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Facing the employment challenge

Lászlò Andor writes about the EU approach to employment policy

THE GLOBAL TRADE PLATFORM

Another turbulent autumn?

Its four years since the collapse of Lehman Brothers, which sent global financial markets into a panic and brought credit markets worldwide to the brink of a meltdown, and marked the beginning of the global financial crisis.

Governments worldwide began what would become multi-trillion dollar efforts to prevent a collapse of the financial system. This has worked, up to a point. Recent economic news has been positive, with an apparent triple lock of policy action in America, Europe and China. What could possibly go wrong?

Restoring stability is a war on many fronts. Just as macroeconomic risk subsides, a number of geo-political threats have reared-up to take their place. Chief among these is the possibility of Israeli military action against Iran. The Strait of Hormuz may soon need defending against an Iranian counter attack. Anti-western riots across the Middle East, and anti-Japanese protests in China, have added to the feeling of growing geo-political fragility. China has also stepped up its activity in the South China Sea, drawing anger and protest from countries also laying claim to the region.

All this could hardly have come at a worse moment. Just as confidence seemed ready to spark back into life, along comes another oil price spike to blow the nascent recovery out of the water.

The return to more normal economic conditions was by no means assured, even without these new threats. Markets may have been getting ahead of themselves in assuming policymakers have finally got a grip.

For the time being Mario Draghi's promise of 'outright monetary transactions' has removed the prospect of a eurozone break-up. Politically intolerable and economically self-defeating austerity measures are likely to bring a return to the eurozone crisis in the coming months. In the US, the Federal Reserve has supercharged the positive mood with another burst of quantitative easing. The central bankers are doing their best to prop things up. Unfortunately, the threat posed by America's 'fiscal cliff' and the political uncertainty of the presidential election mean that we can't assume that the American economy is out of the woods. The Chinese fiscal stimulus seems to be a re-packaging of previously known initiatives. The hopes of a policy induced recovery may be misplaced.

Into this mix the geo-political instability across the globe threatens to turn an unstable situation into something more worrying. Experience teaches us that spikes in energy prices are harmful to economic activity, especially when confidence is low. Historically, nearly all modern recessions have been preceded by a sharp run up in energy costs.

All the work that central banks have been doing in underpinning confidence is in danger of being swept away by events over which we have no control.

Who knows? Maybe it won't happen. But financial markets may be set for another turbulent autumn. ■

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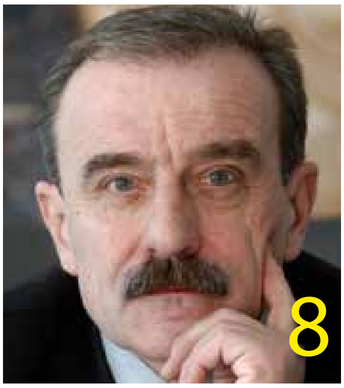

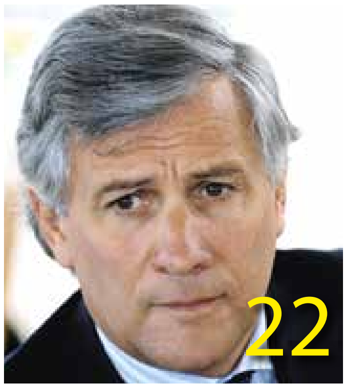

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Global growth through global employment and social affairs

László Andor is the European Commissioner in charge of Employment, Social Affairs and Inclusion

Globalisation and the present economic crisis have created a common political interest in employment and social affairs. During the first half of 2012, I visited the US and Japan. Clearly, we face similar challenges such as youth unemployment, the mismatch between available skills and job vacancies, intensive company restructuring and an ageing society.

This common interest is increasingly shared by emerging economies such as China, India, Brazil and South Africa. They too are beginning to face at least some of these challenges. Indeed, we can talk today of a global interest in issues which, up till recently, were only addressed at the international level in specialised and dedicated bodies.

Youth employment is emblematic in this respect. In May 2012, the G20 labour and employment ministers meeting in Mexico emphasised the need to promote policies that generate employment for youth and facilitate the transition from school to work. They highlighted the need for inclusive green growth, in the context of sustainable development, as a source not only of job creation but of decent work and of the development of new skills.

"The Employment Package provides a common EU approach to employment policy, together with concrete proposals for activating all levers, at all levels of governance, to ensure a job-rich recovery"

In June 2012, the Rio+20 UN conference, which celebrated the adoption twenty years ago by the UN of the sustainable development concept, agreed on the need for a global strategy for youth and employment that builds upon the work of the ILO.

Sustainable development encapsulates a holistic, equitable and far-sighted approach to decision-making at all levels. It emphasises not just strong economic performance but long term intragenerational and intergenerational environmental equity.

However, the generational challenge is also a short term one - in the field of employment. Let us not forget that the background to the Arab Spring is a massive wave of people under 35 years of age striving inter alia for proper labour market inclusion. In the EU, as well as in the US and Japan, youthful frustration in terms of jobs and economic opportunity is also a dramatic feature, this time in the context of a rapidly ageing society.

Europe 2020

In 2010, the EU adopted a strategy for smart, sustainable and inclusive growth, Europe 2020. It sets concrete targets to be achieved by 2020, including having 75% of the active population at work and lifting 20 million people out of poverty or out of the risk of poverty and social exclusion. The employment target requires that more young but also older people, especially women, have a job.

In the EU, we have seen the unemployment rate on the rise again, at over 10% in April 2012. For young Europeans, the situation is bleak: at 22.4%, the unemployment rate for people under 25 is more than twice the rate for adults. 7.5 million young people are neither in employment, nor in education or training. Yet 4 million jobs are still vacant across the EU!

Three of our 27 member states have managed to keep the unemployment rate of young people under 10% but it is over 30% in eight member states and in Spain and Greece, it is over 50%. If we are to restore growth and cope with major structural changes like the greening of the economy, an ageing population and technological change, we need a dynamic and inclusive European labour market.

Creating more, and more sustainable, jobs is the main thrust of the Employment Package the European Commission presented on 18 April. In line with the G20 concerns about youth unemployment and unemployment in general, it provides a medium-term agenda for EU and member states' action to support a job-rich recovery.

The Employment Package provides a common EU approach to employment policy, together with concrete proposals for activating all levers, at all levels of governance, to ensure a job-rich recovery. It involves labour market reform to support labour market transitions, reduce fragmentation, anticipate economic restructuring, develop lifelong learning and deliver youth opportunities.

The Commission urges the member states to focus on job creation in sectors such as health care, information and communication technologies and activities related to cutting down pollution and reducing carbon emissions.

For its part, the Commission aims to encourage labour mobility within a genuine EU single labour market, by helping to match unemployed people with particular skills and experience in one country with vacancies in another country.

The main policy document of the Package addresses several issues of high relevance for youth, such as skills, public employment services, the European labour market, the EU-wide recognition of skills and qualifications.

Youth Opportunities Initiative

At the end of 2011, the European Commission launched a Youth Opportunities Initiative (YOI) to speed things up and support the EU member states' efforts by providing policy guidance and finance for the two coming years.

The EU leaders endorsed the YOI at the highest political level in January 2012. In an unprecedented move, the European Commission then sent action teams to work with the member states with the highest youth unemployment rates (plus 30% of young unemployed), ie. Greece, Ireland, Italy, Latvia, Lithuania, Portugal, Slovakia and Spain. Up to 7.3 billion euros of EU funding was earmarked for reallocation or acceleration of projects targeted at youth employment.

As part of the YOI, I will present a Youth Employment Package at the end of 2012. It will ensure that young people are either in employment, education or training within four months of leaving school, in effect disseminating across the EU youth guarantee schemes which countries like Austria, Finland and Sweden have already put in place.

Designing and implementing such schemes requires coordinated efforts on the part of a great number of actors: public authorities, employment services, education and vocational training institutions, social partners, welfare and social services etc. The Commission will use 4 million euros to help member states set up such schemes.

The Youth Employment Package will also give a boost to apprenticeships and traineeships by ensuring a quality framework in this area. Provided they are of high quality, traineeships can help young people acquire the necessary labour market relevant skills they need to get a first job. The quality framework will clarify the responsibilities of all parties and define a set of quality criteria, such as a proper agreement between the employer and the trainee that specifies the traineeship's objectives and the trainee's mentorship, remuneration, social security and insurance coverage.

The Commission will dedicate 1.3 million euros to support apprenticeships, knowing that an increase of 10% by the end of 2013 would add a total of 370,000 new apprenticeships. It will also use 3 million euros of the European Social Fund to support member states in setting up support schemes for young business starters and social entrepreneurs. It will gear EU structural funds as much as possible towards placements in enterprises, hoping to create 130,000 placements in 2012 under the EU Erasmus and Leonardo da Vinci exchange programmes.

The Commission will also provide financial assistance in 2012-13 to 5 000 young people to find a job in another member state. It will reinforce the budget allocation for the European Voluntary Service in order to provide at least 10 000 volunteering opportunities in 2012.

One crisis is hiding another

Quite apart from the economic crisis, the EU is also facing a daunting demographic challenge, as the baby boomers begin to retire. 2013 will be the first year when the European population has stopped growing. 2012 is the European Year for Active Ageing and Solidarity between Generations.

Its aim is to stimulate commitments from policy makers and stakeholders (social partners, NGOs...) and to promote the concept of "active ageing": older people should get more opportunities to contribute to society and the economy, and take their own life in charge.

Studies show that those countries which have the best record in terms of employment of older people also have the best record for youth employment. More suitable jobs need to be created for older workers, encouraging them to stay longer on the labour market.

But the European year is also promoting a new vision of active ageing that goes beyond employment and includes participating in society. This entails recognising the role of older people as volunteers and carers, and making sure that they can live independently for as long as possible.

In turn, this requires that older people earn sufficiently to carry on living independently. In April 2012, the European Commission presented a White Paper on pensions suggesting ways of maintaining adequate, sustainable and safe pensions in an ageing society and in the face of the present crisis. We cannot lift older people out of poverty without securing decent pensions and minimum income for the elderly.

Channelling restructuring

Today, the pace of technological and organisational change due to globalisation is such that whole sectors of activity are disappearing while others are emerging. From 2002 to 2010, the EU has experienced over 11,000 cases of company reorganisation, closures, mergers and acquisitions, downsizing, outsourcing or relocation. Between 2008 and 2010, the ratio of almost two jobs lost for every one created has increased to 2.5 jobs lost for every one created.

Restructuring management needs to evolve. From a traumatic personal and social experience, restructuring must become a genuine opportunity to evolve. This requires transparency and trust between all the actors involved, as well as a culture of anticipation: retraining in good time the workers of the company which is due to restructure itself, as well as those of the small and medium-size enterprises that depend on it; anticipating the forms of employment and the skills that will be required in the future. It also requires new forms of cooperation, stretching beyond the social partners to the local and regional authorities and even to the universities and training centres.

In March 2012, the European Commission consulted the public on a Green Paper on restructuring, as a first step towards a policy that would encourage the development of a culture of anticipation in this area.

Across the globe

The European Commission is taking the global unemployment situation very seriously. It is implementing a large number of actions to help address the situation within the EU itself and is actively involved in sharing best practices and experiences with other parties. It is pursuing cooperation on employment issues on a global level through a variety of fora, including the G20 meetings and the ILO.

The present crisis has renewed interest in an exchange on employment and social policy with other industrialised countries, both bilaterally and in multilateral fora such as the G8/G20, the ILO and OECD.

Across the globe, the challenges we face are very similar. Whether economically developed, emerging or developing, many countries are now facing the risk of seeing a whole generation go to waste - a potentially unmitigated economic, social and political disaster.

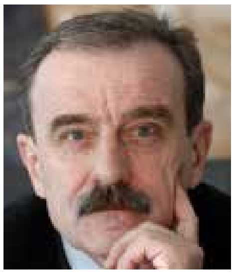
In 2011, the EU took part in a round-table debate with the US and Canada on green jobs. Although each of us has developed its own way of defining and measuring such jobs, we can find common ground. It partly depends on how we define qualifications and skills in the first place.

Precisely, when I visited the US in February 2012, I took part in a seminar on new skills and new jobs. How can we learn from each other? How did the US manage to get such low unemployment rates? How did they deal with getting people to work? How did they make employment services work? What active labour market policies?

On youth employment and active ageing, we have also engaged with Japan, which I visited in July. There is still room for more exchange of practices, for learning more from each other.

Being curious to learn from other countries and regions in the field of employment and social affairs has become crucial to each country or region's capacity to generate growth on its own territory. ■

The Western Balkan's new choice – joint development or individual depression



Hido Biščević is Secretary General of the Regional Cooperation Council. The RCC promotes mutual cooperation and European and Euro-Atlantic integration of South East Europe in order to inspire development in the region to the benefit of its people

Several weeks ago, at the peak of the summer tourist season, I learned that the air control service at the Zagreb Airport Pleso managed to handle nothing less than 10 percent of the entire European air traffic routes network over one single weekend – 10 percent of the entire European air routes network is certainly no small portion by any standard, for any country.

