Munitions List (USML) (eg. 'Military Electronics'). The ITAR also controls parts and components specifically designed or developed for use with named items, as well as parts that are modified or configured for use with named items. In many cases jurisdiction will be obvious (eg. a tank is subject to the ITAR and a pickup truck is subject to the EAR). In other cases, the correct answer is not obvious (eg. a pickup truck that has been upfitted with armour plating is subject to …).

Secretary of Commerce Gary Locke touched on this issue at the Update Conference. Placing two heavy vehicle parts on the podium before him, Secretary Locke explained *"[t]he only differences between [these parts] are that the holes are of minutely different sizes and that one is steel and the other aluminium. They have no functional difference. But, one of these items, the one made out of steel, can be exported almost anywhere without a license. It is for an ordinary fire truck. The other, because it is 'specifically modified,' that is, it has minutely larger holes and is made out of aluminium, is designed for use in a military vehicle, and can get you 20 years in prison if you sell it abroad without a license."*

Of course, there is a formal process in place for answering these esoteric questions, called a Commodity Jurisdiction request, or CJ. However, the process can take months, making a CJ of limited value to businesses trying to make a sale. On top of this, once an exporter knows which regulations apply, a lack of transparency as to whether licenses will be approved, and when, create significant business uncertainty. And, in some instances, licenses may be approved, but with conditions that render the transaction commercially unfeasible.

Parties outside the United States should not, however, sit back smugly in the knowledge that these regulations do not apply to them. The extraterritorial reach of US export controls creates administrative burdens for purchasers of US goods, too. The US Government continues to exert re-export jurisdiction over goods after they leave the United States, in many cases, even if those US goods are incorporated into foreign-made products after their export.

Therefore, a company in the United Kingdom that purchases goods from a US supplier may need an approval from the US Government to re-export the US product, or even to export a UK-made product that contains US parts and components. This is true regardless of whether an approval is also required from the UK Government. Is it any wonder, then, that purchasers may seek to de-content US articles and technologies in preference for alternative sources of supply?

Consequences

"Many current controls aimed at protecting US national security, in fact weaken US innovation and competitiveness in global markets." President

*WE'RE eREADY WHEN YOU ARE.

Bermuda is highly regarded as one of the most sophisticated e-Business jurisdictions in the World. According to Economist Magazine's eReadiness survey, out of seventy countries assessed, Bermuda has consistently ranked among the Top 21, and in 2009 was in the top 10 overall for business environment and connectivity. Not coincidentally, Bermuda's business continuity and data recovery services compete head-on with others in larger business centres, with great efficiency. We are here and eReady to help your business maximise its potential, whatever the challenge.

GOVERNMENT OF BERMUDA
Ministry of Energy, Telecommunications and E-Commerce
Department of E-Commerce

bermuda ebusiness*

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Barack Obama in a taped message to the Department of Commerce's Annual Update Conference, August 31, 2010.

The consequences of these incentives to move away from US sources of goods are far-reaching. Apart from the economic consequences in losses of export sales, industry has long argued that this trend, if not stopped, will also pose serious national security risks. Simply, the United States and its allies rely heavily on the initiative and innovativeness of industry to develop new products and technologies to protect and enhance our security, and by creating roadblocks to businesses in the United States and elsewhere working cooperatively, the current US export control system only undermines the ability of those companies to develop new and innovative products.

A good example of this is the serious deterioration of the US satellite industry once satellite products were moved from the controls of the EAR to the controls of the ITAR. By placing significant restriction on the transfer and retransfer of satellite technologies, the United States systematically undercut the competitiveness of the industry. In short, the domestic industry was put at a competitive disadvantage by the restriction of the sale of goods to overseas markets, even when substantially similar items were readily available in the global marketplace.

What's the idea?

"By enhancing the competitiveness of our manufacturing and technology sectors, they'll help us not just increase exports and create jobs, but strengthen our national security as well." President Obama, August 31, 2010.

After years of US export control authorities denying that the system might need modification, at least in public, President Obama ordered a comprehensive review of the US export controls system in August 2009. The goal of the review was to identify possible reforms, efficiencies and improvements in the system. In the President's words, the assessment was intended to review *"what we control, how we control it, how we enforce those controls, and how we manage our controls."* The results of the review confirmed what many in industry, both in the United States and abroad, have known for years: the current US export control system does not provide security because its structure is overly complicated, it contains too many redundancies, and it tries to protect too much.

Based on these findings, the Administration has proposed a series of reforms *"to build high walls around a smaller yard"* by focusing our enforcement efforts on our *"crown jewels."* President Obama's address, August 31, 2010. The proposal seeks to accomplish this by making classifications and license determinations easier and faster, by reducing the number of controlled items, making it easier to determine if an item meets the criteria of the lists, providing some certainty in the licensing process, and facilitating exports of less sensitive items to destinations and end users that do not pose substantial national security, proliferation, or similar concerns.

Increased sales create greater opportunities and incentives for companies to innovate and refine the technologies that ultimately enhance and benefit US and allied national security. Further, with allied militaries looking increasingly to commercial off-the-shelf dual-use technologies, the United States must ensure that licensing criteria are based on objective technical parameters that take into account the strategic nature of an item and whether or not the item is available from non-US suppliers.

What's the plan?

After reviewing the task force's recommendations, the Obama Administration has determined that it can achieve substantive reform with the transformation to a single control list, a single enforcement agency, a consolidated Information Technology (IT) system, and a single licensing agency. To achieve this, the Administration has laid out a three phase implementation program (details are available at http://www.whitehouse.gov/the-press-office/fact-sheet-presidents-export-control-reform-initiative).

Phase I will include harmonizing the two control lists, establishing new control criteria to determine appropriate control levels, implementing efficiencies in the licensing processes, creating a central Export Enforcement Coordination Centre, and beginning the process of determining needs for a single IT infrastructure for export licensing.

As an example, the regulatory agencies are working to make the CCL and the USML 'positive lists,' based on specific characteristics such as size, speed, wavelength, or the ability to operate under extreme atmospheric conditions. Under this new standard, a part should no longer be controlled simply because it was specifically designed or modified for use in a military application. Once this process is complete, exporters and their customers will purportedly be able to know which agency has jurisdiction over a particular good, and as a result, what the export or re-export licensing requirements are for the good.

Phase II will involve more substantive reforms, to the extent they can be implemented without legislative changes. This will include restructuring the CCL and USML into 'tiered' structures, with licensing criteria depending on the tier into which a good is placed. To the extent that items are identified for decontrol, this may be done unilaterally, or proposals will be submitted to the appropriate multilateral control regime (Wassenaar, etc.).

The hope is to achieve a significant reduction in license requirements compatible with national security priorities. As a trade-off for requiring fewer licenses, the agencies have communicated that enforcement efforts will be increased. That is, fewer parties may need licenses, but those that do had better get them (and comply with them).

In Phase III the CCL and USML would be merged into a single control list. The US Government would implement a system to ensure the list stays current as technologies change and evolve, would implement single licensing agency, would consolidate certain enforcement activities into a Primary Enforcement Coordination Agency, and would create a single, enterprise-wide IT system (both licensing and enforcement).

Unlike Phases I and II, however, the reforms proposed in Phase III could not be implemented administratively. They would require legislation, which significantly decreases the odds that the reforms in this phase will ever come to pass. Simply, it is far too likely that legislators will balk at supporting legislation that could be construed as easing exports of sensitive items or, heaven forbid, acknowledging that other countries might be able to compete with or even surpass the technological innovations of the US.

What does it mean for US exporters and their customers?

For US exporters, the proposed reforms should simply and streamline export licensing determinations. For both exporters and their customers, this should provide an improvement in business certainty.

Certain other reforms are conspicuously missing from the discussion, however. One is any scaling back of the extra-territorial application of the US export control regulations. Therefore, non-US companies that re-export US goods or incorporate US parts and materials into their products will still face the administrative burden of tracking which products and materials are from the United States particularly for companies that sell to countries subject to US embargo (Cuba, Iran, Syria, Sudan and North Korea) and for companies that deal in defence goods.

Another obvious reform that is absent relates to exports subject to another strong and effective export licensing requirement. Therefore, companies that export products subject to controls by their own government will likely continue to require both a national export license and a US re-export license for strongly controlled articles and technologies, particularly in the defence sector.

In sum, the proposed reforms are a change the right direction. They should create efficiencies and provide greater certainty for US exporters and their customers. At the same time, the changes as proposed are not likely to be implemented in their entirety. Further, they are not expansive enough, in that they maintain significant extra-territorial controls, even for re-exports from our closest allies. ■

The provision of funding: loans or capital? Profit participating loans. The Dutch tax view

Jos Peters is the Senior Tax Partner at Merlyn International Tax Solutions Group

Many years ago tax authorities took for granted how tax payers denominated the way they provided funding to group companies. Funding with formal capital is still easy to determine, but as soon as the provision of funding to group companies takes place as informal capital, the analysis can easily get blurred. In addition there are the "funny loans": loan agreements whereby the terms and conditions differ markedly from loans between independent players.

After all, freedom of contract is available in most jurisdictions so parties can on paper agree to anything they want. And if money is provided from the top company in a group to its subsidiaries, the parent will often decide on its own what the terms and conditions should look like. Room for toying around, therefore, sometimes with unexpected consequences. Do it wrong and you end up with non-deductible interest expenses in one group entity but taxable interest income in another group entity. But the opposite is also possible: tax-deductible interest on the one hand but tax free interest income on the other hand.

This occurs because tax authorities, since the mid-eighties of the previous century, have found out that tax courts are willing, depending on the circumstances of each case, to reclassify interest payments into "deemed" dividends. The payer of an interest amount which is reclassified as deemed dividend faces non-deductibility (dividends are not tax-deductible in 99% of jurisdictions) but the recipient of a reclassified interest flow may well be able to claim a tax exemption: if real dividends can be received free form corporate income tax, then deemed dividends should be treated the same way. Many Western-European tax jurisdictions offer such a "participation exemption" nowadays: France, Belgium, the Netherlands, Germany, Spain, Sweden etc. The UK is considering participation exemption too.

"What constitutes a loan for accounting purposes may not be a loan for tax purposes"

During the last three decades or so of the 20th century, the Dutch Supreme Tax Court faced a number of cases whereby tax payers defended a different tax treatment of their interest income or expense than the tax authorities. This usually dealt with interest payment between related entities where conditions were imposed which one would hardly find elsewhere.

In a case where the parent of a group provided a loan to a subsidiary company in the group, but it was clear from the internal documentation that the intention had been to provide equity, but parties wanted to circumvent certain legal disadvantages to a capital contribution so they called the provision of the funds a "loan agreement", the verdict was that this was not a loan but capital for tax purposes despite the wording of the document. The interest income from this loan was subsequently a deemed divided under the Dutch Corporate Income Tax Act (CITA) and remained untaxed (whilst abroad the interest was fully tax deductible).

In a second major verdict, the Supreme Tax Court faced a situation where a subsidiary of a multinational was obliged to redeem a bank loan and asked its parent company to lend her the money to repay the bank. So one loan was replaced by another loan. The verdict here was nonetheless the same. The subsidiary was not doing well at all (which was the reason for the bank to cancel the loan upon expiration date and not refinance the entity via a loan continuation). The Supreme Court held that if a tax payer provides funds to a related party knowing from the outset that the subsidiary will not be able to repay the loan unless circumstances would change dramatically and unexpectedly, the loan is not a loan in a tax sense but the provision of informal capital. If the debtor is Dutch, the interest on such a loan would not be tax-deductible but if the creditor is Dutch, the interest income would be covered by the participation exemption and remain untaxed.

Over the last decade several Supreme Court cases in the Netherlands have dealt with what tax practitioners now describe as "profit participating loans". Multinational enterprises have increasingly provided funding to their subsidiaries through loan agreements which contain a number of "odd" conditions. Generally speaking such loans have three characteristics which differentiates them from third party loans:

a) A relatively long fixed term (25 years or more);
b) A relatively low fixed interest percentage (usually 1%); in addition there is variable interest which is dependent on the net after tax profit of the subsidiary; with good profitability the variable interest percentage can easily exceed 10%;
c) The loan is subordinated: in case the subsidiary goes bankrupt, all other creditors are paid first before the principal of the loan gets repaid.

There are still many jurisdictions where the tax authorities, to determine whether "interest" is really interest in a tax sense, are not allowed to use an economical analysis but have to treat the loan in the same way it is treated for commercial accounting and/or for legal purposes. A reclassification of interest into a deemed dividend will not easily occur there. But in the Netherlands and a few other countries, the tax authorities, either by law or by jurisprudence, are allowed to follow an economical approach. The most far-reaching tax test would be "could the subsidiary have obtained this loan from a bank?" and if not, the loan is no longer a loan for corporate income tax purposes and the interest thereon is a deemed dividend distribution (non-deductible for corporate income tax and perhaps even subject to a dividend withholding tax). This is the approach in the UK, also for transfer pricing purposes.

The Dutch Supreme Tax Court has followed a middle-road when it judged, in a series of verdicts all covering intra-group loans with variable interest rates:

1) That primarily the legal denomination (ie. the denomination under accounting law) of a loan will determine its tax consequences but:
2) In case the loan is granted under such conditions that the creditor, to a certain extent, participates in the business of the subsidiary, the tax treatment of the loan may require reclassification as the hidden provision of informal capital, so the interest payments no longer qualify as such for tax purposes but become deemed dividend income or expense, which is true if the following three criteria have been met simultaneously:

a) The loan has a maturity date of 50 years or more;
b) The interest is highly dependent on the future profitability of the debtor;
c) The "loan" is subordinated to all other debts of the subsidiary.

This Supreme Court verdict was rendered in the case of a French loan which is commonly known in France as a "Prêt Participatif". Interestingly, this PPL contained a clause on an early repayment possibility (which at first sight seems to conflict with requirement a)) which did not bring the judges to a different verdict.