This small piece of statistics is more than indicative, not only for Croatia, but for the entire region of South East Europe (SEE) and its core area of the Western Balkans because it indicates huge potentials, abilities and achievements. But, unfortunately, it also indicates enormous disparities and unused opportunities.

By way of illustration, to counter the highlighted Zagreb Airport achievement, one may turn to the fact that the region of South East Europe is home to no less than 24.5 percent of all registered airfields in Europe, an enormous value in itself – but, lack of cooperation and common strategic focus leads to the fact that, in the entire Western Balkans area, the air traffic statistics are falling, the number of passengers is no more than 3 million per year, as compared to the 15 million at the Vienna airport only.

Huge common regional asset, huge individual national loss. One could only imagine the benefits of regional cooperation in lifting the air transport infrastructure and standards to a competitive level with all these 570 airfields from Slovenia

to Turkey and from Moldova to Montenegro, not to mention the huge value of international over-flight routes.

Statistics points to the biggest asset of the region – its geo-economic position on the map of Europe and the wider area. But, in the Western Balkans it is still more about politics and geopolitics then economy.

Every indicator of the current state of affairs of economic and social life in the Western Balkans and wider SEE region dramatically rings the alarm bell, but the lack of a clear strategic vision, within the region and among its outside partners, still feeds the 'laggard mentality' and policy of denial of the harshest possible effects of the current economic and financial crisis in Europe.

Huge potentials in such priority areas as infrastructure, waterways, transportation, forestry, agriculture and many others still remain 'dead capital' despite prolonged economic crisis, fearful economic collapses or depression.

Indeed, potentials are obvious but largely neglected, fragmented and unused. Airports and over-flight routes are just one of the indicators how the region's geo-economic position must be a starting point for any strategic and 'out of the national box' approach to development, in particular at the time of crisis.

Take the asset of maritime ports in the region - from Kopar, Rijeka, Zadar, Split, Ploče to Thessaloniki and Istanbul: by developing a shared concept of cooperation to serve and access the European and global markets they could provide a higher level of contribution to each individual national budget then by mutual competition.

Or the enormous hydropower potentials of the region, which is a home to comparatively the highest number of usable rivers in Europe – yet, only less than a half of the hydro potential of the region is being utilized, whilst this summer's effects and costs of the draughts are already a burden to every national budget, in particular in a socially sensitive agricultural sector.

Yet, the 'laggard mentality' at the administrative level, plus the political environment and the remaining stigmas towards a genuine functional regional cooperation, still holds back the implementation of many existing projects in this sector; from using rivers in Bosnia and Herzegovina for electricity production to a slow rehabilitation of the Zagreb-Belgrade waterway route to benefit transport, irrigation, agriculture and, last but not least, addressing the alarming issue of unemployment in the region, with 30 percent the average, and close to 50 percent in some of the countries.

Take then the assets in the transport sector, due to the geo-economic position again – set between the EU markets, the Russian Federation, Mediterranean area and, further to the east, Turkey, the Middle East and China - the region should engage in a genuine strategic partnership to develop infrastructure that will ensure that the huge potential is transferred into sustained benefits.

By way of illustration, the region should immediately engage in the strategic project of rehabilitation and modernization

The region would benefit from the modernization of the railway network © RCC/Dado Ruvic

of the railway axis from Ljubljana across Croatia, Serbia and Bulgaria to Turkey, so as to be ready to benefit from the future Bosphorus Europe Railway Corridor, once it starts using the under-Bosphorus tunnels and allows for the fast freight trains to connect the EU market with China.

Or look at the energy transportation sector – electricity, gas and oil transport networks across the region could provide for further functional cooperation among European, Russian and Asian energy partners, to the direct benefit of the region and, more than that, with a strategic effect on the geopolitical and political position of the region and its member states at the international level.

Should, for example, Croatia be ready to position itself on the railway axis between the EU and Turkey and beyond whilst, at the same time, providing a central crossroad point to the Russia–Mediterranean railway axis (port of Rijeka), it would definitely upgrade the relevance and strategic 'value' of the country, not to mention the economic benefits.

In another example, should Croatia initiate the building of an underwater pipeline connecting its northern Adriatic port of Omisalj and its refinery with the refinery in Trieste (only 60 kilometres long!), it would link the entire AdriaDruzba pipeline system from Russia through Central Europe and Croatia with the EU pipeline and refineries network. Certainly a different kind of asset than the fruitless, unproductive and even harmful debates about the AdriaDruzba pipeline and its future, whilst northern, central and even southern European energy transportation systems from Russia to EU are being developed.

And it is not only about the large-scale infrastructure projects. It is about dozens of conceivable projects in different, potentially plausible sectors. Take, again, the forestry potential of South East Europe. Unfortunately, more often than being focused on developing a common approach to forestry management and industrial use, the region is regularly, summer and summer again, confronted with devastating forest fires that, together with illegal logging, are reducing the huge potential of this sector.

Droughts in the area with huge hydro potential, forest fires in the area that is third in Europe in terms of forestry potential only after the Alps and Scandinavia!? Again, an alarm bell to elaborate a regional strategic recovery and development partnership, adopt a common approach and avoid individual depression and stagnation.

The current economic and financial state of affairs in most of the countries in the region additionally calls for a strategic approach to recovery and development in order to make the most of the region's potential and geo-economic position. Economic depression, contracting GDP and shrinking economies, scary unemployment rates, foreign debt, lack of capital investment, poverty rates and other alarming indicators, against the background of the still existing political issues with destabilizing potentials, weak state administrations or even dysfunctional or 'failing states syndromes', together with challenges of corruption and organized crime or negative demographic dynamics across the region, certainly call for urgent rethinking of the overall approach to the Western Balkans, by both the regional leaders and by their EU and international partners.

There is an obvious goal of such a new approach – avoidance of a protracted stagnation in terms of a strategic positioning of the entire South East Europe within the European and Euro-Atlantic integration structures, in particular against the background of a dramatically changing international agenda, current EU inwardness and weaknesses, rising Western–Russia and Western–Sino competition or even resurfacing of the Cold War patterns, as evident with the Syria crisis.

There are also obvious instruments to attain this goal.

"EU instruments should be further engaged in elaborating a regional strategic approach to economic recovery and development"

The EU and NATO enlargement policy must preserve, but also accelerate its transformation power and its security and stability role in the region. As a number of open bilateral issues throughout the region continue to hamper the EU and NATO enlargement, more than sometimes stalling reforms – sometime sluggish precisely because of the lack of strategic resoluteness of the EU, thus allowing other players to step in – it would be advisable for the EU to elaborate and develop a methodology and a strong mechanism to address and resolve all open issues in the region in an amicable and mutually appeasing spirit, but also in a definitive manner.

Last but not least, the EU instruments should further be engaged in elaborating a regional strategic approach to economic recovery and development, in particular in the priority areas where the vast natural and human potential of the region could be turned into profitable assets, thus responding to the social consequences of the current crisis, but also with stabilizing social effects.

A good example would be to include the Western Balkans into the Connecting Europe Facility, where only a small portion of almost €50 billion may provide effective and competitive transportation system in South East Europe, to the benefit of the EU members also.

Political issues must be urgently resolved and 'unfinished peace' must be completed, whilst a common strategic partnership for recovery and development must be established to build upon the vast potentials and resources of the region.

Indeed, it is about common development and mapping of the entire region into the European and Euro-Atlantic structures, or about the dangerous individual economic and social depression and prolonged strategic vacuum in this part of Europe. ■

Trends and patterns in foreign trade of Central Asian countries

Roman Mogilevskii is Project Director at the Institute for Public Policy and Administration, University of Central Asia, and CASE fellow

Introduction

Central Asia is a region which possesses rich natural resources, an educated labour force, cultural diversity and strategic location, especially proximity to China. Conversely, the region is landlocked and remote from most global economic centres, it has a small population and market size, underdeveloped infrastructure, and in some areas suffers from political instability and insecurity; all of which create risks for human development. The relationship between the multiple forces driving development and risks is dynamic. Understanding these dynamics requires consistent monitoring and careful evidence-based analysis of key development factors in the region.

One of the most important factors of economic development is foreign trade, and Central Asia has economies heavily dependent on trade. Below we discuss recent trends and patterns in the total and intra-regional trade of Central Asian (CA) countries and assess their importance and policy implications. Trade between CA countries is considered in more detail, and the analysis covers both formal and informal trade flows.

"Almost all CA countries have ambitions to make a transition from the export of primary products to products/services with higher value added. The most natural markets for these products/services are their neighbours"

The paper distinguishes between informal trade flows in consumer goods with welfare-increasing potential, and illicit trade in goods such as narcotics and weapons. The latter trade, although present in the region and important for some countries, is seen to have limited impact on legal economic activities and is therefore excluded from consideration.

In this study, the period under consideration is from 2000 to 2010 and the region of Central Asia includes Afghanistan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Afghanistan is not always considered part of Central Asia. However, from a trade perspective, the ties between Afghanistan and its northern neighbours are increasingly important and have the potential for substantial growth. Therefore, in this analysis, it is useful to include Afghanistan in the broader CA context.

1. Environment for trade development in the region

The first decade of the 2000s appeared to be a period of economic recovery in Central Asia. All CA countries demonstrated good economic growth: Turkmenistan recorded a double-digit average annual GDP growth rate, and in Afghanistan, Kazakhstan and Tajikistan these growth rates exceeded 8%.

Other macroeconomic factors directly affecting trade include inflation and exchange rate. Inflation in the region in 2000s was quite high. Only Afghanistan and Kyrgyzstan had average inflation rates somewhat below 10% per annum; in Tajikistan and Uzbekistan the decade's average annual inflation rate exceeded 20%. Due to high inflation, the exchange rates of all national currencies in the region appreciated in real terms against the US$ and the Chinese yuan. This real appreciation of regional currencies reduced price competitiveness of commodities produced in these countries on both domestic and export markets.

Trade policies in the region are not particularly restrictive; for example, simple average most-favourable nation import tariffs are in the range 5-15%, which is not high by global standards. There were no dramatic changes in the trade regimes of CA countries in the 2000s. The only important change - the creation of the CU of Belarus, Kazakhstan and Russia - materialized in 2010 and thus did not significantly influence trade flows in the period under consideration.

An important impediment for trade in the region is the insufficient development and poor condition of infrastructure and trade facilitation. These factors are captured by the logistics performance index (LPI) developed by the World Bank. In general, CA countries, especially the smaller ones, do not fare well on the majority of LPI components. Key barriers for trade for these countries are associated with the inadequate quality of trade and transport infrastructure, underdeveloped logistics services, as well as inefficient custom clearance processes. Nonetheless, a comparison of 2007 and 2010 LPI values indicates that all countries of the region, and in particular Kazakhstan and Uzbekistan, achieved visible progress.

According to the LPI, the most notable improvements were in rankings for infrastructure and timeliness of international shipments. These improvements could be a result of massive investments into transport and energy infrastructure in the countries of the region by foreign partners and international development organisations. Examples of large projects include the construction of oil and gas pipelines from Kazakhstan and Turkmenistan to China, the electricity transmission line from Uzbekistan to Afghanistan, and the rehabilitation of automobile road corridors in almost all countries of the region.

Apart from domestic policies and structural issues, trade performance of CA countries from 2000 to 2010 was affected by fluctuations in international commodity prices. International energy and metal prices rose from 1999 to 2008, dropped from 2008 to 2009, and recovered from 2009 to 2010. All CA countries, apart from Afghanistan, specialize in the export of energy products and metals, and some depend heavily on energy imports. So the region was strongly affected by these price developments.

As shown in Figure 1, countries which are net energy exporters (Kazakhstan, Turkmenistan, and Uzbekistan) enjoyed a dramatic improvement in their terms of trade measured by the net barter terms of trade index. In Afghanistan and Kyrgyzstan, price improvements for export commodities were mostly offset by increased fuel prices. For Tajikistan, imported energy price growth resulted in deterioration of its terms of trade from 2007 to 2010.

2. Foreign trade flows in Central Asia in 2000-2010

2.1 Merchandise trade

All CA countries demonstrated very good growth of trade in 2000-2010. Trade turnover expressed in USD increased many times in every country of the region (Table 1). The role of trade in these economies has grown correspondingly; the share of trade turnover in GDP increased very substantially in all countries.

As could be seen from Table 1, CA countries are split into net exporters (energy-rich Kazakhstan, Turkmenistan and Uzbekistan) and net importers (Afghanistan, Kyrgyzstan, and Tajikistan). Energy exporters did very well during the decade under consideration, and their exports increased many-fold mostly due to the above-mentioned positive shock in terms of trade (see Figure 1).

Positive or negative, trade balances in almost all these countries have been large and increasing. Net exporters accumulate their trade surplus in national funds or use other arrangements to invest export revenues; net importers finance their trade deficits through remittances, FDI, and foreign aid. So, exports and imports in all these countries are decoupled; export revenues are used not only for financing imports and are not necessarily the largest source of imports financing.

It is typical for all CA countries to have exports concentrated on just few commodities (Table 2). Key export commodities of CA countries include energy products (crude petroleum oil and natural gas), metals and ores (iron, copper, gold, aluminium etc.) and selected agricultural commodities (eg. cotton and wheat).

Another common feature of trade dynamics in CA countries is the strong increase in imports. This could be due to robust growth of GDP and domestic demand in the region after 2000 and the strengthening of national currencies (see Section 1). As a result, the economies of the region are more open now than they were in 2000.

The main export partners of CA countries are the EU, Russia and China. The roles of the EU and China as export markets increased dramatically between 2000 and 2010. Russia's role as export market for CA economies has reduced but remains large and exports to this country increased in real terms in 2010 in comparison to 2000.

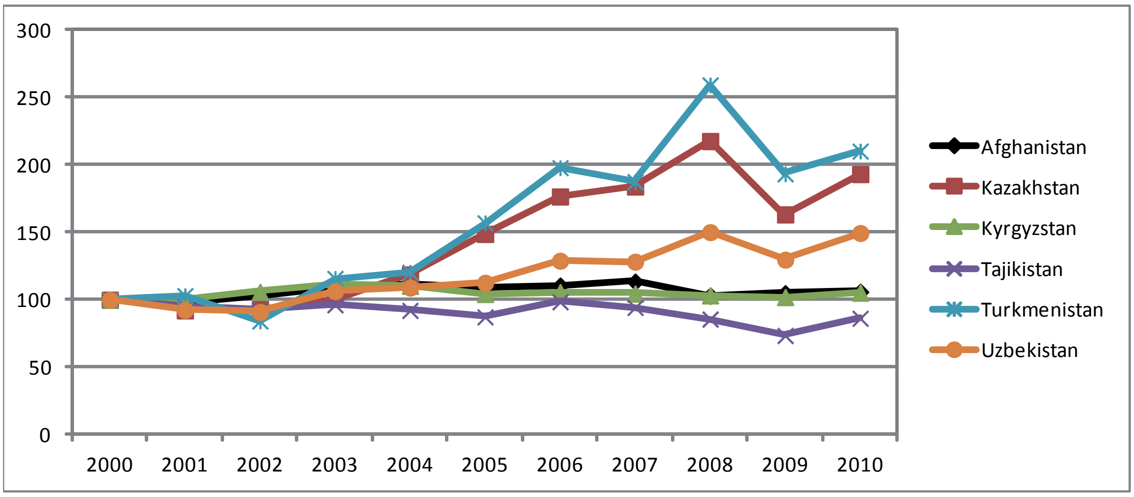
Unlike exports to the EU and China, which consist predominantly of hydrocarbons and metals, exports to Russia are more diversified and the share of manufactured

Table 1[1]. Commodity trade turnover and balance

<table>
<tr><th rowspan="3">Country</th><th colspan="4">Trade turnover</th><th colspan="2">Trade balance</th></tr>
<tr><th>2000[1]</th><th>2010</th><th>2000[1]</th><th>2010</th><th>2000[1]</th><th>2010</th></tr>
<tr><th colspan="2">Billion USD</th><th colspan="4">% of GDP (at purchasing power parity)</th></tr>
<tr><td>Afghanistan</td><td>1.3</td><td>10.7</td><td>10.2</td><td>38.9</td><td>-8.7</td><td>-35.3</td></tr>
<tr><td>Kazakhstan</td><td>13.8</td><td>90.7</td><td>19.3</td><td>45.9</td><td>5.2</td><td>14.7</td></tr>
<tr><td>Kyrgyzstan</td><td>1.1</td><td>4.7</td><td>16.1</td><td>39.1</td><td>-0.8</td><td>-14.4</td></tr>
<tr><td>Tajikistan</td><td>1.7</td><td>3.9</td><td>30.8</td><td>32.0</td><td>-0.4</td><td>-12.1</td></tr>
<tr><td>Turkmenistan</td><td>4.3</td><td>17.9</td><td>48.5</td><td>48.3</td><td>8.1</td><td>4.0</td></tr>
<tr><td>Uzbekistan</td><td>5.5</td><td>20.2</td><td>15.6</td><td>23.5</td><td>0.3</td><td>4.0</td></tr>
</table>

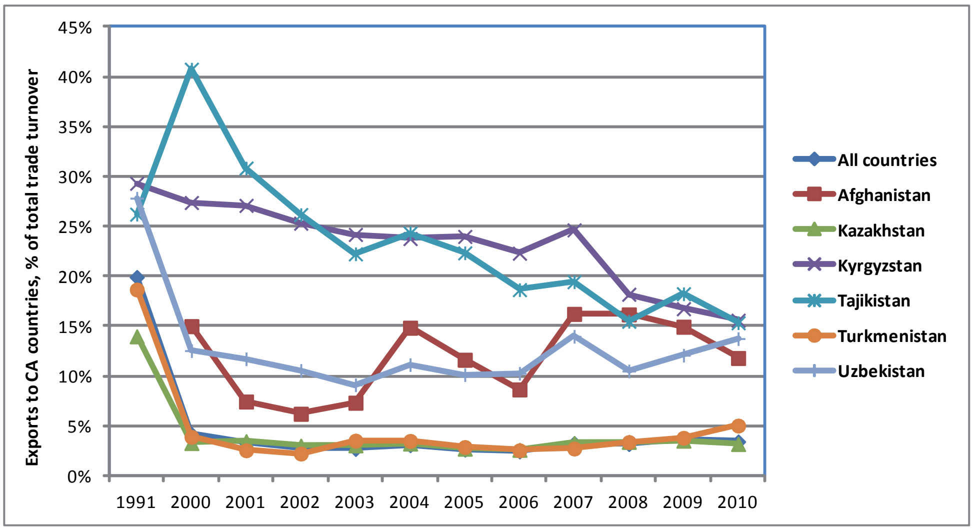
Sources: author's calculations based on COMTRADE database, IMF and CA countries' national statistical sources

Figure 1. Dynamics of net barter terms of trade index in Central Asia



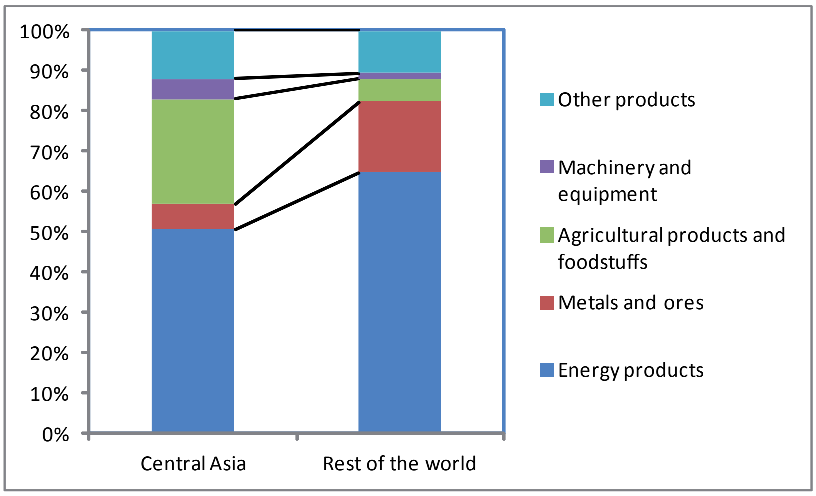
Sources: World Development Indicators and author's calculations

Figure 2. Dynamics of intra-regional trade turnover



Sources: COMTRADE, IMF, World Bank, national statistical agencies of CA countries

Figure 3. Commodity structure of exports of countries of the region to Central Asia vs. the rest of the world



Sources: COMTRADE, national statistical agencies of CA countries products in these exports is higher, with Russia being the main destination of Uzbek cars, Kazakh machinery and Kyrgyz garments.

Changes in the geographical structure of CA imports have been less significant. Russia continues to be the main source of imports for the region, supplying energy and manufactured products. The EU is in second place, providing various machinery and equipment to Central Asia.

Over the decade, China progressed from providing few imports to Central Asia in 2000 to providing over 10% of total imports to the region in 2010, making it the third largest source of imports, according to CA countries' official data. The data do not take into account huge informal imports of Chinese consumer goods, especially textiles (see Section 3.2).

2.2 Trade in services

Available data for CA countries show that exports of services are important only for Kyrgyzstan and Tajikistan. In Kyrgyzstan, in recent years, exports of services were as high as 60% of exports of goods. Exports of services from this country are driven by travel/tourism which provide 40-60% of total service export revenues depending on the success of a given tourism season on Issyk-Kul lake shore. Tajikistan's main exported service is melting of aluminium from imported alumina using cheap electricity in the country. In Kazakhstan and Uzbekistan, exports of services are not as important as the exports of goods.

Imports of services are relatively high in Kazakhstan, where they remain mostly above 30% of imports of goods. Key components of imported services are geophysical services related to oil and mineral exploration (20-50% of the total imports of services) and construction services (17-35% of the total imports of services). These imports accompany massive export-promoting investments in mineral deposits and infrastructure projects including pipelines. In Kyrgyzstan and Tajikistan, key imported services include air transportation and travel (up to a half of total imports of services), which are related to labour migration and travel of shuttle traders carrying a substantial part of merchandise trade in these economies. Thus, in CA countries imports of services are closely linked to the exports and imports of goods.

3. Intra-regional trade

Trade between countries of Central Asia has two major components. The first is formal trade between legal public or private entities implemented according to the regular trade regime, which means payment of all statutory import/export taxes, registration of trade transactions in official statistics etc. The second is informal trade, which is typically implemented by physical persons. The regime applied to this trade in many CA countries is much simpler than the formal one. For example, there are some tax-free allowances for shipments of small weights; for larger shipments, taxes are often levied based on weight and not on the custom value of imported goods; and production certification requirements are simpler or absent.

3.1. Formal trade

Intra-regional turnover of formal trade (defined as the sum of each region country's exports to other countries of the region) is rather small in comparison to the total trade of CA countries (Figure 2). In 2010, intra-regional turnover was a mere 3.5% of the total trade turnover of these countries.

Table 2. Key export commodities, 2010

Country	Commodity	% of total exports
Afghanistan	Dried fruits	45
	Carpets and rugs	37
Kazakhstan	Crude petroleum oil	60
	Iron and steel	7
Kyrgyzstan	Gold	45
	Radioactive chemical elements	11
	Garments	8
Tajikistan	Unwrought aluminium	62
	Cotton	17
Turkmenistan	Natural gas	53
	Oil products	21
	Crude petroleum oil	11
Uzbekistan	Natural gas and other mineral fuels	25
	Gold	24
	Cotton	17

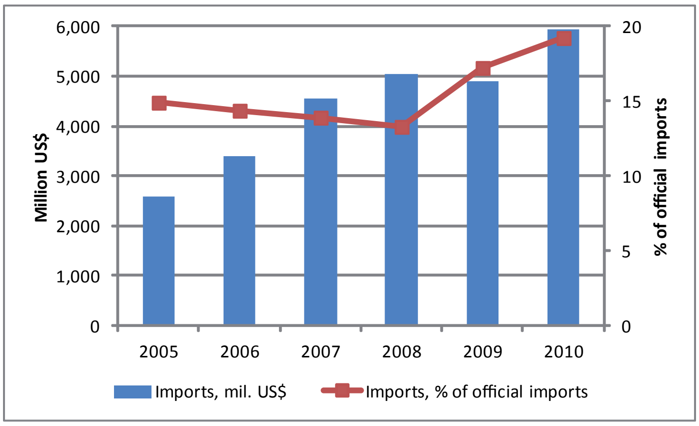
Sources: author's calculations based on COMTRADE database and CA countries' national statistical sources

The low level of aggregate regional trade integration indicators is due to Kazakhstan and Turkmenistan, which account for more than two-thirds of total trade turnover of the CA countries and depend very little on trade with other countries of the region. Kyrgyzstan and Tajikistan used to be heavily reliant on trade with other CA countries, but by 2010 this dependence fell to 10-20% of their total exports/imports. An important reason for the decline of intra-regional trade was the dramatic contraction of trade with Uzbekistan, a major trade partner in 2000, but not in 2010.

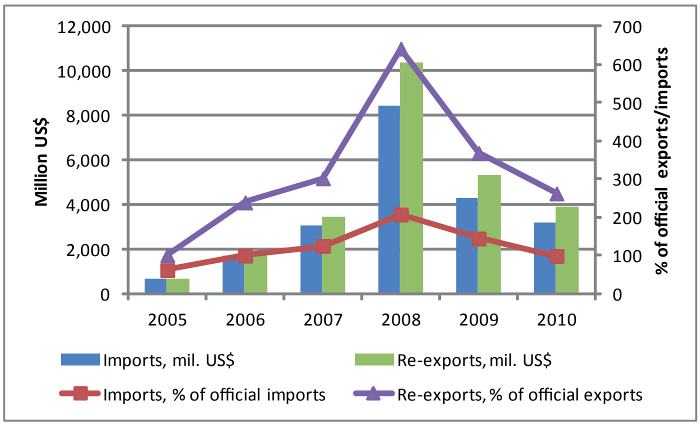
In particular, trade in electricity between Kyrgyzstan and Tajikistan, on one side, and Uzbekistan, on the other side, virtually disappeared for a decade. However, regional trade remains important for Uzbekistan. The decline in trade with Kyrgyzstan and Tajikistan was compensated by considerable expansion of trade in energy products and foods with Kazakhstan and, increasingly, with Afghanistan.