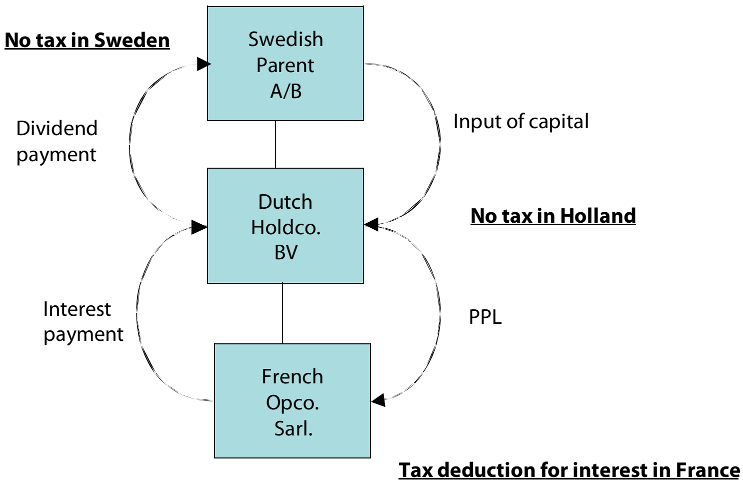
The Dutch tax legislator, at first, did not want to accept that many tax advisers started to use the Supreme Court criteria to create profit participating loans (PPL's) which in the Netherlands would ensure applicability of the participation exemption to the interest income they created whilst knowing that such interest would be tax deductible abroad. For some time the Dutch CITA has therefore contained a special article which made PPL interest income taxable unless the tax payer could prove that the interest was not tax-deductible abroad, but this approach was given up per 1/1/2007 when this anti-abuse article for PPL interest was withdrawn. Consequently, in the Netherlands one may now again apply the old case law criteria to determine whether interest income or expense is also interest income or expense for tax purposes, or a hidden dividend.

With the above explanations in hand one may relatively easily create hybrid intra-group financing structures, via Dutch intermediary holding companies or Dutch group financing companies, from the parent entity in the group to subsidiaries in tax jurisdictions which allow the deductibility of interest on group loans if such loans for commercial purposes are treated as loans, which lead to the tax mismatch described. So one either gets an interest deduction for what in an economical sense is the provision of equity, or a "double dip" (two interest deductions for the same amount) if the group finances the Dutch PPL's from borrowed money in jurisdictions where interest to finance subsidiary entities is tax deductible.

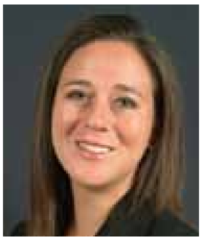
The insertion of a Dutch group entity into such PPL structuring is highly recommended because the interest paid by the subsidiaries should qualify as interest for local corporate income tax, in which case it will likely also qualify for local interest withholding tax. Using the Netherlands in such a set-up implies that one will have access to the Dutch tax treaties which almost invariably imply a zero foreign withholding tax rate. After all, the Netherlands has no interest withholding tax itself so its tax treaties reflect this and the treaty partner is usually willing to give up its own interest withholding tax if the recipient is a resident of the Netherlands. The usual tax treaty requirement that the Dutch entity must be the beneficial owner of the interest income might have to be achieved by taking a final tax planning step (the Beneficial Ownership Booster, BOB) which involves a relatively simple extra step in the set-up which we will gladly explain to anyone who wishes to set up tax effective intra-group financing via PPL contracts with our assistance. In this respect it may be interesting to know that advance tax rulings from the Dutch ruling authority are available for PPL's.

We conclude with an example how a hybrid PPL might bring benefits to a Swedish tax payer with a French subsidiary by inserting a Dutch holding company in the group structure. ■

Exhibit 1



It's time to invest in renewable energies in Guatemala



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Climate change has become one of the most important issues in the world, not only because of its environmental nature, but also since it has such a great effect in international and national economies. One of the human activities that greatly affects global climate is energy generation, especially the one produced through fuel sources, and Guatemala is not an exception. Due to the excessive use of fossil fuels in the country, among other practices, according to the 2010 Environmental Performance Index (EPI), from Yale University, Guatemala is currently ranked at 104 of 163 in its capacity to protect the environment. This position may be overturned if there is more investment in renewable sources, and even though this might be more expensive to set up, in the long run it is cheaper to operate.

Guatemala has the potential to generate electricity through any and all renewable sources. One of its greatest potentials is hydroelectric energy, since there are more than 35 rivers in the country. Before 1996, most of the energy generated in the nation came from hydroelectric plants. But water is not the only renewable source that may be used. Because of its location, Guatemala guarantees permanent access to the sun through solar panels, and biofuels may be easily harvested in its fertile soils. Also, there are 32 different volcanoes in the country, that allow for geothermal energy to thrive. And finally, wind energy may be significantly generated in chosen sites.

The importance of renewable energy sources is that they have environmental, health and cost advantages over fossil fuels. While non-renewable fossil fuel use causes global environmental problems, renewable energy is non-polluting, since they do not release carbon-based warming and polluting agents into the atmosphere. Also, conventional energy sources, such as fossil fuels and nuclear power, create a number of environmental, social, and political problems and are dependent on limited resources found in specific parts of the world. On the other hand, renewable sources may be used repeatedly without being depleted and improve local air quality and reduce human impact on land, water and climate, and therefore there are also indirect savings on health and its costs. Increased use of renewable energy will also help boost local economies through job creation and allows to locally control energy production, ensuring stable prices and increasing security of energy supplies.

As you read this article you will be able to appreciate how Guatemalan legislation favours investment in energy generation, and especially energy deriving from renewable sources, since it is based on free market principles that take into consideration foreign investors, creates specific benefits for renewable energy projects, and the administrative process to set up a generation plant is specifically defined by law, avoiding surprises.

Advantages

Energy legislation in Guatemala derives from the constitutional mandate that electrification in the country is declared as a national urgency and allows for private companies to participate in the process. From this norm, the National Committee on Electric Energy (*Comisión Nacional de Energía Eléctrica*) (CNEE), the State entity in

charge of regulating and supervising compliance in the sector, is now opening for public bidding up to 800MW of energy generation, of which at least 40% will be specifically targeted to renewable energies.

Also, Guatemalan legislation guarantees equal treatment to foreign and national investors, through free market policies. The Constitution states that foreigners may invest in all types of economic activities. There are no restrictions in carrying out transactions in other currencies and to have access to local credit lines. Furthermore, import and export policies are protected and companies are free to repatriate investment capitals or benefits. In the case of any type of differences between the foreign investor and the State of Guatemala, these may be submitted to international arbitration.

"The electric sector in Guatemala is free-market oriented and allows private parties to freely participate in power generation and to be self-regulated"

Principles

Four basic and fundamental principles apply to the electric sector in Guatemala, which allow its participants to easily carry out all electricity related activities. These activities include generation, transportation, distribution, commercialization, and consumers usage.

- Free access to the electric sector
  This principle is considered as a great advance in the Guatemalan electric sector, since it incentivizes private parties to participate in what was previously considered as a State activity. Notwithstanding this principle, the electric sector is subject to those restrictions established by law, such as the need to obtain authorization to use State owned assets, toll prices, etc. Also the quality of these services and prices for specific activities are governed by the technical and coordination standards issued by CNEE and the Wholesale Market Manager (*Administrador del Mercado Mayorista*) (AMM), a private entity that coordinates the operations of agents that participate in the electric sector activities.

- Self-regulation
  With this principle, the State has waived some of its intervention powers and structures, in order to allow social forces to act and boost decentralization and de-monopolization of transmission and distribution of electric energy, to speed up offer growth and satisfy social and productive needs of the inhabitants of the country. Therefore, private participants of the electric sector, through CNEE and AMM, and according to limitations established by law, are empowered to issue norms that encourage development and quality of the service.

- Freedom to participate in the electric sector
  Any person, individual or corporate may participate in the electric sector, through any of its activities. There are no limitations to participate in the electric sector, as long as legal requirements are fulfilled. Also, there are no limitations regarding nationality of participants or their associates, partners or shareholders.

- Service continuity
  The purpose of this principle is to maintain the stability of the electricity service, since it is considered as an essential service for the correct operations of the country. With this principle, the public is ensured the reception of electricity, even when the authorization to generate, transport or distribute energy has been terminated or ended. The reason for this is because the country has borne great economic losses due to interruptions in the service. The Ministry of Energy and Mines is empowered to provisionally place any company under state administration, in order to insure continuity in its operations.

Benefits

Guatemalan legislators saw the need to promote the use of renewable sources to generate electricity in order to protect the environment. The Incentives to Renewable Energy Projects Law creates fiscal, economic and administrative incentives to these types of projects, in order to support their development. Although this law is specially directed to large scale hydroelectric, wind and geothermal projects, nothing in the law prevents other types of projects to apply and obtain the incentives it establishes.

Regarding fiscal incentives created by law, the owner of a project may be benefited by the exemption to some taxes related with the construction and operation of the project. During the investment and construction period of the project, the proponent is subject to the exemption of the Value Added Tax (12%) for all imports of equipment and machinery to be used in the construction of the project. Furthermore, from the moment the project starts operating its owners will be exempt of income tax during a 10-year period. Authorization to obtain the incentives provided by this law must be requested at the Ministry of Energy and Mines during the pre-investment or construction periods.

Also, and in hopes that the term of the Clean Development Mechanism (CDM) of the Kyoto Protocol is extended beyond the year 2012, project owners who contribute with sustainable development of the environment may obtain a Project Approval Letter from the Designated National Authority, in order to become a registered as CDM project at the United Nations Framework Convention on Climate Change (UNFCCC) Secretariat.

Process

Based on the Free Access to Electricity Sector principle, no specific authorization is required to generate electricity. However, if you are using any state asset, such as water or geothermal sources, and when the power to be produced exceeds 5MW, the company must request authorization to use them, from the Ministry of Energy and Mines.

In addition, every person must comply with those laws that tend to protect the environment and the protection of persons, their rights and assets. Based on this norm, the Environment and Natural Resources Protection Law requires the approval of an Environmental Impact Assessment (EIA) for those projects that may deteriorate renewable natural resources or the environment, or introduce harmful or evident alterations to the scenery and to cultural or natural resources.

There are two basic steps required to obtain this authorization. First, obtain approval of an initial environmental assessment in order to determine if the project requires further analysis through another type of instrument. This instrument must describe the nature of the project and its location, its different phases, such as construction, operation and closing, and the possible environmental impacts. Second, if further analysis is required, then a complete EIA must be drafted by an authorized consultant. In this case public participation is given to interested parties and public entities, and an environmental license must be paid for and kept in force.

In conclusion, this is the right time to invest in renewable energies in Guatemala, since our authorities have realized there is a need to promote their use. The electric sector in Guatemala is free-market oriented and allows private parties to freely participate in power generation and to be self-regulated. For consumers, the service is guaranteed, since the market offers continuity in the sector. Also investors may take advantage of the incentives created by law in order to lower their construction and operation costs, and since operation regulations are clearly established by law, and thus avoiding any surprises to investors. Furthermore, as previously stated, the great advantages of renewable energy are that they may be used repeatedly without depleting them; there is no contribution to global warming through polluting emissions; there are savings on health costs, and in the long run, its application costs are lower. ■

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Who has custody of your bearer shares?

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On the stroke of midnight on 31 December 2009 all bearer shares not deposited with an authorised or recognised custodian or converted into registered shares were disabled. Unfortunately, despite the transitional period provided for in the legislation to deposit or convert the shares, some companies still have shareholders in possession of their bearer shares. The big question now is, how can a shareholder or a company deal with these disabled bearer shares?

Background

The introduction of the BVI Business Companies Act 2004 (the "Act"), hailed a new era for the bearer share. The Act reinforced the concept, previously introduced by an amendment to the old International Business Companies Act, that all bearer shares issued by BVI companies (including grandfathered International Business Companies) would be required to be deposited with a recognised/authorised custodian. For many new companies incorporated under the Act and re-registered companies, the power to issue bearer shares is prohibited from inception and as such the requirement to deposit bearer shares is not relevant. Bearer shares in issue that are not deposited with a recognised/registered custodian are now considered to be 'disabled'.

What are the consequences of disablement of my bearer share?

The Act, states that during the period in which a bearer share is disabled, that share does not carry any of the entitlements which it would otherwise carry. Thus, a holder of a bearer share effectively has all of their rights suspended; they cannot vote, or receive distributions or receive any assets on a liquidation or winding up.

Furthermore, subject to certain exemptions any transfer or purported transfer of an interest in a bearer share is void and of no effect during the period of disablement.

What happens now?

The British Virgin Islands Financial Services Commission (the "FSC") has recently issued guidance on how bearer shareholders and companies can re-enable their immobilised shares. The FSC guidance indicates that the preferred method to re-enable the disabled bearer shares is to apply to the High Court of the British Virgin Islands (the "Court") for the requisite extension period.

The Act states that there are two options available to holders of bearer shares:

1. The bearer share may be redeemed by the company; or

2. The company can apply to the High Court of the British Virgin Islands (the "Court") for an extension of time to deal with the bearer shares.

Because of the position posited by the FSC, we would recommend that with regard to option 1, a redemption should be made only for cash consideration. Consideration other than cash (eg. a share for share exchange) would not be permitted under the Act. There is nothing to preclude a shareholder from using the cash to subscribe for new shares in the company, but it should be made clear that this is a distinct transaction from the redemption.

Whilst option 1 may seem the most straightforward, it may not always be suitable for the particular situation in which the company or shareholder in question finds itself. For example, the shareholder may simply not wish to redeem his share and retain the bearer share status rather than having a registered share in place of his bearer share.

Another important factor to consider when deciding whether the redemption option is available to the company is that in order to utilise the redemption procedure, the directors of the company must be able to comply with the requirements of the Act, ie. the redemption payment must be made out of surplus and no redemption may be made unless the company can show that the realisable value of the assets of the company will not be less than the sum of its total liabilities other than deferred taxes, as shown in the company's books of account and its capital and make the required solvency declaration.

It is also important to note that if a company or shareholder chooses to pursue option 1 the company must give notice to the holder of the bearer share stating the redemption price and the manner in which the redemption is to be affected. If the identity of the holder is not known to the company then there is an exemption from this requirement so long as the company has shown that it has made 'reasonable enquiry' as to the identity of the owner. If the shareholder cannot be identified, an amount equivalent to the proceeds must be held on trust for the shareholder in the event they are identified in the future. Furthermore, if the share is to be redeemed without the court application, the member will also have a right to demand payment of a 'fair value' for their shares.

What does the court application process involve?

The application process can be initiated by either the company itself (which is useful if the identity of the holder of the bearer shares is unknown) or the shareholder (or a person interested in the bearer share). The shareholder or company will need to collect as much information and documentation to support their application for an extension. The Court will generally be looking for reasonable explanations as to why the shareholder was not able to comply with the original deadline. It should also be noted that the Court has a discretion whether to consent to the extension so an order to extend may not always be granted.

It should be noted however, that no extensions have yet been granted by the Court and an application to the Court will not guarantee that an extension will be granted.

What should I do once I have been granted an extension?

Upon the grant of an extension, the bearer shares will be re-enabled and the company and shareholders can deal with them again.

There are three options available to the shareholder:

(1) The bearer shares may be converted into registered shares. The company must follow the process as set out in the company's memorandum and articles of association;

(2) The bearer shares may be redeemed by the company (as explained above, also available to the company without a court sanctioned extension); or

(3) The shareholder may deposit the shares with an authorised/registered custodian.

Who is a custodian?

Your bearer shares can be deposited with two types of custodian:

1. An authorised custodian – which comprises a licensed person in the British Virgin Islands or a foreign entity approved by the FSC; or
2. A recognised custodian – which would include an investment exchange or clearing organisation operating a securities clearance or settlement system in a recognised Financial Action Task Force member country.

What happens if I simply do nothing?

If a Company simply does nothing with their bearer shares, the FSC has the power to apply to the Courts in the BVI for the appointment of a liquidator of the company and to liquidate the company. It is therefore important that bearer shareholders and companies with bearer shares in issue, take action as a matter of urgency. ■

For more information on this subject contact Erica Mandryko (erica.mandryko@harneys.com) or Jacqueline Daley-Aspinall (jacqueline.daley-aspinall@harneys.com).

Should set-off rights be registered in the British Virgin Islands?

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Traditionally, the view has been that the right to set off one debt against another does not constitute a security interest but it may be that this position is no longer as clear cut in light of the recent Canadian Supreme Court ruling in *Caisse populaire Desjardins de l'Est de Drummond v. Canada, 2009 SCC 29 (Caisse populaire).*

Security interest defined

A security interest is a right given to one party in the asset of another party to secure payment or performance by that other party or by a third party. A fixed or specific security interest is one which possesses the following features:

(i) it is a contractual right given by a debtor to a creditor in relation to an identifiable asset;
(ii) that right is not by way of reservation of title to the creditor but by way of grant of an interest in the debtor's asset;
(iii) the right is given for the purposes of securing an obligation;
(iv) the asset is given in security only and not by way of outright transfer; and
(v) the debtor's rights to dispose of the asset free from the security interest is restricted by the agreement

What is set-off?

Set-off on the other hand, is the right (contractual, legal or equitable) which allows a debtor who is owed money by his creditor on another account or dealing to secure payment for what is owed to him by setting this off in reduction of his own liability. For instance, a banker is empowered to set off a credit balance on one account against a debit balance on another if the accounts are in the same name and in the same currency. It is an essential tool for debtors who have cross-claims against creditors and is widely utilised in both banking transactions and in mutual dealings in financial markets.

As mentioned above, the traditional view has always been that the right to set-off one debt against another does not constitute a security interest as the arrangement does not grant the creditor a property right in the asset against which set-off is to be effected. It merely involves the setting off of the respective personal obligations against each other and does not rely on a creditor having a property interest in the deposit. The creditor who is setting off has an obligation and has the right to satisfy that obligation by setting off an obligation which is owed to it by the debtor. It therefore does not have anything to do with the realisation of a property interest.

Ruling by the Supreme Court of Canada

Interestingly, in June 2009 the Supreme Court of Canada in *Caisse populaire* decided that set-off rights do create security interests in the case of a credit support arrangement involving cash collateral.

The facts: On 18 September 2000, *Caisse populaire Desjardins de l'Est de Drummond* (the *Caisse*) granted its customer, a company called Camvrac, a line of credit of up to $277,000. A week later, *Camvrac* deposited $200,000 with the *Caisse* in accordance with a "Term Savings Agreement" (the TSA), under which the deposit was neither negotiable nor transferable. On the same day, the *Caisse* and *Camvrac* entered into a "Security Given Through Savings" agreement. Pursuant to this latter agreement, *Camvrac* agreed to maintain and permit the *Caisse* to retain the deposit of $200,000 for the duration of its indebtedness to the *Caisse*. It was also agreed that, in the event that *Camvrac* defaulted, there would be compensation between the credit agreement and the term deposit. *Camvrac* defaulted on the loan on 25 November 2000 and later made an assignment in bankruptcy. The *Caisse* noted on its copy of the "Term Savings Agreement": "To be closed on 21/2/2001 to realize on security".

As *Camvrac* had failed to remit to the Government of Canada (the Crown) income tax and employment insurance premiums deducted at source, the Crown demanded that the *Caisse* pay *Camvrac's* unremitted unemployment insurance premiums and outstanding at-source tax withholdings out of the term deposit funds that it had set-off against *Camvrac's* credit line debt. It was argued by the Crown that the terms of the TSA created a "security interest" within the meaning of section 224(1.3) of the Income Tax Act (ITA) and that the funds that were set-off against it were subject to a deemed trust in favour of the Crown[1].

Section 224(1.3) of the ITA defines security interest as "any interest in property that secures payment or performance of an obligation and includes an interest created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for.

The majority took a functional view of a security interest and held that the TSA did create a security interest in the deposit and that the means of enforcing that security interest was the right of set-off and in supporting the majority's conclusion, it was stated that "it is the encumbrances placed on the debtor's claim against the creditor that ensure that the creditor will remain liable to the debtor, and in this way, ensure an effective compensation remedy. In the view of the majority, these encumbrances placed on the deposit amounted to the acquisition by the *Caisse* of a property interest in *Camvrac's* deposit, primarily because they ensured that the *Caisse* would be continuously liable to *Camvrac*"[2].

In analysing the concept of set-off, Mr Justice Rothstein referred to The Law of Set-Off (3rd ed. 2003) which in the court's view, argues persuasively that some contracts including a right of set-off should be said also to involve security. An example of a set-off situation described by Professor Derham (and which is very similar to that in *Caisse populaire*) was set out as follows:

"...a bank as a condition to the grant of a facility requires that a deposit be made with it which the depositor is not permitted to access until all

indebtedness under the facility has been paid, and the parties agree that the bank may appropriate the deposit in discharge of the debt in the event of default in payment. The essence of the arrangement is that the depositor's property, in the form of the account in credit, is to function as a security. Indeed, in the case of a charge-back in which express words of charge are used, a contractual set-off is the very remedy that would be contemplated..."

The essence of contractual set-off is that the terms of the contract reflect the mutual intention of the parties[3]. Further, if their mutual intention is to create a security interest to ensure that the right of set-off will be an effective remedy, there is no reason to think that a security interest does not exist simply because the parties have chosen one mechanism for realizing on the security, rather than another. What one must consider is the substance of the agreement.

As explained by the court in Caisse populaire, "the situation in this case is in contrast with one in which a bank has what may be a standard term in a deposit agreement that any credit in the customer's account may be appropriated by the bank in discharge of the customer's potential indebtedness to the bank. In that case there is no obligation on the customer to maintain a specific sum or, indeed, any amount deposited in the account at all as security for a loan that may or may not exist. There is no continuous right in the customer's property to protect the bank against default. The customer may withdraw any or all of the amounts in the account at any time. No specific property secures repayment. In these circumstances, based on this type of deposit agreement, the customer's property - its right to claim a deposit - cannot be said to secure its indebtedness to the bank. Unlike the case before this Court, this is a simple contractual right to set-off or compensation without attendant security."[4]

Implications of court ruling

The implication of Caisse populaire is that there is now a greater possibility that set-off rights in the context of cash collateral agreements where credit support is provided may be re-characterized as creating security interests in the cash collateral.

From a British Virgin Islands perspective, the impact of Caisse populaire remains uncertain and there is the possibility that it may set a precedent for the view that cash collateral arrangements and rights of set-off do, in fact, create security interests when they function as security for a borrower's obligation to a lender.

Until such time as Caisse populaire has been addressed by the English courts and/or the courts of the British Virgin Islands, a little more vigilance may be no bad thing. As a general rule, the British Virgin Islands position as regards set-off is that it does not create a security interest and is therefore not registrable. However, as a matter of prudence lenders should consider on a case by case basis, whether set-off in a given transaction might amount to a security interest as a matter of the governing law of the transaction documents and if so, take all appropriate steps to protect their security. ■

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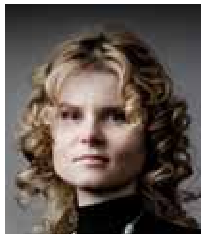
1. Caisse populaire Desjardins de l'Est de Drummond v. Canada, 2009 SCC 29
2. Per Rothstein J
3. Derham, at para. 16.86
4. Per Rothstein J

Contemporary trends in the regulation of the control scope of covenants in European proposals and in Polish Civil Code project



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Introduction

The issue of the control over unfair terms is one of the basic issues of European harmonisation of private law, mainly due to Directive 93/13 of 13 April 1993 on unfair terms in consumer contracts, which was adopted and is being implemented into legal systems of member states of the European Union[1]. However, the subject has not yet been exhausted, and the process of regulating the issue has not yet been terminated.

Fifteen years after the adoption of the aforementioned Directive, ie. on 8 October 2008, the European Commission published an official proposal for the Directive on Consumer Rights[2], the scope of which includes, among others, the issues stipulated in Directive 93/13 in force[3]. The proposal for a horizontal directive is a result of European review and of the national consumer law, ie. the one based upon directives, the substance of which is the protection of consumer rights[4]. From the political perspective, the proposal is significant, since in the event the proposal is adopted, member states will be obliged to implement the directive, which will have to include the requirement of the so-called full harmonisation stipulated in Article 4, which is a controversial issue.

According to the introductory memorandum, the proposal of the horizontal directive arose on the basis of the consultation method (eg. on the side of the European Parliament, member states, entrepreneurs, academics, practitioners), which was then included in the *Green Book* of 8 February 2007. According to the conclusion presented in the summary, the majority of people answering the questions posed were in favour of adopting the horizontal legal instrument applicable in domestic and cross-border contracts, based upon the so-called targeted full harmonisation, the essence of which should be revised and unified issues of basic consumer directives.

As far as the subject of the regulation of the proposal for the horizontal directive is concerned, including, in that respect, the scope of the present paper, ie. the unfair contract terms, of great importance is the fact of creating, the so-called academic projects, so to speak, parallel to the proposal of the horizontal directive in recent years, the aim of which is to encapsulate the *Acquis* Principles in force or to create proposals for common model European legal standards, which, if they did not constitute the code as a standard, universally binding act, they would at least be the so-called optional instrument[5]. In this context we mean, above all, the so-called *Acquis* Principles[6] and the Draft Common Frame of Reference[7])[8].

The importance of the above-mentioned drafts may become a fact, as the European Commission is working on the so-called political CFR. Due to the fact that the horizontal directive draft was created at a time similar to the above mentioned, their mutual influence in terms of substance cannot in fact be claimed. However, all of these directives grow from previous experience concerning the European contract law that is in force in the legal systems of the individual countries, from research and analyses carried out in the field, and they also refer to the judicature of the European Court of Justice[9]. Moreover, the aforementioned drafts may also be attributed common political and legal assumptions, especially in respect to the creation of consistent system of private law standards, at least in the field of consumer law, which still constitutes the core of European legal harmonisation created by means of legal instruments composing the European law,

"From the political perspective, the proposal is significant, since in the event the proposal is adopted, member states will be obliged to implement the directive, which will have to include the requirement of the so-called full harmonisation stipulated in Article 4, which is a controversial issue"

as well as the correction of certain solutions basing upon the research based on the way of functioning of such instruments in legal affairs.

The criteria justifying the scope of the terms' control (the scope of the unfairness test)

Subjective criterion

The proposal for the directive on consumer rights is by definition limited to legal relationships of consumer nature and in that way the proposal is a continuation of the consumer protection policy, which was also the idea behind Directive 93/13 on unfair terms in consumer contracts. The subjective scope of the application of the regulation on unfair contract terms was slightly differently defined in the *Acquis* Principles, which, in that respect, are based upon the provisions of Directive 93/13, which is closely related to the method of creating the Principles[10]; they do not limit in general the scope of application of the regulation on unfair contract terms in subjective terms, but they introduce an objective limitation in certain provisions.

The authors of the *Acquis* Principles acknowledged that *Acquis communautaire* in force does not allow for the unification of all consumer standards as a part of regulation on unfair contract terms. DCFR, on the other hand, suggests another method of regulation concerning unfair contract terms, both in relation to the regulation structure and its scope. In DCFR, a great majority of standards related to the issue of unfair contract terms is of universal nature, ie. they are independent of the nature of the parties of the contract. What is interesting is the fact that in DCFR the subjective issue influences the premises for acknowledging a given contractual provision as unfair, since three standards consist the so-called term unfairness test, ie. in consumer contracts (Article II - 9:403), between the entrepreneurs (Article II - 9:405) and between non-entrepreneur parties (Article II - 9:404).