Figure 4. Dynamics of informal trade in light industry products in selected Central Asian countries

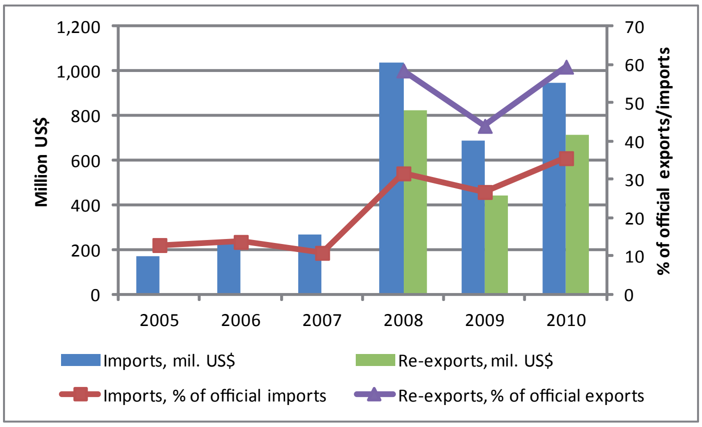
a) Kazakhstan



b) Kyrgyzstan



c) Tajikistan



Sources: COMTRADE, national statistical agencies, and author's estimates

Additionally, while intra-regional trade is not very large for each CA country, it is quite important for certain segments of their trade. A comparison of the commodity structure of exports directed to the countries of the region and to the countries outside the region (Figure 3) indicates that trade in agricultural products (other than cotton fibre), foodstuffs and manufactured products ('Machinery and equipment', and construction materials, fertilizers and other chemicals included into 'Other products' category) occupies much larger share in intra-regional trade than that in trade with the rest of the world.

Regional markets are even more important for exports of services and especially tourism services. For example, service export destinations for Kyrgyzstan, the country the most dependent on these exports, are Kazakhstan, Uzbekistan and Tajikistan, as well as Russia.

3.2. Informal trade and re-exports

Informal trade plays an important role in Central Asia[2]. At the centre of this trade are Chinese commodities (consumer goods including textiles and footwear) which are massively imported to Kazakhstan, Kyrgyzstan and Tajikistan by physical persons, for which these countries have special import regimes with very low taxes; some of these commodities are re-exported further to other countries. Re-exports are especially important for Kyrgyzstan and Tajikistan. Primary re-export destinations for Kyrgyzstan are Russia, Kazakhstan and Uzbekistan; for Tajikistan they are Afghanistan and, possibly, Uzbekistan.

One relatively recent development to this trade in Kyrgyzstan is the gradual conversion of pure trading activity via re-exports of Chinese goods into the production of garments using Chinese inputs (fabrics, accessories and machinery) and the Kyrgyz labour force; this is now a large sector of the Kyrgyz economy.

By its very nature, informal trade is neither easy nor straightforward to measure. One approach to measuring informal trade volumes has been proposed by Kaminski[3]. Since CA countries' official statistics do not provide adequate coverage of these trade flows, Chinese mirror statistics (data on exports of China to CA countries) and its difference from

CA data could serve as an alternative source of information. To assess the volume of informal import or re-export flows of light industry products in Central Asia it is possible to use the supply and demand balance approach.

Sources of supply are imports and domestic production while demand includes domestic consumption and exports. The difference between total supply and total demand can be interpreted as informal indirect imports if negative, or re-exports if positive. In this study we use CA national statistics data for domestic production, consumption and exports and mirror statistics for imports. Calculations show that in 2010 the difference between total supply and total demand appeared to be positive for Kyrgyzstan and Tajikistan and negative for Kazakhstan and Uzbekistan.

It is well-known that re-export flows are very large in Kyrgyzstan – over twice the official exports total value. Re-exports are very significant for Tajikistan, too. In Kazakhstan, informal imports directly coming from China are complemented by those supplied via (and partially processed in) Kyrgyzstan. Finally, Uzbekistan appears to be a major recipient of informal imports (17.4% of official imports in 2010). In general, informal intra-regional trade turnover in 2010 was approximately US$2.7 billion, which is comparable in value to formal trade. It also follows from calculations that informal imports from China are larger than formal ones.

This methodology also allows an estimate of the dynamics of informal trade flows in recent years (Figure 4). In Kazakhstan, informal imports grew steadily approaching the level of almost US$6 billion or almost 20% of total official imports.

In Kyrgyzstan, informal imports grew explosively from 2005 to 2008, exceeding US$8 billion or 200% of total official imports, and re-exports exceeding US$10 billion or. 640% of total official exports in 2008. However, in 2009-2010 informal trade flows in Kyrgyzstan declined due to general crisis-related reduction of demand in all final destination countries and because of domestic political instability. Starting from 2008, Tajikistan became the second re-exporter in the Central Asia.

These estimates also suggest that informal trade makes a substantial contribution to GDP of these countries. In 2010 in Kyrgyzstan, the value added of informal trade and garments production was the largest in the region, estimated at 16.5% of GDP. In Kazakhstan, Tajikistan and Uzbekistan, the estimated impact of informal trade on GDP is smaller but significant, at 0.6%, 2.4% and 0.4% GDP respectively.

3.3. Trade with Afghanistan

Trade linkages between Afghanistan and other CA countries have improved significantly, when the anti-terrorist coalition launched operations in Afghanistan in 2001. CA countries provide considerable logistical support to the coalition operations. Gradually, bilateral trade relationships between Afghanistan and other countries of the region have strengthened.

In 2010, these countries provided about 12% of Afghanistan's total imports and absorbed some 8% of this country's exports. Exports to Afghanistan consist primarily of energy products (oil products, electricity); for Kazakhstan the most important export item is wheat flour. Exports from Afghanistan to other CA countries are much smaller in absolute terms, and the main recipient of Afghanistan's goods (cement, agricultural products and machinery) is Tajikistan. Thus, trade of Afghanistan with other CA countries is concentrated on a few commodities is below its level achieved in 1970s.

As follows from the above discussion, informal trade between Afghanistan and Tajikistan is probably worth several hundred million US$ and is as important as formal trade.

4. Policy implications

The observed trends and patterns of trade in Central Asia suggest a number of important policy implications:

- Almost all CA countries have ambitions to make a transition from the export of primary products to products/services with higher value added. The most natural markets for these products/services are their neighbours. Regional trade policy should, therefore, be an important item on CA countries' policy agendas.

- Development of transport and energy infrastructure in the region has demonstrated its capacity to increase trade volumes and change trade structure significantly.

- Protective trade policies in the region do not seem effective either for export promotion (almost no manufactured exports), or for import substitution (as the large scale of informal trade suggests).

- Formal and informal foreign trade is important for both economic and social development of CA countries. Trade lowers consumer prices, provides the government budget revenues needed for social infrastructure maintenance, and increases employment opportunities for key social groups such as women, overall contributing to poverty reduction and social equality in Central Asia.

In conclusion, any pragmatic and viable long-term development strategy for CA countries should place trade, including regional trade, high on the agenda. ■

1. 2002 for Afghanistan.
2. Bartlomiej Kaminski, "How the Kyrgyz Republic Has Seized Opportunities Offered by Central Asia's Economic Recovery" (Washington DC: World Bank, 2008).
3. Kaminski, 2008.

Communicating value in the 21st century

Jane Diplock AO is a professional director, a board member of the International Integrated Reporting Council and a former Chair of IOSCO

These days reading a newspaper and listening to bloggers can leave a reader quite depressed about the state of the world. With the global financial crisis and the European sovereign debt being headline news most weeks and the subsequent social, commercial and financial upheaval it is no surprise many people are convinced the global financial system is currently broken – and that is before letting the predictions about food, water, energy and resource scarcities get you down. However, I do believe there is hope - there are certainly challenges regarding scarcities that have political and social implications worldwide but these will also form the catalyst for innovative business opportunities of tomorrow.

"Investors increasingly want to know the longevity and sustainability of the businesses they invest in"

Business leaders, investors and other stakeholders are increasingly realising that we cannot continue to exploit the natural resources of the world without thinking about the future – about making businesses sustainable and reducing waste. Resultantly environmental, social and governance reporting are moving into the mainstream hand in hand with an inclination towards an integrated approach to managing enterprise and to reflecting this in an integrated report.

This has not been a sudden change but like most revolutions it has blossomed from a series of increasingly converging trends. It is born out of profound disappointment with the short-term focus that led to the global financial crisis and the sovereign debt crisis, as well as an increasing concern for our planet. We are finally coming to realise that interconnectedness of all things is also the case in financial systems as it has always been recognised in natural systems.

Across the world there is a growing momentum for a new way of managing enterprises which requires a holistic approach to the management of the natural, human, financial and other capitals used by the organization with an understanding of how these interrelate. This means that reports need to demonstrate the value delivered by this holistic management approach to shareholders and other stakeholders. What is measured is also managed, and what is reported is managed, and the best way to approach this is through integrated reporting <IR>.

The recent past is littered with examples of failing businesses where management pulled out the resources and left investors to suffer the losses. This is a culture that is no longer tolerated, and investors increasingly want to know the longevity and sustainability of businesses they invest in – meaning sustainability issues have definite investment consequences.

Furthermore, consumers have been empowered by the use of social media and are able to communicate to the world concerns about the activities of businesses – the need for businesses to react to this with a sustainable strategy cannot be ignored. With reputation imperative, it is too much of a risk for businesses to ignore ethical and social responsibility – as a result most would agree with Hillary Clinton's conclusion *"the only future is a sustainable future"*.

Sustainable is intrinsically linked to the other big challenge of the 21st century which is financial stability. The recent crises have led to some depicting the demise of capitalism, which I believe is certainly not the case. However, it has been wounded by the actions and excesses of some, and confidence – a critical force in economic growth is in short supply.

Consequently, there have been calls for significant reform away from selfish short term interests. The concept of an unbridled freedom of the market to regulate itself and the entirely free market philosophy has been undermined and a balanced approach to regulation and powerfully increased transparency and disclosure are vital to solving the dilemma of financial stability.

During the financial crisis some managers stole the future savings of millions of investors – through encouraging short term strategies that permitted them to super remunerate themselves and let the pension and other funds they managed, suffer. This was always unsustainable and finally came to a head as a detriment or even demise of the institutions they managed. The interlinked nature of global business meant that the failure of some of these enterprises seriously threatened global financial stability.

Already we can begin to learn from the recent crises and form innovative solutions that will mean we can create an environment where capital is efficiently employed to raise economic performance world-wide, and long-term investments can take place without the threat of destructive volatility and failure of confidence which lead to systemic risks and financial instability. Throughout the entire world, in China, India, Russia, Spain, irrespective of the domestic political system, there is an agreement that these are the challenges that need to be addressed.

The questions that remain to be answered are firstly, how to encourage entities to think beyond the next quarterly result and secondly, how to align the behaviour of managers and boards to think more long term about the sustainability of the enterprise? The answer is to provide the appropriate frameworks and incentives to align behaviour towards greater financial stability.

Andrew Haldane, Deputy Governor of the Bank of England, pointed out: *"The over whelming predominance of short-termism in markets compounded by a system ill-suited to integrate and account for externalities simply removes many of the broader systematic risks from the financing and investment equation"*.

Short-termism is the concern of many trying to build the business case for sustainable investment – Al Gore and David Blood recently suggested it is *"driving our economies and our planet into liquidation"*. Haldane wrote a fascination article[1] that shed light on why this is happening. He points out that markets are about matching saving to investment, while realising the benefits of patience and the growth associated with this.

These days investors tend to excessively discount future outcomes, Haldane quotes Pigou's hypothesis that peoples' preferences alter as distant outcomes become closer to the present – the long term investor can become the short term speculator if assets can be cashed.

In the 1940s through to the 1970s Haldane points out the mean duration of US equity holders was around 7 years – by 2007 it was 7 months. Naturally, this had a very distorting effect on market behaviour – leading to volatility and fragility in the global capital markets.

I believe the problem can be found in company analysts and investors seeking their information in backwards looking annual reports. As a result all stakeholders are in the dark about environmental, social and governance risks and thus the sustainability and longevity of a company.

A credible response is to limit short-termism by developing a more holistic approach to business management – marrying financial management to the management of the business more generally and reporting this management holistically into one integrated report. This is not just about reporting – it is about fundamental change of management thinking.

Over the last five years, HRH The Prince of Wales, author of *Harmony*, Mervyn King who transformed reporting in South Africa through his *King Reports*, and the academics Bob Eccles and Michael Krzus with their landmark *One Report* have combined with the work of the International Integrated Reporting Council (IIRC) and its collection of influential people and companies to provide a catalyst for this change.

The response to the recent IIRC Discussion Paper demonstrated there is impressive consensus building – but my contention is that there is more to be done. Engagement with the world's political decision makers for one is imperative – global standards rarely gain traction without strong political will. This issue needs to be firmly on the agenda of the G20 and the Financial Stability Board because doing so would gain the attention and priority setting of the world's policy makers and international standard setters.

The IIRC's next step is to issue the International <IR> Framework (the Framework) so stakeholders can know what an integrated report actually is. <IR> aims to create value, dynamic interconnectedness and simplification of reports – not increase the clutter. The proponents are aware that this needs to be a market-led movement and therefore have pulled together a Pilot Programme made up of a 75-strong Business Network and 25 companies in the Investor Network.

The list of companies testing <IR> is international and impressive including Volvo, HSBC, Microsoft Corporation and The Coca Cola Company to name a few. The draft Framework will be published in Q2 2013 ahead of further consultation before Version 1.0 is made public in December 2013.

I wonder whether, in the emerging global culture where social networking can be a catalyst to very real changes, such as the Arab Spring, it would be useful to engage social networking in this movement – a narrative that everyone can engage in. I was recently at a presentation that called on us to *"unleash the inner Lady Gaga in all of us"*.

Perhaps Lady Gaga is the right person to relay an integrated sustainable message and many of her 28 million followers would agree and understand that the fixing of the planet and the global financial system are vital to their future prosperity.

I am a great optimist – I foresee the 21st century as a century of opportunity, of worldwide growth, refreshing of the environment and increasing equality. For the first time in human history we have tools to allow us to do this. We have access to vast quantities of data which we can now mine and use to improve life.

To quote Samuel Palisimo, Chairman of IBM, *"without question the issues we face today are challenging, but they are solvable. I am optimistic – not because I expect human nature to change, but because we now have at our disposal an enormous new natural resource: a rising tide of data that enables us to see and understand our world as never before."*

We have the tools to use this knowledge to manage the enterprises which drive global economic development. This data will enable holistic management thinking and refinement of strategy in a sustainable way. It will marry with the tools of Integrated Reporting to drive the management of enterprises to a more sustainable long term perspective where investors can take long term investment decisions with confidence.

I do believe that we have the capacity to solve the problems of the environment, financial stability and inequality with renewed understanding. We will develop a truly sustainable capitalism. ■

1. Short-termism: an impatient market is not a happy market, 3rd September 2010

Sustainability reporting for a sustainable future

Marjolein Baghuis is Director of Marketing and Communications at the Global Reporting Initiative (GRI)

Companies play a vital role in the transition to a sustainable global economy. Changes in the way companies report their performance and impacts will have a big effect on the future economy, and this month companies are invited to help shape this future by providing feedback on the next generation of sustainability reporting guidelines.

On 31 October 2011 the world's population reached seven billion – that's seven billion people supported by one planet with depleting resources and increasing temperatures; seven billion people to feed, to treat and to support financially; seven billion people whose lives are affected by the practices of thousands of companies around the world every day.

"Establishing a sustainability reporting process helps companies to set goals, measure performance, and manage change"

Companies are increasingly developing and promoting their corporate social responsibility, or sustainability, activities – the things they do to protect and improve the economy, environment and society. An important dimension of this work is monitoring, reporting and improving sustainability performance, and sustainability reporting can support this dimension.

A sustainability report is an organizational report that gives information about economic, environmental, social and governance performance. For companies and organizations, sustainability – the capacity to endure, or be maintained – is based on performance in these four key areas.

Reporting for change

Establishing a sustainability reporting process helps companies to set goals, measure performance, and manage change. A sustainability report is the key platform for communicating positive and negative sustainability impacts.

To produce a regular sustainability report, organizations set up a reporting cycle – a program of data collection, communication, and responses. This means that their sustainability performance is monitored on an ongoing basis. Data can be provided regularly to senior decision-makers to shape company strategy and policy, and improve performance.

Sustainability reporting is therefore a vital step for managing change towards a sustainable global economy – one that combines long term profitability with social justice and environmental care.

Who is it for? Every company and organization in the world can start reporting their economic, environmental and social performance. Companies talk about both internal and external benefits of sustainability performance disclosure – from brand recognition to retaining talented employees and, importantly, improving their sustainability performance.

Guidelines for comparability

The process of sustainability reporting can help individual companies in many ways – including by helping to improve their understanding of risks and opportunities; streamlining processes, reducing costs and improving efficiency; improving reputation and brand loyalty; and mitigating – or reversing – negative environmental, social and governance impacts.

By following internationally accepted guidelines for reporting – such as those of the Global Reporting Initiative (GRI) – companies can compare their performance over time and with other companies. And when reports are prepared using such guidelines, stakeholders who need to know about companies' performance – including investors, customers and employees – have comparable data, enabling them to identify trends and make informed decisions.

GRI produces a comprehensive Sustainability Reporting Framework that is widely used around the world, to enable greater organizational transparency. The Framework includes the *Sustainability Reporting Guidelines* – which set out the Principles and Indicators organizations can use to report their economic, environmental, and social performance – and *Sector Supplements* – tailored versions of the *Guidelines* for organizations in different sectors.

The Framework is developed via a multi-stakeholder due process: input to the Framework comes from business, civil society, labour, accounting, investors, academics, governments and sustainability reporting practitioners. Thousands of companies of different sizes, sectors and locations use the *Guidelines*, so they have to be widely applicable and consider the widest possible range of stakeholder interests. As a result of the credibility, consistency and comparability it offers, GRI's Framework has become a de facto standard in sustainability reporting.

Developing new guidance

Sustainability is a journey. Along the way, organizations need to set goals, measure performance, and integrate a sustainability strategy into their core planning. The reporting guidance that companies use is also on a journey of continuous improvement.

With frequent changes in the economy, environment and society, companies face ever changing sustainability challenges – from reducing greenhouse gas emissions to tackling bribery and corruption. For GRI's *Guidelines* to be relevant and useful in this changing sustainability landscape, they also need to be revised by experts regularly.

GRI's next generation of *Sustainability Reporting Guidelines* – G4 – is now being developed, and GRI is calling on professionals, companies and experts around the world to provide their input to the development process.

G4 aims to meet the following development priorities:

- to offer guidance in a user-friendly way, so that beginners can easily understand and use the *Guidelines*

"Sustainability is a journey. Along the way, organizations need to set goals, measure performance, and integrate a sustainability strategy into their core planning."

- to improve the technical quality of the *Guidelines'* content in order to better support reporting organizations when preparing the report, and users when using it
- to align with other international disclosure standards and relevant metrics
- to improve guidance on identifying 'material' content – from different stakeholders' perspectives – to be included in the sustainability reports
- to offer guidance on how to link the sustainability reporting process to the preparation of an integrated report aligned with the guidance to be developed by the International Integrated Reporting Council (IIRC)

Expert Working Groups have developed new guidance and disclosure items on supply chain, governance and remuneration, management approach, boundary, application levels, greenhouse gas emissions and anti-corruption. GRI is now asking for the public to provide feedback on the recommendations.

What you can do

Start reporting! Take a look at the information you are already collecting – through human resources, procurement, finance – and read GRI's *Guidelines* – you will find that you already know your performance in many areas. Talk to your stakeholders, and determine what the most important and relevant – 'material' – topics are for your organization to report on. For training, support and guidance, you can visit www.globalreporting.org. ■

Global Reporting Initiative™

Help shape the future of sustainability reporting! An Exposure Draft of G4 is now available online for public comment until 25 September, and proposals for new reporting guidance on anti-corruption and greenhouse gas emissions is available for comment until 12 November – this is an important opportunity for those who use the Guidelines to help shape the future of corporate reporting. Register on the Consultation Platform (http://goo.gl/f6z6h) and have your say before 25 September.

Corpor

What is the Commission's definition of Corporate Social Responsibility?

Antonio Tajani: The Commission defines corporate social responsibility as the responsibility of enterprises for their impacts on society. Those impacts are usually positive and can sometimes be negative. The Commission believes that both sides of that equation are important: maximising the positive impacts of enterprises on society, and identifying, preventing and mitigating possible negative impacts.

The financial and economic crises have prompted companies to move away from 'business as usual' social models in an effort to behave more responsibly. In promoting CSR now, what are the aims of the Commission in the medium and long term?

Antonio Tajani: CSR is not a quick fix to the serious economic and social problems we currently face. It is not a magic, short-term solution to growth. But on the other hand, as we focus on measures to promote growth and job creation in the short term, we cannot lose sight of the medium and long term. That is as true for public policy as it is for companies.

It is in the medium and long term that the excellence of European companies in the field of CSR will pay off. It will contribute to the creation of an environment in which our enterprises can grow, compete and innovate – to their own benefit and to the benefit of the countries and societies in which they operate.

How do you see CSR as in the interests of the enterprise?

Antonio Tajani: A strategic approach to CSR is increasingly important to the competitiveness of enterprises. It can bring benefits in terms of risk management, cost savings, access to capital, customer relationships, human resource management, and innovation capacity.

Because CSR requires engagement with internal and external stakeholders, it enables enterprises to better anticipate and take advantage of fast changing societal expectations and operating conditions. It can therefore drive the development of new markets and create opportunities for growth.

By addressing their social responsibility enterprises can build long-term employee, consumer and citizen trust as a

ate Social Responsibility

Creating an environment in which enterprises can innovate and grow

Antonio Tajani, Vice President of the European Commission, in a Q&A with World Commerce Review, discusses the Commission's pioneering role in the development of public policy to promote CSR

basis for sustainable business models. Higher levels of trust in turn help to create an environment in which enterprises can innovate and grow.

The Commission has played a pioneering role in the development of public policy to promote CSR ever since it's 2001 Green Paper and the establishment of the European Multi-stakeholder Forum on CSR. How has this policy contributed to progress in the field of CSR?

Antonio Tajani: By working in partnership with enterprises and other stakeholders the Commission has helped to raise awareness of the importance of CSR, and has promoted a greater understanding of the challenges and the benefits.

The very nature of CSR makes progress hard to measure scientifically. But some indicators of progress include: the number of EU enterprises that have signed up to the ten CSR principles of the United Nations Global Compact has risen from 600 in 2006 to over 1900 in 2011; the number of organisations with sites registered under the Environmental Management and Audit Scheme (EMAS) has risen from 3,300 in 2006 to over 4,600 in 2011; and the number of EU companies signing transnational company agreements with global or European workers' organisations, covering issues such as labour standards, rose from 79 in 2006 to over 140 in 2011.

How are you encouraging enterprises to explore the opportunities for developing innovative products, services and business models that contribute to societal wellbeing and lead to higher quality and more productive jobs?

Antonio Tajani: The leitmotif of the EU's innovation strategy is innovation to address societal challenges, and the Commission engages with companies through many channels. The European Innovation Partnerships are good examples of this, looking at issues such as water, and active and healthy ageing. I have also personally proposed a meeting between companies form the CSR Europe network and different departments of the European Commission, to explore how we can collaborate even better in the field of innovation ton address societal challenges. Finally we are establishing a European award scheme for CSR, with the theme *"Partnership, Innovation and Impact."*

"... the Commission has helped to raise awareness of the importance of CSR, and has promoted a greater understanding of the challenges and the benefits"

How is European policy in the promotion of CSR consistent with the global framework?

Antonio Tajani: Ensuring consistency with the global CSR framework was one of the objectives of our new policy. We have made sure that our definition and understanding of CSR is CSR is consistent with the core internationally recognised CSR guidelines and principles.

In our view they are: the 10 principles of the UN Global Compact, the OECD Guidelines for Multinational Enterprises, the ISO 26000 guidance standard on social responsibility, the ILO labour standards, and the UN Guiding Principles on Business and Human Rights.

We have also invited large companies to make reference to these guidelines and standards when developing their own CSR approaches. We don't aim to create new guidelines and standards at the EU level. Rather we want to work towards a situation in which the CSR expectations on all enterprises everywhere are broadly similar, irrespective of where in the world they operate.

The positive impacts of CSR on competitiveness are increasingly recognised, but enterprises still face dilemmas when the most socially responsible course of action may not be the most financially beneficial, at least in the short term. How can the EU strengthen market incentives for CSR?

Antonio Tajani: We have identified three broad areas to explore: consumer policy, investment, and public procurement. Regarding consumer policy, we are not convinced that comprehensive CSR labelling is useful or feasible, but will look at how EU consumer policy can help to further raise demand for goods that are produced in a socially and environmentally responsible manner.

In the investment field, the Commission has recently proposed a new EU regulation that would make it mandatory for all retail investors to be informed how environmental, social and governance factors are taken into account in their investments.

As far as public procurement is concerned, the Commission has made proposals that clarify how public authorities can use social and environmental criteria in their buying practices. But we also have to be careful about administrative burden here, especially for smaller companies. For that reason we have also said that a general CSR requirement covering all company policies should not be used as a criterion in public procurement.

A growing number of companies disclose social and environmental information, and this can facilitate engagement with stakeholders and the identification of material sustainability risks.

Integrated financial and non-financial reporting represents an important goal for the medium and long term; how is the Commission ensuring a level playing field and transparency of the social and environmental information provided by companies in all sectors?