The discussed above subjective scopes of the results of the proposals in question initially indicate the concepts that lie at their root. Thus it may be concluded from the proposal on the directive on consumer rights that it is based upon the necessity of protection of the so-called weaker party of contract and it guarantees a consumer protection in relation to the scope regulated by the proposal solely due to the subjective premises stipulated in the directive, without reflecting upon the subjective arguments of the proposed regulation. It may be claimed that the authors of the *Acquis* Principles considered the axiology related to the object of the regulation on unfair contract terms in certain cases, unifying the consumer standards, at the same time, however, introducing a limitation resulting from the working methodology adopted in the *Acquis* Group.

Still, in a sense, the members of the DCFR team were the most diverged from the provisions of *Acquis communautaire* in force[11], and when suggesting model standards of the European private law they were governed mainly by the subjective scope of the regulation related to the nature of contract terms which are supposed to be the subject of a detailed control system; simultaneously, they considered the necessary framework of the European law standards that are now in force. The proposal of the regulation included in the Polish project of the Civil Code is based upon the conclusions drawn from the analysis of Directive 93/13 on unfair terms in consumer contracts, from the project of the new directive on consumer rights and from the project of DCFR and *Acquis* Principles. The proposal aimed at removing inaccuracies included in the Civil Code, which is presently in force. The main problem with the control over unfair terms consists is the control of their content. As compared to the present regulation, the project introduces the control of the model content in professional trading, while in the so-called common trading, all contract terms are subject to the content control in relation to their unfairness.

However, the very indication of the subjective scope of a particular regulation does not yet determine the approval of a particular protection concept and its outcomes, since the clue is the already mentioned nature of the contract terms, which are subject to special regulation in relation to general control of the content of the legal relationship resulting from a contract. Considering the above, the subsequent part of the present paper will deal with the issues of the objective scope of control within the regulation frames of unfair contract terms.

Objective criterion

Under Article 30 of the draft horizontal directive, the draft's chapter pertaining to authorisations in the frames of control of contract terms applies to contractual clauses prepared/formulated beforehand by an entrepreneur or a third party to which a consumer has consented without entertaining the possibility to amend the contents thereof, in particular when such terms are a part of a standard contract formulated previously.

Article 1 mentioned above, defining the scope of the application of the said regulation does not refer to the notion of a term which has not been negotiated individually used in the motives and earlier in Directive 93/13 (Article 3.1). The above is made more specific in Article 30.2 on the grounds of which the circumstance that a consumer entertained the possibility to amend certain aspects of contract terms or of one specific provision, does not exclude the application of this chapter of the draft horizontal directive to other contract terms which shape the part of the contract.

Article 30.1 of the draft horizontal directive did not use the notion of a term which has not been negotiated individually (used in motive 45) as is the case in Article 3.1 and 2 of Directive 93/13, and moreover, the definition of the objective scope of application of the draft consumer rights directive included in mentioned Article 30.1 is of a closed nature, while in Article 3.2, Directive 93/13 treats the same definition rather as one of the cases of a non-negotiated nature of a specific clause ipso facto leaving the scope of other cases in which it ought to be assumed that a given term has not been negotiated individually, although traditionally on the grounds of Directive 93/13 it was assumed that it is a definition of the notion of a term which has not been negotiated individually which found such an expression in the majority of national public policies of EU member states[12].

Article 30.1 of the draft horizontal directive, similarly as Article 3.1 and 2 of Directive 93/13 (differently than in the motives) does not refer to the notion of the standard contract term itself, but to its descriptive definition as a contract term constituting an element of a standard contract, formulated beforehand. In relation to the above, it is necessary to draw attention to the fact that the difference in the formulation of Article 30.1 of the draft horizontal directive and of Article 3.2 of Directive 93/13 may be of significance precisely in reference to a standard contract term.

Based on the above, it is possible to hold that the scope of the application of the draft horizontal directive covers the standard and individual terms covered by the presumption of the nature that have not been negotiated. In relation to the standard terms, the effectiveness of the proof carried out under Article 33 of the draft directive is, therefore, rendered dependent on the demonstration of the individual nature of the contract term and the circumstances denying the imposed nature of the contract term, ie. the fact that a consumer entertained the possibility of influencing the contents of a given term.

In defining the scope of the application, the draft horizontal directive in a clear way refers to the regulations of Directive 93/13, in particular expressing the so-called mixed approach to the regulation of the issue of unfair contract terms. Protecting the consumer, the draft horizontal directive does not at the same time provide for their full protection, ie. also as regards contract terms which have been negotiated, which would be a consequence of the full adoption of the stance on the necessity to extend the protection also to the so-called weaker party to the contract.

On the other hand, the scope of exclusion from under the control does not extend solely to standard terms, for the purpose of restricting the unilateral shaping of the content of a legal relationship by one of the parties on a *quasi* right-creating principle. For the issue here is a broader aspect, and namely restricting the abuse of the contractual position of one party (an entrepreneur) by the imposition of the contents of a legal relationship on the other party (a consumer). Hence, it is possible to assume that a standard contract term is covered by the scope of the application of the draft horizontal directive in each case whereas other contract terms are not subject to control if the entrepreneur proves its negotiated nature.

In keeping with the above-presented remarks regarding the regulation to be found in Article 30.1, the draft horizontal directive does not directly define when a given clause has not been negotiated or whether it has been negotiated. However, from the article quoted above, one must conclude that an entrepreneur ought to demonstrate that a consumer entertained the possibility to amend the contents of the clause proposed by the entrepreneur. If the consumer took advantage of such a possibility and a given clause had been amended, the evidence of such an amendment shall not be difficult to prove. However, the circumstance of the existence on the part of the consumer of the possibility to amend the contents of a given contract term which the consumer took no advantage of is problematic in terms of evidence.

I am of the opinion that the signing by a consumer of a statement formulated by an entrepreneur under which the consumer does not express the will to amend specific terms and conditions or the provisions thereof or when the consumer does not take advantage of such a possibility shall not be sufficient proof. The acceptance as proof of a consumer's own handwritten statement of a similar content, but with the simultaneous evidence for the circumstances that the consumer entertained a factual possibility to become acquainted with given contract terms, to understand their contents and legal effects, to ponder over them should they express such a wish or to discuss them or seek explanation, would not be excluded. Such a general wording of the draft directive, after all loaned from Directive 93/13, surely does not facilitate a coherent assessment of the different as well as the similar cases.

The *Acquis* Principles refer to the regulation of Directive 93/13 in chapter 6 pertaining to contract terms that have not been negotiated although they are not identical regulations. The objective scope of the application of this chapter already follows from the title of this part of the *Acquis* Principles to subsequently find its confirmation in Article 6:101.1 whereby the standard contract term was taken as one of the examples of non-negotiated clauses.

The *Acquis* Principles, following in the footsteps of Directive 93/13 and similarly to the draft horizontal directive, introduce a definition of a term that has not been negotiated (Article 6:101.2) and impose the burden of proof of the circumstance that the standard contract term has been individually negotiated on the proponent (Article 6:101.4). The definition of the term that has not been negotiated in the *Acquis* Principles refers to the definition in Directive 93/13, however without the subjective restriction (exclusively to a consumer). Moreover, it follows from Article 6:101.1 sentence 1 that the premise for the formulation of a given clause is one of the circumstances with bearing on the assessment of the adherer's possibility to influence the contents of a given clause and does not, as in eg. the draft horizontal directive, constitute an independent circumstance, as if preliminary in terms of the issue of the possibility of the adherers bearing (in the draft directive - the consumer) on the contents of the term.

The *Acquis* Principles also introduce a presumption of the formulation of a given term by an entrepreneur if it was set forth by a third party to the consumer contracts. Refuting this presumption is connected to the entrepreneur's duty to demonstrate that a given term has been introduced to the contract by a consumer. As indicated above, the *Acquis* Principles impose the burden of proof on the proponent that a standard contract term has been negotiated, ie. the other party's possibility to influence the contents of said clause[13].

It is proof to the circumstance that in a given legal relationship, a standard contract term has ceased to be a standard, but has become a clause that has been individually negotiated, while the evidence for the non-negotiated nature of an individual clause burdens the party which may derive legal effects from this fact, ie. in principle the adherer.

The *Acquis* Principles introduce the definition of a standard contract term despite its absence in Directive 93/13. For under Article 6:101.3, the standard contract term is a term which has been formulated in advance for several transactions involving different parties, and which have not been individually negotiated by the parties. From this definition it follows that the premise for the drafting of a clause beforehand constitutes an autonomous basis for the assessment. Due to the reference to a non-negotiated nature of a contract term, it is possible to conclude that it is a reference to its definition in which, in turn, the drafting of a term beforehand has a bearing on the assessment of the adherer's possibility to influence the contents thereof. It is a definition referring to the definition of the standard contract term from Article II -1:108 of the DCFR, although, the systematics of the DCFR regulations has such a result that the similar definitions are more legible. For in the DCFR, the definition of the standard contract term is the first definition whereas that of a term that has not been negotiated individually is a subsequent one.

In this latter scope, it is necessary to refer to Article II -1:110 which similarly as the *Acquis* Principles renders the non-negotiated nature of the clause dependent on the lack of a possibility for one party to influence the contents thereof and, in particular, due to its being formulated previously while regardless of the fact whether it is a standard contract term or not. The DCFR regulation (Article II - 1:110.4), similarly as the draft horizontal directive in relation to consumer contracts, imposes the burden of proof on an entrepreneur of the negotiated nature of a contract term whereas in the scope of the standard contract terms, the proof of a given term having been negotiated individually has been imposed on the party that quotes this circumstance (Article II – 1:110.3), ie. in practice, on the proponent, similarly as in the Acquis Principles regulation. Furthermore, the DCFR similarly as the draft consumer rights directive, excludes the negotiated nature of the term in the case when the other party chose one of the clauses it was imposed on (Article II – 1:110. 2).

The Polish project of the regulation of the control of terms departs from the definition of an individually negotiated clause within its scope including all the terms and provisions of an act in law concluded with a consumer or in the frames of so-called ordinary trade and commerce. The part regulating the standards is assumed to constitute a supplement to the provisions regulating the control of the contents of unfair terms. The project starts from an assumption that the category of standards has lost its central significance, especially in the case of consumer relationships. The notion of a standard retains its importance in professional transactions in which the qualification of a given term as a standard constitutes the premise for the control of the contents as regards unfairness.

Recapitulation

From the considerations above, it follows that in the above-presented scope, the draft horizontal directive, slightly departing from the solutions adopted in Directive 93/13, refers also to the regulation included in the DCFR whereas the *Acquis* Principles, in the above-given aspects of the regulation regarding the subjective scope departing from Directive 93/13, uphold its regulations in the objective scope. However, all the projects stand by the necessity of assessment of a given term as regards their non-negotiated or negotiated nature. However, the considerations on the grounds of the mentioned projects as well as on the grounds of the effects of the implementation of Directive 93/13 demonstrate the difficulties related to the application of this premise, in particular in terms of proof, especially in consumer contracts which leads to the looseness of the system and uncertainty in the application of the law. Modifying

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certain issues, the draft horizontal directive does not, however, make an attempt at solving the fundamental problems and in fact preserves the status quo in this scope as has been presented above.

In view of the above, it is necessary to draw attention to the proposals which do not refer to this premise. The issue here is the French concept, mentioned above, within the frames of which control in consumer contracts covers all clauses and the circumstance that they have been or have not been negotiated is not taken into account. Taking into consideration certain differentiation depending on the consumer's influence (or, more broadly, a party) on the contents of a clause, it is possible to refer to proposals which command to take this circumstance into account at the assessment of the nature of a given term in terms of fairness or unfairness[14] with the appropriate construction of a general control clause.

In this concept, it is not necessary to examine the issue of imposing a given term onto a consumer, ie. the control covers all clauses in consumer contracts (apart from those determining the main content of a contract), but the control is carried out on the bases of a fairness test which also includes the negotiated or non-negotiated nature of a given contract term. In contracts between entrepreneurs, the negotiated nature of a given contract term could exclude the control its contents on the basis of an unfairness test, which would not exclude the possibility of controlling this contract term on the basis of the general provisions on the limits of the contents of a contract.

In the legal relationships between entrepreneurs, the emphasis could be placed on the control of the standard contract terms (non-defining the main contents of an agreement, similarly as in consumer agreements) and so due to the legitimacy of restricting quasi right-creating activities whereby the standard can be only a term which has not been subject to negotiations since in the case to the contrary, it becomes an individual and negotiated clause. The question of the adoption of an appropriate solution pertaining to the standard contract term itself would be of significance in this scope. From the practical point of view, the definition of a standard as a contract term formulated beforehand with the view of its multiple use is insufficient for a synonymous manifestation of a standard nature of this term.

In this scope, one could think of an addition of the premise of an expression of a standard in writing (which is not and which is not to be synonymous with the written form), ie. in the form of a printout or another type of a record. For this would still constitute the sanctioning of the practice in the scope of the creation of standard contract terms and, from the point of view of the application of the law, of significance for the admissibility of control of contract terms in terms of their unfair nature in contracts between entrepreneurs. The considerations presented above indicate that the issues related to the regulation of control of contract terms, including the standards, are still debatable while the debate is still open both on the European and national levels. ■

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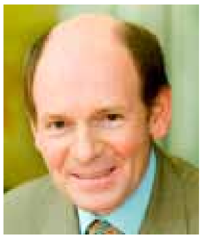
1. EC Official journal of 24 April 1993, L 95, pp. 0029-0034.
2. COM (2008) 614 final.
3. Apart from Directive 93/13, the proposal for the directive on consumer rights also includes the provisions of the following Directives: 85/577 of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises (Official Journal of 1985, L 166/51), Directive 97/7 of 20 May 1997 on the protection of consumers in respect of distance contracts (Official Journal of 1997, L 144/19), Directive 1999/44 of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees (Official Journal of 1999, L 171/12).
4. The basis of the proposal for the horizontal directive was the so-called Action Plan on a More Coherent European Contract law (COM (2003) 68 final, Official Journal of 2003, C 63/1). See eg. G Howells, R Schulze, Overview of the Proposed Consumer Rights Directive, in: G Howells, R Schulze, Modernising and Harmonising Consumer Contract Law, Munich 2009, p. 4, note 9. One of the European projects, as a part of which a detailed report on the implementation of particular consumer directives into national legal systems was prepared, was the EC Consumer Law Compendium, which was published in a form of a book; see H Schulte – Nölke, Ch. Twigg-Flesner, M Ebers (eds.), EC Consumer Law Compendium. The Acquis and its transposition in the member states, Munich 2008.
5. See more Ch. Von Bar, H Beale, E Clive, H Schulte- Nölke, Introduction, in: Ch. von Bar, E Clive, H Schulte – Nölke in., Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR). Outline Edition, Munich 2009, p. 36 et seq., H Schulte- Nölke, Scope and Role of the Horizontal Directive and its Relationship to the CFR, in: G Howells, R Schulze, Modernising and Harmonising Consumer Contract Law, Munich 2009, p. 29 et seq.
6. Abbreviated name of the Principles of the Existing EC Contract Law (Acquis Principles). See the publication in original and translated into Polish together with the introduction: M Pecyna, Kwartalnik Prawa Prywatnego of 3/2008, p. 809 et seq., especially: Principles of the Existing EC Contract Law (Acquis Principles). Contract I. Pre- Contractual Obligations, Conclusion of Contract, Unfair Terms, Munich 2007; Publication of Contract II in printing.
7. Abbreviated DCFR. See the complete version: Ch. von Bar, E Clive, Hans Schulte – Nölke et all. (eds.), Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR). Outline Edition, Munich 2009.
8. On the relationship of the two proposals see also eg. F Zoll, Unfair Terms in the Acquis Principles and Draft Common Frame of Reference: A Study of the Differences between the Two Closest Members of One Family, Juridica International of XIV/2008, pp. 69-70, M Pecyna, Europejskie Prawo Umów, Wprowadzenie (Introduction to the explanation of the Acquis Principles – MP's and translator's note), Kwartalnik Prawa Prywatnego, of 3/2008, pp. 809-813.
9. See also M Pecyna, Nieuczciwe postanowienia umowne w projekcie dyrektywy o prawach konsumenta, Zasadach Acquis i DCFR. Różne środki do tego samego celu?, Transformacje Prawa Prywatnego 1-2/2009, p. 91 and next.
10. See G Dannemann, Introduction in: Principles of the Existing EC Contract Law (Acquis Principles). Contract I. Pre – Contractual Obligations, Conclusion of Contract, Unfair Terms, Munich 2007, p. XXVIII-XXIX, M Pecyna, Wprowadzenie do tłumaczenia Zasad Acquis, KPP of 3/2008, pp. 812-813.
11. DCFR Team. See the information on the structure and work of that group in: Ch. v. Bar, E Clive, H Schulte – Nölke (eds.), Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR). Outline Edition, Munich 2009, p. 47 et seq.
12. See: M Ebers, Unfair Contract Terms Directive (93/13), w: H Schulte – Nölke, Ch. Twigg- Flesner, M Ebers (eds.), EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States, Munich 2008, s. 226, J Stuck, Unfair Terms w: G Howells, R Schulze (eds.), Modernising and Harmonising Consumer Contract Law op. cit., s. 116.
13. See: T Pfeiffer, M Ebers in: Principles of the Existing EC Contract Law (Acquis Principles). Contract I… op. cit., p. 215-216.
14. See: The Law Commission and The Scottish Law Commission Report (LAW COM No 292), p. 31-32.

Successful ways for branch registration of English companies in Austria



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In the past the registration of a branch of an English company in Austria encountered significant legal resistance and often was rejected by the courts. The cause of this resistance was more often than not a lack of understanding of the Austrian courts of the legal structure of English companies and the inability of the applicants explaining the characteristics of English companies to the Austrian courts. With the recent decision of the Commercial Court of Vienna[1] the registration of an English limited company was accepted and the resistance was finally broken. BMA Brandstätter Rechtsanwälte GmbH represented the English limited company in this case and successfully registered the branch in Austria. By following the steps which led to this positive decision, the registration of English branches in Austria should be trouble-free in the future.

The origins of these problems are the differing legal systems. It is well known that in England the common law system is in legal force whereas Austria is a civil law country. These differing legal systems led to essential differences in the company laws of both countries.

In England the *ultra vires* doctrine has been in legal force since the landmark decision of 1875 of the House of Lords in the case *Ashbury Carriage Company v. Richie*. According to the *ultra vires* doctrine a company's legal capacity is defined by its memorandum of association. Therefore the memoranda of association of English companies were drafted in a particularly extensive and detailed way, especially their scope of business. That was done to give the companies the necessary legal capacity and their directors the necessary capacity to act for the company. In accordance with the *ultra vires* doctrine, acts of the directors of the company exceeding the scope of business of the company are considered void. This often led to conflicts with contractual partners and creditors of such company.

The Companies Act 1985 abolished the *ultra vires* doctrine and explicitly allowed general clauses fixed in the memorandum of association. Now, the Companies Act 2006, in contrast to the *ultra vires* doctrine, regulates in section 31 that in case of doubt the scope of business of a company is unrestricted, as long as there were no restrictions explicitly made. Furthermore, the limitation of the capacity to act of the directors was basically abolished by section 39 and 40 of the Companies Act 2006.

Despite these changes in the legal system, very often in practice the old memoranda of association are still in use in which one can find provisions such as:

- *"To invest and deal with the monies of the Company in such shares or upon such securities and in such manner as from time to time may be determined."*
- *"To lend and advance money or give credit on any terms and with or without security to any company, firm or person ..., to enter into guarantees, contracts of indemnity and to secure or guarantee in any manner and upon any terms the payment of any sum of money or the performance of any obligation by any company, firm or person..."*
- *"To borrow or raise money in any manner and to secure the repayment of any money borrowed raised, or owing by mortgage, charge, standard security, lien or other security upon the whole or any part of the Company's property or assets ..."*

Usually there are no such provisions in Austrian memoranda of association. The *ultra vires* doctrine does not apply in Austrian company law, the legal capacity of legal entities is basically unlimited. In particular, the legal capacity is independent of content and range of the company's scope of business.

If an English company wants to register a branch in Austria with a memorandum of association containing such provisions as quoted above, such provisions are interpreted by the Austrian courts in the sense that the company wishes to do banking business. As a prerequisite the courts demand a license according to the Austrian banking regulations. Since the English company actually is not involved in any banking business, does not intend to do so, and is thus not prepared for obtaining a banking licence, the registration of a branch often fails because of such misunderstanding.

During the registration procedure of the decision quoted above the English company successfully explained to the court the differences between the two legal systems and clarified the misunderstanding about the content of the English memorandum of association and the actual activities of the company.

It was outlined to the Commercial Court of Vienna that content and range of the memorandum of association is still influenced by the *ultra vires* doctrine. Furthermore it was explained to the court that the legal term of banking business is harmonised by the directive 2006/48/EU. Therefore, banking businesses that require a license in England require a license in Austria too and vice versa. Requiring a license from an English company that does not need a license in England would be a violation of Austrian banking regulations. This would constitute a violation of the harmonized legal term of banking business and at the same time a violation of the principle of freedom of establishment according to articles 49 and 54 of the EU-treaty in the Lisbon version.

Crucial for the understanding and the correct interpretation of such provisions of English memoranda of association as quoted above is the fact that the company only deals with its own money and not with money from others. This is the essential difference to the banking business, where it is all about money from customers. Taking out credits or issuing bills of exchange is usual commerce and not banking activity. Finally it was explained to the court in this case that according to the Austrian banking regulations a banking business is only given if its activities exceed a certain quantitative threshold. Sporadic credit and loan accommodation – as it is usual in commerce – is not meant to be a banking business.

Considering the legal characteristics during the registration process of a branch of an English company in Austria and explaining these characteristics to the court should make the registration of English branches trouble-free in the future. ■

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1. Commercial Court of Vienna, the 22nd March 2010, 73 Fr 14201/09 x – 9.

Ukraine: Overview of recent developments in telecommunications

Oleksiy Didkovskiy is the Managing Partner and Head of the Corporate and Telecommunications Practice at Asters, Kyiv, Ukraine

The Ukrainian telecommunications market has enjoyed dynamic growth over the last five years, with an increasing number of telecommunications operators. According to the National Communications Regulation Commission (the NCRC), the Ukrainian telecommunications regulator, the number of licensed telecommunications operators reached almost 1,500 in Ukraine in 2009. The NCRC reports stable development of the industry despite the global economic crisis.

The prospects of the Ukrainian telecommunications sphere depend on a range of factors, the regulatory framework being one of the most important among them. Further growth of the industry will in many respects be contingent on whether the regulator will be prompt and effective in addressing the challenges facing the telecommunications market.

A number of amendments to the telecommunications law, which have recently been adopted or are being considered by the Ukrainian Parliament, may contribute to the development of telecommunications services in Ukraine. For instance, the changes in the radiofrequency licensing procedure made in late 2009 permitted mobile operators to reallocate frequencies, an opportunity not available before. This regulatory development may be important for the effective use of the frequency spectrum as a whole. Specifically, it is likely to optimize the use of the spectrum, which is currently highly fragmented requiring more bordering channels, by providing the possibility to minimize the number of bordering channels through reallocation of frequencies.

> **"M&A activity involving top telecommunications market players continues to shape the market"**

The NCRC approved new licensing rules for fixed telecommunications services in late 2009. The new rules, unlike the previous ones, do not provide for separate IP telephony licensing and, therefore, are more technologically neutral. Another development is the introduction of IMEI base and such services as number portability (to become effective in early 2011) and national roaming. Speaking about the proposed legislative amendments, a draft law recently submitted to the Ukrainian Parliament seeks to simplify market access by removing the requirement to obtain a license for certain types of telecommunications activities. Also, there are ongoing discussions regarding setting up of a universal services fund, an idea met with lukewarm support by the market. It is unclear at this point whether such a fund will be established since several recent proposals in this respect have failed.

Lack of agreement and coordination between various state authorities often stands in the way of introduction of new technologies and solutions in Ukraine. A striking example of this is the situation, which arose around the third generation mobile telecommunications services with the use of UMTS technology (3G). At present, only one operator in Ukraine (Ukrtelecom, a state-owned telecom monopoly) has a license to render such services. A plan to issue four new 3G licenses was announced in September 2009. The NCRC scheduled the tender for the first of the four licenses for 27 November 2009 despite the fact that the conversion of the relevant radiofrequencies was still underway. The tender was cancelled by the NCRC itself on 27 November 2009. The main reason behind the cancelation was inability to accomplish conversion of the required radiofrequencies following a motion by the President of Ukraine to the Constitutional Court, as well as differences between the military, the government and the President as to the radiofrequency conversion and the licensing procedure. The Constitutional Court dismissed the President's motion on 27 January 2010. Eventually, a working group was formed to finalize the draft conversion plan. Although Ukraine still lags badly behind in the 3G technology sphere, the relevant license tenders are expected to take place no sooner than late 2010.

Along with further development of the telecommunications market, fair competition issues come to the forefront in Ukraine. For instance, the matters recently considered by the Antimonopoly Committee of Ukraine (the AMC) include the following: the case regarding recognition of Ukrainian mobile communications operators as monopolists in the market of provision of access to their own networks; the issue of fraudulent advertisement in the telecommunications market (in respect of the so-called "zero" tariffs); and formation of the tariffs for access to the electronic communications cable ducts. Notably, three telecommunications companies are on the top-ten list of undertakings subject to the largest fines imposed by the AMC in 2009. The above is indicative of increasing attention on the part of the antitrust authority to the telecommunications industry, which may significantly influence development of the latter.

M&A activity involving top telecommunications market players continues to shape the market. A major deal in this sphere is the transaction between Telenor Group, a leading provider of telecommunications services worldwide, and Altimo, the telecom arm of the Alfa Group, completed in April this year, where Asters acted as a Ukrainian counsel to Telenor. As a result of this transaction, Telenor and Altimo combined their common assets in OJSC VimpelCom, a major telecommunications operator providing services in Russia, the CIS and Southeast Asia, and Kyivstar, a leading Ukrainian telecommunications operator, under a single holding structure, VimpelCom Ltd. The contemplated sale of the state-owned shareholding in Ukrtelecom may become another landmark transaction in telecommunications sphere, which will not only change the market balance, but also influence further regulatory process. ■

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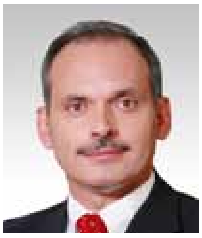

Investing in Ukraine: improvements in 2010

Armen Khachaturyan is a Senior Partner and Nikolai Sorochinskiy is an Associate at Asters, Kyiv, Ukraine

Restoring economic and political stability

Due to high demand for steel, Ukraine's primary export, and increase in domestic consumption in pre-crisis years, the Ukrainian economy became one of the fastest growing emerging markets in the region. The average GDP growth in 2000-2008 was more than 7 percent. This led to a substantial spike in foreign investment, in particular in the financial sector where foreign ownership exceeded 35 percent. The music stopped in 2008. Ukraine was one of the countries hardest hit by the global financial crisis, facing a GDP decline of 14 percent in 2009.

In 2010 the economy is experiencing a cautious recovery. In the second quarter the GDP grew at a 6 percent rate. According to the latest monthly analyst poll by Consensus Economics, Ukraine's economy is likely to expand by 4.2 percent in 2010 and 4.4 percent in 2011. Forecasts from the International Monetary Fund are less optimistic, projecting growth of 3.7 percent in 2010 and 4.3 percent next year.