Antonio Tajani: The Commission has said that it will make a legislative proposal on the disclosure of social and environmental information by enterprises, and has recently been working on an impact assessment to assess different options for this. I believe that we can make a proposal that is in the interests of enterprises, investors and other stakeholders. I will also argue strongly that any new requirement should not apply to small and medium sized enterprises. ■

Integrated reporting and the supply chain

Mike Reid is Associate Director, Energy, Environment and Sustainability at Grant Thornton UK LLP. Mike recently completed a secondment to HRH The Prince's Accounting for Sustainability Project where he was the project manager for the IIRC

"In the 21st Century the only viable development is sustainable development", Hillary Clinton, US Secretary of State, 22 June 2012, Rio +20 Conference

Introduction

Whether you are a supplier, shareholder, customer, employee or regulator, the information reported about an organisation is now more widely available than ever before and that trend is only likely to continue. Today, companies live in an integrated space where the boundaries are blurred between the inside and the outside where there is an opportunity and a need to engage more closely with a wider stakeholder audience. We are seeing the emergence of reporting models where traditional, compliance based models are being influenced by emerging sustainability models that will influence not only the way that companies report but directly influence their behaviour internally and externally across their supply chain.

The concept of integrated reporting

Integrated reporting *"brings together material information about an organization's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates. It provides a clear and concise representation of how an organization demonstrates stewardship and how it creates and sustains value."*[1] Integrated reporting requires integrated management, where stakeholders come together to create and share information that will help all involved to understand their roles, relationships and performance in the value chain. This evolving reporting model will be built on the concept of capital stewardship – to preserve and enlarge multiple forms of capital, all, of which contribute to the long-term value creation for the company. In the past the focus has been on financial capital but the trade-offs with human, natural, social, intellectual and manufactured capitals will be integral to this new reporting model.

Reaching out to a wider audience

Companies are essentially formed to maximize financial value to the shareholder so the primary audience for financial reporting is the investor community. Financial reporting helps suppliers and other stakeholders assess performance but the manner in which the information is currently reported is of limited use. The current reporting model is backward-looking with limited strategic context and presented in a format that is not user friendly – this is fit for a regulatory purpose but not as a mechanism to communicate to a wider audience.

A stakeholder based reporting model assumes a much larger audience and accordingly the purpose of integrated reporting is to demonstrate the interdependence of stakeholders. This model incorporates Environmental, Social and Governance ("ESG") elements that will affect the financial value of the company. A key feature of integrated reporting is that the information being reported externally should mirror what is reported internally. Reporting should be backed up by integrated behaviour or thinking in the organisation and reflected in the overall business strategy and decision-making. This requires integrated governance systems and robust stakeholder engagement where suppliers have a key role to play.

Crisis of confidence

Companies face a challenge to gain trust from their stakeholders. The banking crisis and executive remuneration policies place boards and regulators under greater scrutiny from shareholders and stakeholders. In order to restore trust, companies need to report in a more transparent way that shows they care about more than the bottom line – integrated reporting can help this process. By providing readers with a complete view of the risks and opportunities facing the business, stakeholders will have access to better information to make better decisions that helps to gain trust in the wider community.

It's good to talk

Integrated Reporting reflects a shift from a static approach to reporting to a dialogue based approach that seeks continuous improvement. One of the main changes to the reporting model is with stakeholder engagement that will require a cultural change in many companies.

On-going research[2] has established that few stakeholders share a common understanding about the purpose of reporting where languages vary among groups. This leads to a lack of trust between stakeholder groups and little incentive for them to act. As a supplier, if you would like to better understand how your customer was managing the impact of forthcoming regulations, what do you do?

Companies need to engage openly with their stakeholders to understand what they should be reporting on but this interactive approach can create opportunities for continuous improvement where ideas can be shared for product innovation and defect reduction.[3] By listening to its suppliers and customers, a company can use this information to determine its internal strategy and drive continuous improvement.

"Integrated reporting... takes a focused approach to providing financial and non-financial information to a broader audience of stakeholders"

Blogging and tweeting

The use of social media provides alternative mechanisms that can help companies communicate across their supply chain. A company can create a rich, interactive dialogue with their suppliers to better understand purchase behaviour and ESG awareness. Adopting the new approach, companies can gather stakeholder input rapidly and redirect the discussions towards topics of interest that emerge from the community. In the context of integrated reporting, this can help companies determine the important ESG factors and the impact of various proposed business strategies as well as discuss key topics of interest as soon as they arise.

Tone from the top

Integrated reporting can function as a driver of organisational change and it is vital that this change is led from the top. Leaders need to be engaged throughout the process where information reported needs to be closely aligned to the vision and strategy of the organisation. A number of companies and their leaders have become synonymous with this evolving model, whether you are Unilever (Paul Polman), GE (Jeff Immelt), Kingfisher (Ian Cheshire) or J Sainsbury (Justin King) they can demonstrate how this is connected through the functions of the company and beyond across the supply chain to build enterprise knowledge management and data collection systems.

There is a question of what should come first – organizational change then reporting or vice versa - either way, it requires leaders to actively embrace and advance it. Integrated reporting and integrated thinking can enable stakeholders to create and share information, helping them to understand their role in the process and performance of the company.

Investor perspective

The interests of companies, suppliers, society and investors do not converge automatically and stakeholder engagement can help to address their needs and provide the necessary information and channels to act. With better financial and non-financial information, investors will make better decisions that advance the public interest but to enable investor attitudes to change requires other changes to capital allocation models.

There is a question of the relevance of ESG data to many investors particularly those with a short to medium term investment horizon. Investment managers need to be given incentives to make investments with a long term horizon that recognise the stewardship of all capitals. Analysts need to reveal the connections between ESG metrics and profit growth and integrated metrics need to become embedded in investment models. This may also require impetus from regulators to mandate integrated reporting for filing and listing purposes.

The Sustainable Stock Exchanges[4] is a global initiative set up to explore how the world's exchanges can work together with investors, regulators, and companies to enhance corporate transparency, and ultimately performance, on ESG issues and encourage responsible long-term approaches to investment that can help address corporate transparency and promote long-term investment.

Legal impediments

The benefits of providing forward looking, insightful information to a wider stakeholder audience is countered by the risk that companies become open to challenge when targets are not realised. Adopting an integrated approach across all company functions, including the support of the legal department, is essential to the successful adoption of integrated reporting, otherwise, its reluctance could become a significant obstacle. The risk of legal challenge in the USA is a major reason why companies stop providing data not required by law however, this has not stopped some corporations from using integrated reporting to show suppliers and customers their commitment to sustainability and confidence in their performance.

Use of technology

The process of gathering and sharing data across the supply chain can enable the company to develop a suite of reporting tools and communicate its strategy in different formats to different stakeholder groups. In theory, a company can create a platform for stakeholders to cherry pick the data that is relevant to their needs rather than producing a suite of static documents.

A more dynamic web-based report can use new technology to present information in an audio-visual form that can allow suppliers to have the same privileges as investor groups to communicate with the senior team. Companies will also be able to manage information flows more effectively to their suppliers so that they can alert suppliers to regulatory changes and commodity risks.

Material – to whom?

The most urgent issue now is to reach agreement on what issues are material, by sector, and providing clear guidance to reporters and this needs engagement with your suppliers and other key stakeholders. All stakeholders need to understand how companies are affecting all of their various stakeholders and integrated reporting can enable a 360-degree view of both risks and opportunities that benefits the company and its suppliers. A well-structured materiality analysis is crucial for any company to develop its strategies and objectives and KPIs should be set on the most material items.

In 2008, Rabobank of the Netherlands integrated its financial and sustainability reporting and experienced an internal redefinition of what is material to the company. It also demonstrated in its report on sustainability in the food supply chain[5] that it is comfortable participating in discussions and finding integrated supply chain solutions for companies. This collaborative approach demonstrates how organisations can go beyond their traditional service approach and add value by adopting a more open, collaborative approach to add value throughout the supply chain.

Varying degrees of progress

A comprehensive review of the sustainability performance of over 2,000 global large cap companies was conducted by EIRIS[6] earlier this year and this highlights that companies are on a journey to address sustainability issues across their supply chain. For example, Apple has yet to tackle some of the key ESG issues it faces. In particular, some of the company's main risks are linked to its operations and suppliers in countries of concern for human rights and supply chain labour issues. Although the company has recently taken some steps to address this, for example through the auditing of some of their Chinese suppliers, the company still has a considerate way to go to fully address all its sustainability related risks.

Conclusion

Integrated reporting is by no means a panacea for the malevolent behaviour of companies; instead it takes a focused approach to providing financial and non-financial information to a broader audience of stakeholders. BP, until recently were winning awards for the quality of their sustainability reporting which showed that management can describe a strategy or policy that may give stakeholders an impression of the company's commitment to sustainability when in practice their performance may be somewhat different.

So will integrated reporting get underneath the corporate spin to reflect meaningful and transparent information? Integrated reporting can be a powerful framework to mitigate the risk of reputational damage caused by supplier actions and can help demonstrate to consumers that company is managed in a sustainable way. The success of integrated reporting relies on convincing companies, investors and governments to take action with support from other key stakeholder groups across the supply chain. ■

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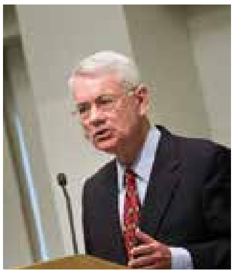

It's time to stop investment protectionism

James Bacchus, Victor K Fung, Harold McGraw III and Gérard Worms[1]

It is time for a much-needed reminder of the tremendous potential that investment liberalization can unleash on the ailing global economy, and for the G20 to create a more stable and predictable climate for cross-border investment.

Although international investment is rising again after plummeting from the record levels registered just before the global financial crisis began, global foreign direct investment (FDI) remains 15 percent below pre-crisis levels. Rising, too, are restrictions on FDI through various forms of investment protectionism that are clouding the future for global economic growth.

To help counter this rising threat of investment protectionism, the International Chamber of Commerce (ICC) has released revised guidelines to help increase cross-border investment flows and thus stimulate economic growth and prosperity across the globe. Like the recent EU-US statement endorsing investment's key role in the global economy, we hope that G20 leaders recognize FDI's role in promoting growth and standing strong against the temptations of protectionism.

Boosting FDI in today's global economy is a pressing concern to developed and developing countries alike. The new world of international investment no longer holds to the weary *"North-South"* stereotype. More than half of all inbound FDI today – 52 percent – goes to developing and transitional economies. Outbound FDI from developing and transitional economies is also increasing rapidly – $388 billion in 2010, up 21 percent from 2009.

Yet the business confidence needed to boost investment flows worldwide is constrained by significant uncertainties ranging from excessive sovereign debt and macro-economic imbalances to the increasing influence of state-owned enterprises and sovereign wealth funds, as well as the growing trend of *"re-regulating"* international investment.

In 2000, only two percent of all government investment measures taken worldwide imposed new restrictions on international investment. In 2010, that proportion had risen to nearly one-third – 32 percent. UNCTAD has warned that this *"maintains the long-term trend of investment policy becoming increasingly restrictive rather than liberalizing."*

Other stereotypes of the past no longer apply either. Most of the new measures limiting international investment are being used not by developing countries but by developed ones. This is particularly the case in the financial and natural resources sectors, and reveals a disturbing and short-sighted trend away from free markets towards increasing discrimination in favour of *"national champions"* and local companies in *"strategic industries."*

"Boosting FDI in today's global economy is a pressing concern to developed and developing countries alike"

The new ICC guidelines, which draw on the collective experience and specific suggestions of businesses throughout the world, reaffirm business's belief in what the G20 has described in its action plan for jobs and growth as the role of investment *"to unlock new sources of growth."*

The guidelines reiterate the basic obligations of investors, investing countries, and host countries with respect to such traditional concerns as fair and equitable treatment of investment and protection against expropriation without just compensation.

But the guidelines also go far beyond the previous version to address several *"new"* investment issues that have emerged since 1972, during four decades of expanding globalization.

They emphasize the global need for the free flow of capital to spur investment and of services to support investment, as well as the need for transparency and due process in the governance of investment. They also state that host countries should respect international rules related to foreign investment such as local content, equity caps, technology transfer, domestic sales limitations, and the mandatory use of indigenous technology.

The guidelines outline the protection of intellectual property rights, the prohibition of discrimination in government procurement, and anti-corruption. They contain language which specifically addresses corporate responsibility, strengthening previous provisions on labour rights, setting out new obligations on human rights, and incorporating new obligations related to environmental protection and sustainable economic growth.

ICC has taken into account that governments are increasingly deploying FDI through state-owned enterprises and sovereign wealth funds. The new guidelines address the role of the state by setting out, for the first time, the principle of fostering competitive neutrality in cross-border investment. They also underscore the need to establish an effective means of upholding the rule of law relating to international investment, including through investor-state dispute settlement.

Resisting investment protectionism is essential to promoting economic growth. The G20 should establish appropriate rules, drawing on guidelines from international business, so that the global economy creates more opportunity, prosperity and hope for workers and entrepreneurs alike. ■

The ICC Guidelines for International Investment are available on USCIB's website at:
www.uscib.org/docs/ICC_Investment_Guidelines.pdf.

International Chamber of Commerce
The world business organization

Gérard Worms, Harold McGraw III and Victor Fung are respectively Chairman, Vice Chairman and Honorary Chairman of the International Chamber of Commerce. Mr Worms also serves as Vice Chairman of Rothschild Europe. Mr McGraw is Chairman, President and CEO of The McGraw-Hill Companies. Mr Fung is Chairman of the Hong Kong-based Li & Fung Group. James Bacchus, a former member of the US House of Representatives and former Chairman of the Appellate Body of the World Trade Organization, chaired the drafting group that revised the ICC Guidelines for International Investment. He co-chairs the global practice group at Greenberg Traurig.