> **"... the effects of the crisis offer considerable start-up investment opportunities due to reduced prices of assets, including stocks, attractive commercial rental prices, and lower labour costs"**

The crisis of 2008 resulted in a nearly 40 percent devaluation of the national currency, the hryvnia, which reduced imports and gave a boost to the Ukrainian exporters. In 2010 the new government was able to halt increases in the import price of natural gas, which Ukraine receives mainly from Russia and which is vitally important for energy-intensive Ukrainian industrial manufacturers. These changes, coupled with more favourable world prices for Ukraine's main export commodities, resulted in the current account surplus of $400 million in the first six months of 2010. During the same period of 2009 current account deficit stood at $479 million.

Despite this recovery, the effects of the crisis offer considerable start-up investment opportunities due to reduced prices of assets, including stocks, attractive commercial rental prices, and lower labour costs (the average monthly salary in 2010 is $267).

Also, in early 2010 a new president, Viktor Yanukovych, was elected and his party together with allies formed the new parliamentary majority and government. This ended a period of political volatility and divided government which Ukraine experienced since 2005. Today Ukraine is experiencing something it lacked for the past five years: a unified government capable of passing major economic legislation. The new government announced an ambitious program of deregulation and reform. It remains to be seen how far it goes in fulfilling these promises. However, many of the laws passed by the new government so far have been rather business friendly.

In short, 2010 saw marked improvements in the Ukrainian investment environment, caused by political stability, upward revisions in sovereign debt credit ratings, some deregulation, GDP picking up at the annual 6 percent in the second quarter, and finally monetary stability and a more balanced budget. Unless there is a serious external negative push, all of this is likely to result in improved investment environment and greater interest of foreign investors in the country.

Capital markets: Ukrainians abroad

In Ukraine the domestic stock market is still quite weak, due to a variety of factors. This means that larger capital markets transactions require Ukrainian companies to tap international, not domestic, markets. The most popular destinations for Ukrainian companies seeking substantial investment have been the London Stock Exchange, in particular its Alternative Investment Market, and the Warsaw Stock Exchange.

The access of Ukrainian equity issuers and borrowers to these markets in 2009 was quite limited. However, this situation improved in 2010.

According to various market research outfits, at least ten Ukrainian companies have expressed an interest in an IPO in late 2010 and 2011. June 2010 saw the first-ever IPO by a Ukraine-based IP sector company with EasyDate, a Scottish company with all major operational facilities located in Ukraine, entering the LSE's Alternative Investment Market.

Major agribusiness companies eye debt and equity issuances on international markets with particular interest. In April 2010 a major poultry producer Avangard had an IPO on the London Stock Exchange and a major sunflower oil producer Kernel had a secondary public offering in Warsaw.

Investing in Ukraine: risks and opportunities

Perhaps the most important feature of Ukrainian business environment is the dominance of several politically powerful business groups, mainly centred in the Eastern industrial regions of Donetsk and, to a lesser extent, Dnipropetrovsk. Business regulation is marred by a high degree of bureaucratization and lack of transparency.

As far as the general economic and political environment is concerned, the general barriers to investment in Ukraine are often high levels of political risk (although these diminished dramatically with the new government installed in 2010), excessive regulation, and lack of transparency. There was a time when this level of risk was offset by quite attractive returns on investment which were unheard of in the West. The returns diminished in the current global economic environment but are likely to pick up if the global economy does reasonably well in the coming years.

One of the few Ukrainian sectors which showed positive results even at the height of the global crisis in 2009 was agriculture. Investors recognize that Ukrainian agricultural companies stand to benefit long-term from Ukraine's enormously fertile land and low production costs. These fundamentals may even allow Ukraine to reclaim the title of a "breadbasket of Europe" as the country was often referred to in the early 20th century. Even during the crisis, a number of dynamic businesses invest heavily in this sector. For example, in June 2010 Mriya agroholding attracted a record-breaking $75 million in financing from the International Finance Corporation. Ukrainian agribusiness also actively seeks access to international capital markets.

Since foreign ownership of agricultural land is prohibited and existing law prevents the sale of agricultural land by its present owners until at least 2012, lease arrangements are the only way allowing foreign investors to obtain agricultural land. Sale and limited foreign ownership of non-agricultural land is allowed.

Removal of restrictions on foreign investment

From the legal perspective, the single most important limitation for foreign investors in Ukraine is the fact that Ukrainian national currency is not freely convertible and that Ukraine has a system of currency restrictions. Ukrainian currency cannot be remitted to any account outside of Ukraine without a special license issued to the payer by


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the central bank of Ukraine. Only foreign currency can be used in settlements between residents and non-residents. Sale of Ukrainian currency and acquisition of freely convertible foreign currency is also subject to strict regulation that provides for an exhaustive list of grounds for these transactions.

These restrictions were further tightened in response to the world financial crisis but 2010 saw substantial improvements in the regulatory environment for foreign direct investment in the country.

In June 2009 the Parliament adopted the Law Amending Certain Laws of Ukraine to Overcome Adverse Consequences of the Financial Crisis, which came into effect in November 2009 (the Anti-Crisis Act). The Anti-Crisis Act provided that monetary investments in Ukraine made by foreign investors had to be: in the Ukrainian currency; through special "investment accounts" opened with a Ukrainian bank; and that all foreign investments in Ukraine had to be registered with the central bank (National Bank of Ukraine). There was also a prohibition on early repayment of foreign currency loans to foreigners by Ukrainian borrowers and amendments to the amendments to foreign currency loan agreements between Ukrainian borrowers and foreign lenders resulting in accelerated loan repayments.

The Law of 27 April 2010 abolished most of these requirements: there are no longer restrictions on modification and early repayment of foreign loans and registration of foreign investment is optional. Foreign investor still have to use special investment accounts opened in Ukraine but they no longer have to convert their investments into Ukrainian currency. In a relatively minor but important change, 2010 also saw the abolishing of the mandatory contribution to the Pension Fund which used to be required for currency conversion operations.

However, not all restrictions are gone. For example, Ukrainian law still requires all loans from foreign lenders to be registered with the central bank and caps the maximum permitted interest rate for such loans.

New incentives for public-private partnerships and infrastructure investment

Another recent change which could facilitate investment in infrastructure projects is the new Public-Private Partnership Law of 1 July 2010 (the "PPP Law"). The Law expands the range of sectors where PPP can be employed. Under the new Law these sectors include construction and operation of highways, railroads, airports, bridges, ports, tourism, healthcare, power generation, exploration and extraction of natural resources, and several others.

The PPP Law introduced a number of changes to land legislation which are meant to make it simpler to obtain land rights for PPP projects: (i) the public partner must provide all land allocation project documents and other necessary documents for leasing the land, arrange for approval of the documents by the respective authorities, and, if necessary, obtain a positive report of the state land use expert. The relevant costs are to be reimbursed by the private partner; (ii) the right to lease the state or municipal land for a PPP can be obtained through a simplified procedure: the private partner can secure the lease as part of the PPP tender without an additional land auction, which is normally required for state and municipal land; (iii) the private partner can use land easements held by the public partner if this right is granted to the private partner by the agreement governing the PPP project.

The PPP Law introduces other incentives for private partners in infrastructure projects. For example, in concession arrangements depreciation of assets used in the PPP project will now be deducted from concession payments payable by the private partner. Concession under Ukrainian law is close to the internationally known "build-operate-and-transfer" PPP arrangement.

"Ukraine is in active talks with the European Union on the proposed so-called "deep" free trade area between Ukraine and the EU"

Euro 2012 championship incentives and deregulation in real estate and construction

The approaching Euro 2012 football championship which will be organized jointly by Poland and Ukraine spurs some development activity in several major Ukrainian cities. Ukrainian authorities make efforts to attract foreign investment in the infrastructure projects associated with the championship. For instance, the development projects associated with Euro 2012 are free from the mandatory infrastructure development charges. These charges, normally payable to the local authorities, can usually amount to up to 10 percent of the estimated cost of construction.

As in many other countries, the construction industry in Ukraine felt the sting of the 2008-2009 financial crisis particularly acutely. Ukrainian lawmakers sought to mitigate the negative impact of these events and to boost the industry. The law now allows developers to defer the payment of infrastructure development charges. There are also several reform efforts under way to reduce the number of permits required to start construction.

Looking ahead

In late July 2010 Ukraine received the first $1.9 billion tranche from the International Monetary Fund as a part of a 29-month stand-by arrangement worth $15.15 billion. The funding is staggered with each successive tranche dependent on compliance with the Fund's conditions. Among them is continuing budget tightening as the Fund requires Ukraine to slash budget deficit to 3.5 percent of GDP by the end of 2011 and to 2.5 percent by 2012. Renewed cooperation with the IMF already brought upward revisions of the Ukrainian sovereign debt by the major rating agencies.

Among other developments worth watching for investors is the continuing discussion surrounding the draft Tax Code which was adopted by the Parliament in its first draft in June 2010 and which triggered substantial criticism for its unbalanced and too fiscally-minded approach to tax administration.

Ukraine is in active talks with the European Union on the proposed so-called "deep" free trade area between Ukraine and the EU. The parties previously announced that talk would be concluded and the association agreement including an FTA would be signed by the end of 2010. However, it is unlikely that this tight timeframe will be met. Depending on how soon the FTA will come into existence and on how the agreed FTA looks in the end, the FTA might also have a substantial impact on investment opportunities in the key sectors of the Ukrainian economy. ■

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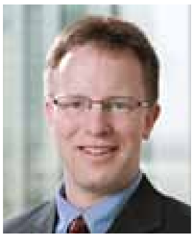
Gateway to Europe: North Rhine-Westphalia as a magnet for German and European distribution centres



Dr John D Gatto is the CEO NRW.INVEST (North America) LLC

The world is getting smaller. Today, trade and the division of labour are world-spanning, causing the flow of commodities to grow steadily.

"The world's best-performing logistics location" is the title bestowed on Germany by the World Bank. In a survey entitled *"Connection to Compete 2010"*, internationally operating cargo and transport companies voted the Federal Republic of Germany into first place ahead of Singapore and Sweden, out of a total of 155 countries.

In Germany's most populous federal state, North Rhine-Westphalia, the outstanding infrastructure now also acts as a magnet for many domestic and international logistics companies. And the word has spread as far as the USA. This year, with Amazon and TK Maxx, the European subsidiary of the US corporation TJ Maxx, two major American distribution companies have already opted for the location in the heart of Europe.

The internet mail order company Amazon is bringing its third logistics centre to North Rhine-Westphalia. Following Hesse (Bad Hersfeld) and Saxony (Leipzig), the company is now planning a distribution centre in North Rhine-Westphalia (Werne). Amazon's introduction will be the opening of an over 60,000m² logistics centre is planned in an existing building in Werne in September 2010. This will create around 80 new jobs.

There is no doubt that the central geographic location within Europe and Germany, the excellent employee potential and the outstanding links to all major freeways played a key role in the decision to locate in the most populous German federal state, North Rhine-Westphalia. Amazon had been searching all over Germany for nearly a year before it decided in favor of the North Rhine-Westphalian location thanks to the support of NRW.INVEST.

The American company TK Maxx will construct its distribution centre on a roughly 70,000m² site in Bergheim near Cologne. The groundbreaking ceremony for the retail company's new logistics and processing headquarters took place in March 2010. This company location will create around 1,000 new jobs in the region. Business operations are due to commence before the end of the year. The expansion of the company in Germany and Western Europe is to be driven from Bergheim.

"We are proud that, with Amazon, we have succeeded in bringing a third large logistics company to North Rhine-Westphalia this year", emphasizes Petra Wassner, management spokeswoman of NRW.INVEST GmbH. In addition to Amazon and TK Maxx, the international fashion company Esprit is also establishing its European distribution centre in North Rhine-Westphalia. The state-owned location agency supported the companies in their search for a suitable logistics location.

More than any other German federal state, North Rhine-Westphalia offers outstanding conditions for companies wishing to use the location for their German or overall European distribution. The central location of North Rhine-Westphalia in Europe and the marked expertise of the entire logistics landscape provide great growth potential to these companies in particular. The central location in Europe and the cumulative know-how still hold great growth potential.

17.9 million people live in North Rhine-Westphalia alone – almost exactly as many as in Australia. With 526 inhabitants per square kilometre the state is more densely populated than either Japan or the Netherlands. The most important conurbations are the 'Ruhr Metropolis' with around 5.4 million and the 'Rhine Axis' with 3.5 inhabitants. Nearly 150 million people live within a 500-kilometer radius of the state capital, Düsseldorf. This represents a third of all consumers and 45 percent of the purchasing power in the EU.

Its direct vicinity to the Netherlands, Belgium and Luxembourg as well as its close-knit transport network make Germany's no. 1 investment state the transport hub of Europe. No other region can boast such highly efficient freeway, road and rail networks. Together with the expanding cargo airports and the waterways they secure access to the seaports as well as to many destinations in central, eastern and southern Europe.

It is therefore no wonder that the central hub for logistics in Europe has emerged here. There are more than 21,600 companies and 272,000 employees involved in the logistics industry in North Rhine-Westphalia. If the logistical tasks in trade and industry are added to this figure, then there are well over 600,000 people working in this sector. Every year, they generate sales of over €70 billion. Global players such as Deutsche Post AG, FedEx Corp., FIEGE Stiftung & Co. KG, Rhenus AG & Co. KG, Schenker AG and TNT Holding GmbH are based in North Rhine-Westphalia. More than a quarter of all distribution centres in Germany are to be found here, including well-known companies such as UPS, Wincanton and NYK Logistics. This makes the most populous federal state Germany's no. 1 logistics location.

Multimodal transport as the answer to the growing volume of goods

North Rhine-Westphalia has the densest rail network in Germany. High-speed trains such as the Thalys or ICE provide fast connections to Brussels, Paris, Amsterdam, Berlin and Basel. North Rhine-Westphalia also occupies a leading position in goods transport with its own close-knit network and its strong regional, port, industry and works railways. DB Schenker Rail and over 50 other companies cover around three billion ton-kilometres every year on the rail tracks of North Rhine-Westphalia. The trans-shipment station Cologne-Eifeltor is the most important terminal for combined transport (CT) in Germany. Numerous other CT terminals throughout the state form major interfaces in the rail network of North Rhine-Westphalia. The Ruhr region is linked directly to the seaport of Rotterdam via the new stretch of Dutch freight transport track known as Betuweroute.