Defending the global digital marketplace

Jake Colvin is Vice President for Global Trade Issues with the National Foreign Trade Council

Biographer Walter Isaacson told me recently that Steve Jobs *"was seized with the importance of improving the framework governing the flow of information around the world"* in conversations he had with the late Apple CEO. Jobs recognized the danger that information and ideas could become Balkanized, interrupting what has been a mostly steady march towards more integrated, productive and innovative economies since the onset of the internet.

Individuals, businesses and governments mostly take for granted their ability to access information and conduct business online and across international borders along with the substantial economic benefits that accompany those activities. Yet access to information relies on the existence of appropriate regulations and policies, and a general attitude by governments that the benefits of openness to digital information and technologies outweigh the potential costs.

Today, as billions of people increasingly adopt digital technologies and habits, and the companies that provide them are more global in scope, the world has arrived at an inflection point when it comes to electronic information. While many countries are building frameworks that enable access to the best technologies and ideas, others are testing policies that reduce access to global flows of digital information, products and services. As the internet matures, it is important to recognize that emerging attempts by some countries to restrict information flows could have far-reaching impacts on entrepreneurs, innovators and economic growth. In order to fulfil the substantial promise of the internet to improve economic development, countries must craft future policies that promote that open and secure access to the global digital marketplace.

The economic impact of digital information

It is difficult to overstate how important the exchange of digital information and use of related technologies and services have become in the lives and especially the livelihoods of billions of people. Manufacturers, farmers, retailers and service providers use information technologies and cloud services to improve their productivity and manage international customers, suppliers and employees.

From streamlining payroll services to interacting with customers to developing smart power plants that can be monitored remotely, companies everywhere are utilizing digital information and technologies across their businesses. In all, more than three-quarters of the value created by the internet goes to traditional industries that would exist without it, according to McKinsey.

Entrepreneurs and small businesses benefit greatly from digital technologies, which permit anyone with an internet connection to reach new markets, test ideas and interact with partners around the world at low cost. Small businesses in China and Korea that used the internet intensively grew approximately three times as fast as companies that did not rely heavily on it, according to a Boston Consulting Group (BCG) survey of around 6,200 small and medium-sized companies across several countries.

Microenterprises, comprised of one or a few employees, are able to market and sell products around the world via online platforms like Etsy and South America's MercadoLibre. eBay estimates that in 2010 approximately $4 billion of gross sales were the result of cross border trade and were conducted mainly by microenterprises. Advances in networked technologies are enabling these individuals and small companies to access information and services inexpensively and conduct business via the cloud instead of through large investments in physical operations or software.

The internet has created a variety of new opportunities and business models, which further empower small businesses and entrepreneurs to participate in global markets. Revenues from mobile application stores, already an $8.5 billion industry in 2011, are projected to grow to $46 billion by 2016, according to ABI Research. Kiva, a micro-lending service founded in 2005, has assembled a network of nearly 600,000 individuals who have lent over $200 million to entrepreneurs in places where access to traditional banking systems is limited. Millions of others use online advertising, e-commerce and innovative payment technologies to reach customers and partners around the world. Even blogging can be a full-time, lucrative profession.

As writer Alex Pappademas suggested in a June 2012 GQ profile of Scott Schuman, publisher of the men's fashion blog the Sartorialist, *"the internet demolishes long-standing hierarchies, sows democracy, takes power out of the hands of elites and middlemen and redistributes it to scrappy upstarts with big dreams."* (Schuman last year indicated he earns more than a quarter of a million dollars from sponsorships.)

"As the internet matures, it is important to recognize that emerging attempts by some countries to restrict information flows could have far-reaching impacts on entrepreneurs, innovators and economic growth"

These economic benefits to businesses, entrepreneurs and workers add up. According to a March 2012 study by BCG, the internet economy currently accounts for 4.1 percent of GDP across the G-20 countries. The size of the internet economy in those countries is expected to double between 2011 and 2016. Those figures do not include the economic benefits of e-business services such as websites, Facebook pages and crowd-sourcing platforms that permit consumers to research products and services online before buying them in stores or the productivity gains and cost savings companies realize from leveraging cloud services.

The economic promise of the internet is especially large for developing economies. By 2016, according to the same study, emerging countries will be responsible for a third of the internet economy of the entire G-20 and nearly half of its growth.

Constructing new virtual economic walls

Despite the substantial economic benefits of maintaining access to the global digital marketplace, a small but growing number of government policies threaten to create new virtual walls that could undermine the open nature of the internet and the ability of companies and individuals to transmit or retrieve information across borders.

Indonesia, Korea and Turkey are among several countries that have proposed or enacted measures that would require financial services providers to process data on-shore or force companies to locate physical infrastructure such as servers within their borders. China has proposed rules that would require companies to innovate and develop technologies locally in order to sell to the government. In 2011, the Kazakhstan government announced that all local .kz domains would have to run off of servers located physically in the country.

In May, the Ethiopian government criminalized the use of services such as Skype that use voice over internet protocol (VOIP) technology in part to protect the monopoly of its sole state-owned telecom provider Ethio-Telecom. Over the past several years, a variety of countries including Egypt, Guatemala, and Vietnam have blocked access to US-based information services including Facebook, Wordpress and YouTube.

Some countries would like to make it easier to monitor or unplug altogether from the global internet. Russia has called for more international control of the basic functions of the internet, a development which could lead to a less open, less global internet subject to the whims and taxation of national authorities. Iran has already announced its intention to divorce itself from the internet and replace it with access to a 'clean' national intranet, subject to stringent national monitoring and regulation.

One difficulty with addressing this emerging digital protectionism is that new online roadblocks are not as clear-cut or easy to spot as tariffs on physical goods. In some cases, countries are attempting to address legitimate national interests such as consumer protection, national security, privacy, or public morals in ways that unnecessarily restrict or discriminate against international information and services. Other countries are simply invoking these concerns as a pretext for shutting the door to global ideas and businesses to improve their ability to control information or protect local economic interests.

These issues are perhaps inevitable growing pains of the internet as companies and countries struggle to adapt to an information-based global economy. At the same time, measures that shut out global internet-enabled services and ideas jeopardize the ability of individuals and businesses to benefit from the global economy. Policymakers everywhere ought to think carefully before placing restrictions on flows of information or internet-enabled services regardless of the rationale.

Advancing the economic promise of the internet

There is some evidence that this economic promise is an increasingly critical factor in policy decisions addressing information and the internet. In Cuba earlier this year, I spoke with government officials, academics and bloggers who repeatedly emphasized the importance of the internet to economic growth, including to the success of the small-scale entrepreneurs that President Raul Castro is trying to encourage. At the same time, they clearly struggled to reconcile that potential with the political uncertainty that greater access would bring.

Entrepreneur and fellow traveller Esther Dyson summed up the prevailing attitude in Cuba, observing in a Project Syndicate blog post that, *"Everyone agreed that internet access could dramatically help the economy, but seemed unwilling to concede that it was regarded as a political threat and thus was being delayed intentionally."*

Even within this context, telecommunication and internet policies in Cuba are evolving, albeit slowly. Texting prices, set by the state telecommunications company, have dropped. Cubans now have the ability to use computers in hotels. The government permits a Cuban version of Craigslist called Revolico.com to function, implicitly acknowledging and facilitating the grey market that has existed in Cuba for so long. Such a development would have been unthinkable even several years ago.

Other countries are working together to create a more open and secure digital economic framework by applying familiar disciplines that cover international trade in goods to information and electronic products and services. Mauritius signed a joint set of principles with the United States in June 2012 signalling that international internet-enabled services and information flows should not be restricted, that foreign companies should be treated fairly to provide telecommunications and related infrastructure, and which committed the countries to work internationally to increase digital literacy.

In the Asia-Pacific region, a group of innovative and diverse countries, including Australia, Malaysia, New Zealand, Singapore, the United States and Vietnam, are negotiating a trade agreement, the Trans-Pacific Partnership (TPP). Negotiators there are discussing for the first time the possibility of including specific commitments that would permit access to legitimate information flows and business services, avoid discriminating against foreign suppliers of digital products, and allow flexibility in the storage of data and servers within the region.

The global trade policy framework that has emerged over the past 60 years establishes basic rules of transparency, fairness and non-discrimination for international transactions involving physical goods, while still permitting governments to regulate in support of national interests such as privacy and security. Working with other innovative economies to apply those same concepts to information and electronic services can help secure an open, transparent framework to facilitate participation in the global digital marketplace.

Recognizing this, the Obama administration has taken the lead in raising these issues in speeches and in forums such as the Organization for Economic Cooperation and Development, which last year developed a communiqué on principles for internet-policymaking. Now with TPP, the United States and its trading partners have an opportunity to enshrine new commitments in the Asia-Pacific region.

This kind of international cooperation is increasingly necessary to ensure access to an open global electronic marketplace. As companies and workers rely increasingly on remote servers and cloud applications, and as digital information policies continue to evolve, it is becoming easier to get confused or wrong-footed on complex regulations and legal issues.

Small businesses and entrepreneurs in particular would benefit from cooperation among governments to ensure fair, non-discriminatory access to global digital markets and to improve their ability to navigate privacy standards, security regimes, and issues of jurisdiction and liability.

While these are increasingly complex policy areas, it is critical for governments to develop and apply laws and regulations in a way that is fair and transparent and without walling off the innovation that comes from open access to global information, digital services and technologies. In fact, overly restrictive policies, such as a requirement that companies house sensitive data solely within a country's borders, could make that information less secure by preventing companies and governments from taking advantage of redundancies and multiple storage capabilities of international cloud service providers.

Google's Chief Technology Advocate Michael Jones told an Atlantic Exchange Forum in May that *"there's a war going on right now"* for the future of the internet. Creating a trade policy framework for the digital age will be vital to winning that war and preserving the ability of innovators and entrepreneurs everywhere to participate effectively in the global marketplace of the 21st century. ■

Ethics in business – how to do the right thing

International law firm Eversheds recently brought together business leaders and legal professionals to examine and debate what constitutes good ethics in business. Also discussed was how firms can make high ethical standards a cultural reality.

Ros Kellaway, partner at Eversheds discusses some of the key themes and expert opinions that emerged.

Ethics in business have recently been brought to the fore by recent high profile cases around tax avoidance and executive pay, where questionable motives have led politicians, regulators, consumers and employees to probe further into how organisations operate on a daily basis. This has created much discussion about what good ethics actually involves and how firms can ensure it is firmly placed within their culture. With 99 of the FTSE100 companies now having an ethics policy and code in place, it does appear that the UK's leading businesses have begun to prioritise ethics as a key issue.

As well as bringing together senior business people, the Eversheds event included contributions from prominent thinkers in the field of business ethics such as corporate philosopher, Professor Roger Steare; general counsel of the Investment Management Association, Christiane Valansot; and research director at the Institute of Business Ethics, Simon Webley. While the best approach for making good ethics part of a business' core fabric was highly debated, there was a consensus that the key to successful business ethics is to empower all within an organisation to act ethically.

Do policies mean practice?

It was agreed that an ethics policy is not sufficient in itself, as signing a code of ethics does not result in changes of behaviour. Training and the means to obtain advice on key business decisions are also essential. However, introducing a policy is a good first step as it is important that standards of ethical behaviour should be led from the top of a business. Equal opportunities monitoring is a prime example of policy that began as mere compliance but has now evolved into a cause that has real meaning within organisations. The same can happen with ethics policies.

There was also broad agreement that in order to change behaviours, businesses have to make employees think about ethical dilemmas in practice so that they have the ability to work problems out for themselves. It was suggested that this should be tackled through employee training during the first 100 days of an employee's time with a business so that a baseline of values is established from the outset.

However, it is also important to recognise the difficulties that could be experienced by smaller-sized companies when trying to fully address all their ethical issues due to natural restrictions of time and budget.

Decision-making frameworks

Professor Roger Steare highlighted the role of 'decision-making frameworks' and how these can empower employees to make the right choices. He called for a move towards an 'ethic of humanity', with a change from a fear-driven compliance culture to one where people's natural compassion and humanity are allowed to prosper. Research shows that there is a natural shift in the way people behave around the age of 32-33, where they mentally 'grow up' and behave towards others in a more compassionate way. Professor Steare said that, in fact, there is no dissonance between humanity and responsibility as the two qualities can sit happily side-by-side.

However, he also believes it is important not to have lower expectations of younger generations. Research suggests that the millennium generation behaves in a different way to those that have gone before. It doesn't want to be told what to think or what to do. With social media channels such as Twitter proving popular for this generation to report and share social wrongs, this could mean that younger people will take a more proactive and autonomous approach when it comes to ethics in business. As a result, there is an enormous opportunity to empower new generations with the confidence to conduct businesses in an ethical manner.

"To ensure that good ethics is practised throughout a business, a culture of integrity and trust should be fostered"

The value of board-level support

Christiane Valansot shared her thoughts on situations where board-level support for ethics policies was not present. With organisations often having a 'tick-box' approach to complying with ethics and only paying lip service to any policies on ethical behaviour, she urged in-house counsel to try to change this culture from within.