Hans-Werner Gabriel, UPS Director CGN Airport Operations

"UPS has been operating its European air hub at Cologne-Bonn since 1986. Over 2,300 staff now work here in the largest UPS branch outside the USA. We value the central location in North Rhine-Westphalia with its good infrastructure which allows fast connections with short drives and flights to the customers. This is why we set up our first branch in Europe here over 30 years ago – the foundation stone for our 6,000 employees in North Rhine-Westphalia and 40,000 in Europe today. We are pleased to be part of the Rhine-Ruhr region and, not least due to the extension of the night flight permit for Cologne-Bonn Airport issued by the state government of North Rhine-Westphalia, we want to continue to grow, to invest and to create jobs here."

North Rhine-Westphalia lies at the intersection of important European waterways and although the state has no coastline, links to the major European seaports are guaranteed. 226 kilometres of the Rhine, Germany's most important waterway, flow through North Rhine-Westphalia. 120 ports on the Rhine and canals handle around 133 million tons of cargo by ship each year. Furthermore, Duisburg port, the world's largest inland port, is to be found here, handling around 80 million tons of goods every year. Future prospects are good: According to experts, container handling will grow annually by 5 percent up to 2025 – it will already have doubled by 2015. The growing volume of goods traffic poses new challenges for the port. In multimodal transport, smart concepts combine shipping, rail, road and air traffic.

Two large international airports – Düsseldorf International and Cologne-Bonn Airport – as well as other airports with European connections link the state to all major domestic destinations and to metropolises and economic centres all over the world. High-speed trains bring travellers to the European air hub Frankfurt/Main Airport in less than an hour. Primarily, Cologne-Bonn Airport plays an important role in air cargo. It is now already Germany's second-largest cargo airport after Frankfurt am Main. More and more goods from and to Asia and America are transported via this air cargo hub. Over 560,000 tons of freight take to the skies from here every year.

A network of around 2,200 kilometres of freeways connects every major town or city in the state directly and quickly to the European freeway system. Every important town or city in the state has its own freeway access and exit ramps. This also includes around 4,900 kilometres of highways, 12,800 kilometres of country roads and 9,800 kilometres of district roads.

Green logistics and sustainability

How companies organize their transport will have an increasingly strong influence on success. Rising prices for raw materials and the problem of transport-related environmental pollution determine the future of logistics – and of industrial real estate. Proximity to the markets will therefore play an increasingly important role in the search for locations for new investments. The Rhine region scores points in the contest for investors with its central location, dense infrastructure and sufficiently free and sufficiently large commercial zones.

Sustainability and reduction of CO_2 emissions are also increasingly important issues for logistics. Protection of the environment is no longer regarded only as a cost factor, but also as an opportunity for the further development of the companies and as a competitive advantage. The carbon footprint is also gaining importance in the logistics sector.

Besides the reduction of emissions, green buildings are now also an important issue in logistics. Some logistics buildings, eg. the GARBE Logistics Park Westfalenhütte in Dortmund, have already been awarded a gold medal for sustainable construction.

There are still many challenges to overcome. North Rhine-Westphalia has recognized the opportunities and taken up the issue in research and practice.

Green logistics means the holistic transformation of logistics strategies, structures, processes and systems in companies and company networks to create environmentally sound and resource-efficient logistics processes.

In practice, green logistics manifests itself as a bundle of measures. The objective is to make individual components (vehicles, buildings) energy efficient and environmentally friendly, as well as to examine and improve the entire logistical process, ie. to optimize paths, avoid deadheads and develop software-aided energy efficiency concepts.

And industry is on board: For Oliver Wittig, Supply Chain Manager Germany at Henkel AG & Co. KGaA, green logistics is a meaningful trend and not a passing fad. Udo Brekow, Head of Corporate Sales & Solutions at Dachser GmbH & Co. KG, sees a significant trend in the subject areas sustainable value-added chains, efficiency and energy alternatives. For Gerd Deimel, Vice President Logistics & Supply Chain Aliseca GmbH (Lanxess), green logistics is also highly relevant. His company has clear CO_2 reduction targets, with the targets for 2012 already achieved in 2009. And with its GoGreen program the logistics service provider Deutsche Post DHL is aiming to improve CO_2 efficiency by 10% up to 2012 and by 30% up to 2020.

Research and development

Today, the availability of qualified specialists and access to practice-oriented research and development are decisive criteria for the assessment of logistics locations. This was recognized at an early stage in North Rhine-Westphalia and collaboration between industry and research has been promoted intensively in many ways.

Practice-oriented universities for qualified specialist staff

The regional employment market/specialist staff situation is also among the key decision-making criteria for companies in the logistics industry which are looking for a location. As there are universities in the region which are particularly well positioned in this respect, this significantly simplifies the search for qualified personnel.

Especially the logistics sector, which is developing more and more away from pure haulage to the comprehensive provision of services, requires a variety of different specialists. Many logistics companies now perform value-adding services ranging from packaging and labelling through invoicing and goods provision to the order-related assembly of sub-components and end products, as well as services such as call centres.

The over 463,000 students at the universities of North Rhine-Westphalia offer huge potential in terms of highly qualified employees. There are eleven different courses of study, including three at private universities, geared specifically to the logistics industry. Added to this are numerous students in related courses such as computer science, electrical engineering / automation technology, industrial engineering or mechanical engineering. In many fields of study, logistics is a discipline in its own right. This includes, for example, container construction in mechanical and structural steel engineering. Specialist logistical knowledge is also required in nautics, ie. the steering of container ships.

The focal points of the logistics study courses offered in North Rhine-Westphalia are varied: from a logistics diploma in the field of technical logistics to a master's degree in the physics of transport and traffic. Besides the University of Dortmund and the University of Duisburg-Essen, the European University of Applied Sciences Brühl in the Rhine region offer courses of study in "Logistics Management". The dual studies combine theory and practice at an early stage. A semester abroad is an integral part of the course, ensuring that students gain international experience. The University of Logistics and Economics in Hamm offers courses including "Industrial Engineering in Logistics" and "Logistics Management", and at the University of Neuss for International Economics students can gain a Bachelor of Science in "Logistics and Supply Chain Management".

About NRW.INVEST

NRW.INVEST GmbH serves as the central contact point for investments in North Rhine-Westphalia. It provides potential investors from Germany and abroad with a one-stop service ranging from location information and business premises searches to arranging and guidance through negotiations and approval procedures. In addition to subsidiaries in Japan and the USA, NRW.INVEST operates foreign branch offices in China, India, Korea, and Turkey. In China, NRW.INVEST is represented with three branch offices in Nanjing, Peking and Shanghai.

With this wide variety of courses related to the logistics industry the universities in North Rhine-Westphalia are reacting to increased demand and developments in the sector, thereby ensuring that highly qualified young people come on to the employment market. North Rhine-Westphalia therefore also provides all the prerequisites for successful company development.

Rising prices for raw materials and the problem of transport-related environmental pollution determine the future of logistics. Location and transport connections are assuming ever-increasing importance for companies wishing to set up business. Regions with dense infrastructure, a central location and sufficient vacant lots – such as the Rhine region in the middle of Europe – profit from this. How companies organize their transport is becoming more and more of a success-critical factor. Experts are in agreement that logistics is a key function with growing importance and North Rhine-Westphalia, Germany's most populous federal state, will continue to be the gateway to Europe for many more companies in the future. ■

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Among other things, NRW.INVEST (NORTH AMERICA) LLC organizes visits to North American companies and seminars, as well as information events on the business location North Rhine-Westphalia or on particular industrial or service sectors.

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The Lusophone Triangle

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In these last few months international investors have been getting acquainted with a reality that only a few of them were aware of: the Lusophone triangle.

One of the most important legacies of the Portuguese maritime expansion of the 15th century is the dawn of a community of more than 220 million Portuguese speakers.

This community includes countries in four continents: Europe – Portugal; Africa – Angola, Cape Verde, Guinea–Bissau, Mozambique and São Tomé e Príncipe; South America – Brazil, and Asia – East Timor. To these we could also add the Chinese Special Administrative Region of Macau that also has historical bonds with the Portuguese-speaking countries.

Nowadays it is common to think about Angola, Brazil, Cape Verde, Mozambique and Portugal as countries not only with strong cultural bonds between them, but also as a market as a whole deserving a common strategic approach.

"... the fact that Portugal is a member of the EU can make it a privileged platform for investment in Africa and South America"

Think for example about the recent 'dispute' between Portugal Telecom (PT) and Telefonica concerning the Brazilian telecom VIVO. The main strategic interest PT was defending was its presence in a multi-continental market, almost twenty times bigger than its home market, speaking the same language, a fantastic advantage when you are thinking about telecoms, media and contents.

Consider for example the leading role these countries can have in the energy sector. Angola, Brazil and East Timor are oil and gas producers; Brazil or Mozambique having some of the biggest embankments in their respective continents and the investment some of these countries are making in the renewable energy sector: for example over 60% of the energy produced in Portugal during the first semester of 2010 was from renewable sources. Just think about the synergies between these different realities if these countries are object of an integrated strategic approach from companies investing in the energy sector at a global scale.

Think for example about the geopolitical influence of these countries that control immense territorial waters in the Atlantic Ocean; Portugal in the North Atlantic with the Azores Islands just between Europe and North America, Cape Verde standing between the North and South Atlantic and between Africa and South America and finally Angola, Brazil and Mozambique - countries with a vast coastal line and extremely rich maritime resources.

"The 'Lusophone triangle' is in our opinion a reality that deserves your attention"

Take a minute to think about the enormous economic potential of the exploitation of the maritime resources of the above mentioned countries, when important R&D efforts are made in fields such as energy, biomedicine, pharmaceutical or the food industry.

These are just a few examples from a reality where much more could be found.

Another advantage for global investors to consider these countries as a whole is that although having many important aspects in common they are different economic realities, thus reducing the investment risks.

For these last few years Portugal has been strongly affected by the international economic and financial crisis and experienced negative growth of its GDP and a big increase of unemployment and of fiscal debt. Portugal is a member of the European Union and of the eurozone. For the last decades its economy shifted from being an agricultural and industry-based economy to a services-based economy.

The deep changes its productive system and its economy suffered led to difficult times, when instead of converging upon the standards of living of other eurozone countries, Portugal didn't grow as much as its 'partners'.

However, its government has a deep confidence in a new development model based on a very strong investment in education and R&D, in exploring the possibilities that its geographical situation and its continental waters provide, in taking the lead in the renewable energy sector and exploring the benefits from strong historical and cultural bonds with countries from other continents.

As far as foreign investment is concerned Portugal has a friendly environment and has made in recent years a remarkable effort to reduce the burden of bureaucracy that had been a big handicap to the competitiveness of the country. Some of the most important changes have occurred in corporate law, reducing the formalities needed to incorporate a new company, a process that in some cases can be made in a single day and where in most cases public deeds are no longer necessary.

Portugal has also recently reformed its labour law in an effort to increase the flexibility of the labour market, although the dismissal regime isn't as flexible as the ones of some of its peers.

Despite all these efforts, which are encouraged by investors from all over the world, there are still some important reforms to be made that would be highly prized. Probably the most relevant one would be the judicial system reform, allowing justice to be delivered more quickly. In fact one of the biggest problems economic agents can be confronted with is the slowness of justice and the excessive amount of time in obtaining a decision in a judicial claim. Governments have been trying to tackle this issue in many different ways but none of them has been able to find the correct solution.

These realities combined with the fact that Portugal is a member of the EU can make it a privileged platform for investment in Africa and South America.

Having acknowledged this reality the Portuguese legislator has established a tax exemption for profits distributed to Portuguese companies by companies resident in African Portuguese-speaking countries and East Timor. This tax exemption can occur when the following conditions, amongst others related to the nature of the economic activities involved, are met:

a) The company beneficiary of the profits' distribution is subject to corporate tax;
b) The beneficiary holds, at least, in a direct way, 25% share capital at the subsidiary for a period not inferior to two years;

c) The distributed profits must have been subject to taxation at a rate not inferior to 10%.

"The dynamics, quality and economic capacity of Brazilian companies make the country not only a FDI (foreign direct investment) receiver, but also an important investor in other markets"

This tax exemption is especially important when you consider the fact that Angola has not signed any Double Taxation Conventions.

After having experienced the first negative growth in recent years in its GDP (-0.2%) Brazil has surprised the world economic community by announcing an expansion of 9% for the first quarter of 2010 and a yearly forecast of 7%; this after having experienced an average growth of 4.8% between 2004 and 2008. These are results that most of the governments of the world don't even dare to dream about. These results combine with relative moderate inflation growth, around 4%, for such an active economy and a fiscal surplus that moves around 2.4% of GDP.

Brazil is one of the emerging stars of the world economy, a group that also includes China, India and Russia, and is also a stepping stone to the MERCOSUR (the South American Community established between Brazil, Argentina, Paraguay and Uruguay with the objective of promoting the free transit of production goods, services and factors between the member states and of fixing a common external tariff and adopting a common trade policy with regard to non-member states and regional communities). Between the MERCOSUR objectives we can also find the one of establishing a coordinated policy in economic sectors related with foreign trade such as, for example, agriculture, industry, taxes, monetary system and exchange policy, amongst others.

Apart from the full member states, MERCOSUR has associate members, a category that includes Bolivia, Chile, Colombia, Ecuador and Peru. Mexico is an observer of this international community.

"... the main sectors that could benefit from foreign investment would be infrastructure, energy (namely renewable energy), tourism and industrial production of consumption goods"

Although being generally considered as a country presenting good conditions and opportunities for foreign investment, Brazil has some aspects still needing to be reformed, namely the indirect tax system. The VAT correspondent tax in Brazil is the ICMS, which is not a federal tax but a state level tax thus leading some states to use it as policy instrument for attracting investment to that state. The central government has already taken the first steps towards a reform of the tax system that will make the ICMS more homogeneous throughout the entire territory.

As we all know Brazil benefits from the existence of important natural resources that make it one of the most dynamic raw materials markets globally. The richness and beauty of the country also make it one of the top touristic destinations of the world, still with many unspoiled destinations.

Brazil has developed a high quality university-level teaching system, also due to a close academic link with the United States and Europe. The high teaching standards that Brazil has achieved allows the country to form high quality professionals in every field. For that reason, and also due to the high investment in R&D, the country can be considered a leading country in many industries and services.

The dynamics, quality and economic capacity of Brazilian companies make the country not only a FDI (foreign direct investment) receiver, but also an important investor in other markets.

For the purpose of this article we would like it known that in recent years Brazilian companies have increased their investment volumes in the Portuguese market and in the Portuguese-speaking African countries.

This could be considered as a new important characteristic of the so called 'Lusophone triangle'; the investment flows between these countries don't have a single direction. We can instinctively see Brazilian companies investing in Angola (or other African country) or Portugal, Portuguese companies investing in Brazil and Angola, or Angolan companies investing in Portugal and Brazil.

As far as Angola is concerned after the spectacular years of 2007 (estimated 20%+ GDP growth) and 2008 (estimated over 12% GDP growth), the year of 2009 was a bit deceptive with an almost flat evolution of the GDP (estimate -0.20%). These figures combine with less attractive ones that rank the country at the bottom of some of the socio-economic indicators.

When speaking about Angola and the African Portuguese-speaking countries, one must not forget that they are still recovering from a long period of instability (independence wars, sometimes followed by civil ones). The economic perspectives of Angola benefit from the existence of immensely rich natural resources and also from the need to build basic infrastructures and to create a solid national industry. Angola has been an economy heavily dependent of the oil industry and its economic results, but struggling to create a new economic paradigm.

In this effort Angola, and likewise the other African Portuguese-speaking countries, mainly Mozambique and Cape Verde, are making serious efforts to develop their economies, thus creating the conditions for nationals and foreigners to invest and create new businesses, and can count on the help and experience of the other two vertices of this triangle, Brazil and Portugal.

As previously stated, the main sectors that could benefit from foreign investment would be infrastructure, energy (namely renewable energy), tourism and industrial production of consumption goods.

At a political level all these countries have recognized the importance of the bonds existing between them by creating the CPLP (Community of Portuguese Language Countries). Having close links and being present at these jurisdictions Raposo Bernardo has had the direct experience of assisting some projects of investment developed between these countries, thus attesting and recognizing the importance and the dynamics of the investment flows between them.

The 'Lusophone triangle' is in our opinion a reality that deserves your attention. ■

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Polish controversies over sending VAT invoices electronically

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The validity of VAT invoices sent by electronic means such as email or fax and the taxpayer's right to reclaim the VAT indicated in such invoices has recently become a disputable issue between tax authorities and taxpayers. In its recent judgment, the Polish Supreme Administrative Court has ruled on the issue to the taxpayer's satisfaction, stating that invoices can be sent by electronic means, even if they do not constitute "electronic invoices" according to Polish law provisions.

The VAT invoice plays an important role in the supply of goods and services in the scope of documentation. It indicates the moment when the tax point arises. According to the Polish VAT law, the tax point normally arises if the VAT-able activity is documented by an invoice, at the date of the invoice. On the other hand, a recipient of an invoice can reclaim the input VAT presented on the invoice in the reconciliation period in which the invoice has been received. Therefore, once the invoice is correctly issued and handed to the buyer, the VAT amount can be accounted for and claimed in the right reconciliation period.

"Polish courts are eager to interpret the local law provisions in line with EU law"

The Polish VAT law provides for the requirements for issuing invoices correctly. Moreover, as of 2005, additional provisions concerning the way of issuing, transferring and storing of electronic invoices came into force. The law on electronic invoices prescribe the use of electronic data interchange (EDI) system or electronic signature while transmitting the electronic invoices in order to ensure their accuracy, security, authenticity and integrity. The recipient needs to accept the electronic invoices in the prescribed format. However, the VAT law does not prescribe the form of sending regular invoices. In particular, it does not state that a regular invoice should be sent to the buyer by post.

The dispute between the Minister of Finance and the taxpayers arose over the issue of the validity of the VAT invoices which have been sent by the issuer via email (as an attachment) or fax and have subsequently been printed out and stored in a paper form by the buyer. The Minister of Finance claimed that invoices received via electronic means, and not secured by electronic signature or EDI, cannot be treated as a valid VAT invoice. According to the minister's interpretation of the tax law provisions, the term "to issue an invoice" should be understood as producing an invoice in paper form. The minister claimed that an invoice sent by email and printed out does not allow the recipient to reclaim VAT on purchases by using such an invoice as a proof of payment. The taxpayers disagreed with the above and questioned the interpretation before the administrative court.

"The Minister of Finance claimed that invoices received via electronic means, and not secured by electronic signature or EDI, cannot be treated as a valid VAT invoice. According to the minister's interpretation of the tax law provisions, the term "to issue an invoice" should be understood as producing an invoice in paper form"

The taxpayers emphasized that invoices sent by traditional mail often reach the addressee up to a few months from being sent, which is very inconvenient from the tax deduction perspective. Sending invoices by electronic means allows a cut on the costs of printing, therefore reducing the use of paper and protecting the environment. Moreover, the threat of scamming invoices sent via fax or email is in fact similar as in case of sending paper invoices by traditional post.

In its judgment, the Polish Supreme Administrative Court favoured the taxpayers' point of view. The court ruled that according to the Polish VAT law provisions, the term "to issue" an invoice cannot be understood as producing an invoice in paper form. Therefore, according to the Court, the taxpayers are entitled to issue invoices with the use of electronic accounting systems and send them by electronic means.

Such a way of transmitting the invoice to the recipients meets the requirements as set out in the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax as well as the national tax law, and cannot preclude the right of the buyer to deduct input VAT from such an invoice. However, the Court claimed that such invoices (unlike the electronic invoice sent with EDI or electronic signature) need to be stored in paper form by the buyer.

The presented judgment provides an example of positive approach and is a sign of changes that are about to be introduced in Poland, and which clear the way for a business-friendly administrative environment. This is particularly important in the context of opening the Polish market not only for huge international companies, but also for smaller foreign entrepreneurs. The ruling also shows that the Polish courts are eager to interpret the local law provisions in line with EU law, and protect the taxpayer's right to deduct the input VAT on purchases. ■

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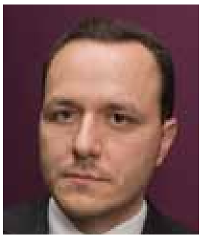
An overview of the legal opportunities of capital placement in Poland for foreign investors



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The conduction of an economic activity abroad as a form of location of capital

For numerous foreign investors it is always the same basic question – how should I locate my assets to effectively increase my profits? Even though some of them get convinced by their managing bodies, analysts, advisers and strategists to move their production or business activity abroad, their finally face an obstacle in the form of new or unclear administrative and legal formalities, which – not uncommonly – cannot be overcome in an appropriate way. How to get through all these burdens?

Forms of carrying out of the economic activity in Poland

To begin with some explanation needs to be done in the context of entrepreneurs from abroad planning to undertake business in Poland. According to the Polish Act on Freedom of Economic Activity, foreign entities from EU member states are eligible to undertake and perform business activities under consideration of the same rules as Polish citizens. In other words they are entitled to run their enterprises in every form allowed by the Polish law, unless the fulfilment of additional conditions is required (eg. taking out a license or obtaining of permission). Therefore foreign investors are entitled to create and register partnerships and capital companies. Moreover, the limited liabilities companies who have their registered offices abroad may establish branches or representative offices in Poland. On the other hand, the commencement of economic activity not always requires the creation of a new entity. A noteworthy solution is entrance into an already existing company (eg. capital company) as a shareholder by means of share acquisition. This requires a conclusion of a contract on acquisition of shares, which shall be made in writing, with signatures certified by a notary.

Costs connected with commencement of economic activity

Subsequently, it is important to analyze and to choose the concrete form in which the business activity shall be realized after detailed consideration of individual needs and circumstances of concrete investor. If there is a limitation of liability for assumed obligations asked, it is recommended to deliberate the establishment of a limited liability company, since the shareholders shall not be liable for its obligations. The incorporation of such company requires the execution of the articles of association in notarial deed form and registration into the National Court Register. The notarial fee in this case depends on the amount of the share capital of the company and should cost c. 160 PLN, assuming that the limited liability company with minimal share capital (at least 5,000 PLN) shall be incorporated. Due court fee for first entry into the National Court Register and additional fee for publication in journal for the company's announcements (*Monitor Sądowy i Gospodarczy*) shall amount to 1,500 PLN.

Special economic zones

Before a foreign investor decides to locate money outside his domestic environment, he often has to face the issue of the new investment location. This requires a consideration of many factors, for instance: access to essential resources, road and transport infrastructure, tax benefits or area surrounding. What is worth of considering for this reason is the conduction of the economic activity in a special economic zone (Specjalna Strefa Ekonomiczna). Special economic zones are particular areas covering selected territories in Poland, which are created on the basis of a Regulation of the Council of Ministers which offer special economical benefits for companies launching economical activity within.

Benefits resulting from the location of the production in special economic zone

Currently there are 14 special economic zones functioning that are located in different parts of Poland. Hence the selection of the most geographically suitable region shall not pose a problem. The beginning of every activity in a special economic zone requires the obtaining of special permission granted by the minister competent for the economy. Prior granting this permission the minister competent for the economy consults the administrator of the special economic zone in this matter. Additionally it should be pointed out that entrepreneurs running their business in special economic zones are entitled to receive the public assistance according to the conditions contained in the permission granted. Moreover, the income received from the conduction of the business activity in the special economic zone is generally exempted from tax on income to the extent specified in the Polish Act on Corporate Income Tax.

In addition to the aforementioned it should be emphasized that in order to encourage foreign entities to invest in Poland more attention should be paid to the few formal obstacles left. Particularly simplification of all necessary formalities is required, which will hopefully happen soon. ■

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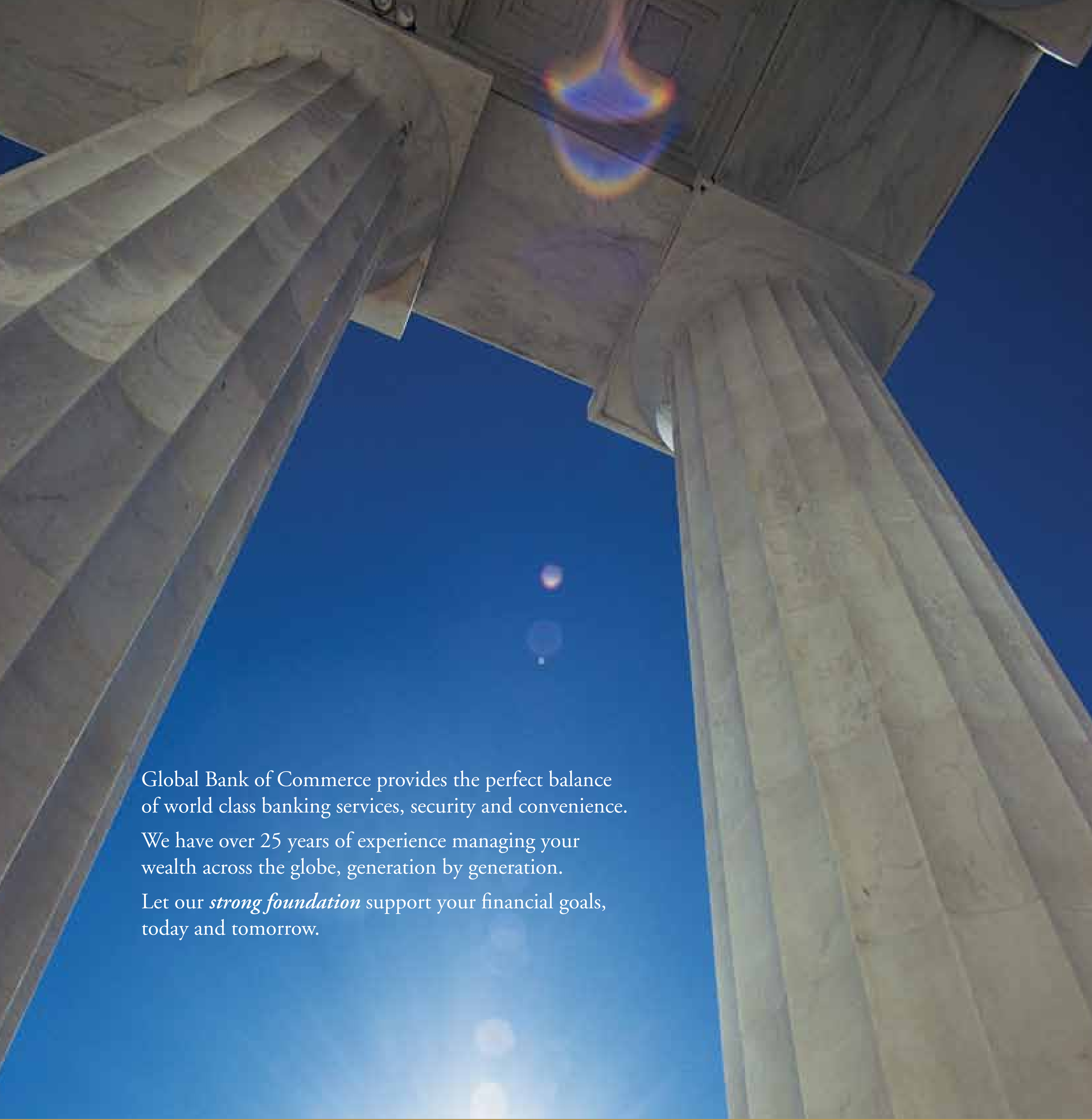

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