She also emphasised that, regardless of board-level support, the buy-in of people within the business is just as important. Educating employees in the business about ethical practices to develop a strong ethical culture is the real key.

Shareholders and ethics

The larger theme of whether public companies should consider ethical practices beyond legal compliance was aired. Public companies are accountable to their shareholders, and it could be argued they should not be concerned with 'ethics' unless it is specified in their mandate.

However, Professor Roger Steare argued that greater focus on ethics within public companies would serve to benefit the needs of shareholders in the long term because this kind of approach creates a more sustainable business. He cited evidence that the life of a company on the Dow Jones has reduced from 30 to 18 years and explained that instead of each company trying to beat its opponents – which he deemed a dysfunctional approach – the business community should be working together to strive for ethical excellence.

Translating your ethics to other cultures

Simon Webley from the Institute of Business Ethics continued the debate by asking whether an organisation should impose its values on other cultures. He explained that while a company's values are non-negotiable, there are areas of choice when it comes to applying them. The way corporate values are applied as set out in a code of ethics can be interpreted in a way that still allows a business to stick to its values, whilst being mindful of cultural difference. For instance, a good example is the giving of gifts to ladies with whom companies have a business relationship on International Women's Day, a custom widely celebrated in Russia but one that may appear discriminatory to outside eyes.

It was concluded that encouraging and promoting a culture of openness within a business, where employees feel free to raise questions on whether they should be doing certain things without fear of chastisement for raising a problem, was the way forward to ensure that cross-cultural ethics are dealt with in the best way possible.

The ethics agenda – driven by legislation

Several participants believe it is inevitable that increased levels of legislation will be introduced to combat the crisis of confidence in businesses being played out in the media – particularly around current hot topics of executive pay and tax avoidance.

Although more legislation will not automatically change the culture of all businesses, it may help make them move in the right direction. But, it is also recognised that politicians may struggle to find a balance between winning the 'hearts and minds' of businesses, the media and the general public, as each has its own and differing priorities.

Overall, participants concluded that good business ethics need to extend beyond a code of ethics accompanied by a box-ticking culture of enforcement.

To ensure that good ethics is practised throughout a business, a culture of integrity and trust should be fostered. It is important to prioritise the empowerment of all within an organisation to act ethically, as the most junior are often those that can actually put ethical policies into practice on a day-to-day basis. ■

Middle East Association

British companies urged to look at Maghreb with new eyes

The MEA held a very successful conference on *'The New Maghreb: Business Opportunities in North Africa'* at the Royal Geographical Society on Tuesday 12th June, kindly sponsored by Clifford Chance and Nur Energie. It was attended by around 140 delegates and attracted high level participation from Algeria, Morocco and Tunisia.

The event highlighted some of the recent trends and developments in the region, the importance attached by the Maghreb countries to strengthening their relations with the UK, and the huge demand for British expertise and partnerships in areas ranging from energy and construction to English language teaching and financial and professional services.

In a keynote speech which reflected the conference theme of the '*New*' Maghreb, Mostafa Terrab, Chairman, Moroccan British Business Council, urged British companies to look at the Maghreb with new eyes, and use it as a stepping stone to the emerging market of Africa, against the backdrop of the economic downturn in Europe. *"Europe needs a growth zone – Africa is that economic hinterland,"* he said. *"Africa is the solution, not the problem."*

He spoke about the need for a *"shift of mindset"* to look beyond the traditional sectors towards new areas of industrial competitiveness such as automotive, renewables, and aeronautics. The region is a source of industrial competitiveness for British and European business, he said.

Changing dynamics

Dr Claire Spencer, Chatham House, also highlighted the changing dynamics between North Africa and Europe. North Africa has a lot of what Europe needs, she said, while the Maghreb needs technical and managerial skills and credit lines. Migration could be a motor for economic growth, rather than a threat. *"We need to capture the dynamism and energy of this generation for the benefit of Europe and North Africa, through co-development."*

Morocco, Algeria and Tunisia had weathered the storm of change well and remain stable, compared with other countries in the Arab world, she said. *"The unthinkable may soon be possible – political and economic participation."* She and other speakers noted the growth in political protest and industrial action, which, while a sign of a vibrant society, could have an impact on investors.

In an inspiring speech HE Mr Alaya Bettaieb, Tunisia's Secretary of State for Investment & International Cooperation, charted Tunisia's progress towards democracy, and the growth of pluralism and freedom of expression. He acknowledged UK and international support for Tunisia in conducting transparent elections leading to the first ever elected parliament and government. The process is moving smoothly, he said, with the constitution due to be finalised by the end of the year and elections due to take place in March 2013. 50 reforms are under discussion.

"Europe needs a growth zone – Africa is that economic hinterland ... Africa is the solution, not the problem"

Tunisia's efforts to improve good governance, create a transparent environment and fight corruption have been appreciated by investors; SMEs, including those from the UK, had started to come to Tunisia. *"Tunisia is really on the move,"* he said. He underlined efforts being made to tackle unemployment by promoting entrepreneurship and employability through measures such as setting up venture capital funds, technology parks, business incubators and assisting SMEs.

Lord Marland, Parliamentary Undersecretary of State for the Department of Energy & Climate Change and Chairman of UKTI's Business Ambassadors Group said, *"I applaud the governments of the three countries for the fundamental sea-change in their attitude to business, business methods and embracing the broader world, creating opportunities for British business."* He highlighted the importance attached by the UK government to developing international relationships and supporting business, and urged British companies to *"take full advantage of what is a strong and flowering relationship."*

Mostafa Terrab, Chairman, Moroccan British Business Council, addressing the gathering

Stronger British presence needed

Lady Olga Maitland, Chairman, Algeria British Business Council, stressed the need for a stronger British presence in Algeria and urged British companies to take advantage of the enormous opportunities arising from Algeria's diversification efforts, with the boom in construction and infrastructure development from dams, schools, hospitals, to highways and the metro. *"Algeria is saying to me, where are the British businesses? Algeria needs our skills, our training, our expertise, in English language teaching, in construction, in agriculture...,"* she said, noting Astrozeneca's recently signed joint venture with Algeria's Biopharma Co. She also stressed the personal wealth and development in Oran, where HSBC plans to open a branch.

Rachid Sekak, HSBC Algeria, and Dr Elias Boukrami, Regents College London, later highlighted Algeria's economic strength and investment potential, noting Algeria's $153 billion economy, high level of foreign reserves, ambitious $270 million investment programme from 2009-2014, and availability of funds.

However the challenges arising from Algeria's complex regulatory environment were not glossed over, amongst them the 49% cap on foreign ownership, foreign exchange controls and difficulties in obtaining visas – patience and persistence are required.

Alex Lambeth, British Expertise, highlighted the potential for British companies to play a greater role in construction and infrastructure in Morocco and Tunisia. He noted the focus in Morocco on social infrastructure and low cost housing, with 100,000 units a year planned. Railways, ports, airports, and tourism are also driving construction, as are plans to host the Africa Cup of Nations in 2015. There is a need for British expertise in high end consultancy projects, sustainable building and in renewable energy.

In Tunisia, public construction and infrastructure plans are not yet fully clear following the Revolution – but here too housing is a priority. Aid funded projects also offer opportunities, eg. African Development Bank. There is scope for British companies to partner with well qualified, experienced and outward looking Tunisian companies, to pursue opportunities in Libya and across Africa.

Energy sharing and cross-border co-operation were important themes highlighted in the session on energy, as were industrial integration and co-development. Also underlined were the opportunities for SMEs, with many smaller independent companies involved in exploration in Morocco and Tunisia.

Ahmed Mecheraoui, Advisor to the Algerian Minister of Energy and Mines, highlighted the opportunities for 'win win partnership' in developing Algeria's energy resources, underlining the Government's commitment to develop Algeria's enormous shale gas reserves (at least 230,000 tcf) in the face of dwindling conventional reserves. Results of pilot studies have been promising. A huge investment in logistics, equipment, and specialist technology, as well as in human resources, will be required – foreign participation is a pre-requisite.

Renewable energy development

The development of renewable energy throughout the region is significant not only in terms of meeting the region's own energy needs but also in terms of contributing to Europe's carbon emissions reduction targets and spurring the development of a new renewable energy technology industry, hence contributing to job creation. The TUNUR solar project in Tunisia's southern desert, being developed by Nur Energie with Tunisian investors, will potentially make a significant contribution to the UK's electricity supply.

Dr Ranald Spiers, Director General, Middle East Association; HE Mr Alaya Bettaieb, Secretary of State for Investment & International Co-operation, Tunisia; Lord Marland, Parliamentary Under-Secretary of State, Department of Energy & Climate Change, and Chairman of the UKTI Business Ambassadors Group; HH Princess Lalla Joumala Alaoui, Ambassador of the Kingdom of Morocco to the UK

Morocco has made particularly good progress in renewable energy as a result of strong political backing, the availability of finance and the opening up of the production of energy from renewable sources to the private sector. The government is prioritising new energy and energy efficiency and is looking to install 4gw to 2020 through solar and wind energy, with marine energy a target for the future. Morocco currently imports energy from Spain, but this could be reversed.

The need for increased economic integration came out strongly in the panel on financial and professional services; the complementarity of the Maghreb economies and the potential for the region to be a viable commercial partner of the GCC were underlined. Mustapha Mourahib, Clifford Chance Casablanca, highlighted the importance of regional integration in attracting liquidity, and also called for further development of the regulatory framework to international standards, reform of the judicial system and further training in financial services.

Mounir Guessous, Morocco Financial Board, outlined the role of the Casablanca Financial Centre as a stable platform to access Africa's untapped potential, focusing specifically on Great North West Africa. *"Casablanca will bring all of the opportunities from across this region together in a single aggregation for the global investor community,"* he said, highlighting Morocco's many attractions for investors, such as political stability, robust regulation, efficient infrastructure and tax incentives.

The final session on industry further developed the theme of the paradigm shift in industrial development and Morocco as a competitive platform to access regional markets, with reference to the automotive and aeronautical industries. The importance of partnerships and training was once again highlighted. Delegates also heard about the development of Tanger Med port as a logistics, industrial and commercial hub with a high level of connectivity to global logistics flows. The Tangiers Free Zone recently won the accolade of being ranked 'Best Port Zone' by *fDi Magazine*. ■

The Middle East Association is taking a trade mission to Algeria from 10th -14th November, visiting Algiers and Oran. For further details please email: mea@ctgrouptravel.co.uk.

Doing business in Iraq – the new opportunity

The situation in Iraq is changing - with GDP growth outstripping China and the USA, a booming oil and gas sector, and a growing labour force, there are excellent business opportunities in the region that should be considered. Tawfiq Tabbaa, managing partner for Eversheds in Iraq and Jordan, highlights some of the key areas – including local laws – that companies targeting Iraq as a potential business destination should consider before taking the leap.

While Iraq does still make headlines, it is becoming clear that as political and security issues improve so too is the general environment for conducting business. Investors are increasingly considering the region as a hub for maximising growth potential, with the business community increasingly looking to establish a presence in this area of the Middle East. When it comes to the practicalities of such a move, businesses require a good understanding of the wider economic, legal and legislative scenarios and challenges to make the most of the business opportunities available.

First steps

The region represents an economy in transition, which in turn means that the regulatory framework is also in a state of evolution and flux.

Of most importance for international businesses is the favourable investment laws. Iraq is unique in the Middle East in that it is one of the few jurisdictions to allow 100% foreign ownership in all sectors. While ownership of land is not permitted, apart from in the housing sector, investment law allows for a number of incentives and guarantees to circumvent the situation, including leasing terms not exceeding 50 years, exemption from custom duty, and exemption from fees and taxes for 10 years.

Interested parties should note that the minimum capital required for establishing an LLC is IQD 1 million. However, this requires pre-approval from the Ministry of Interior, which is one of the biggest obstacles facing investors. One of the largest drawbacks is that the process lacks transparency and can take as long as six to 12 months.

The alternative would be to establish a branch office, which only applies in the case of involvement with Government contracts. Alternatively businesses can establish a representative office, but this means that organisations can only conduct business development and marketing activities. It is only when companies have secured a contract that they can convert to a branch office and actually conduct business in the region.

The most interesting and flexible way to do business is via a joint venture agreement. It is not an easy solution and is subject to a number of limitations, but one option would be to place the holding company outside of Iraq, where the relationship can be governed by different laws and jurisdictions.

Taxing times

The current tax rate for all industries in Iraq is a flat rate of 15%, apart from in the oil and gas sector where the new Iraqi Oil and Gas Tax Law specifies a corporate income tax rate of 35%.

However, from a business perspective, it is essential to distinguish between trading 'in' as opposed to trading 'with' Iraq. It is in the case of the former where tax issues take on a much greater importance, and any contractor 'trading in' will need to be registered in Iraq and obtain a tax clearance from the Iraqi authorities. Meanwhile, goods or services provided outside of Iraq should not be subject to corporate taxes on the basis that this is considered to be trading 'with' as opposed to trading 'in' the region.

In terms of employment taxes, it is an employer's responsibility to report taxes due in respect of individuals working in Iraq. Taxes are subject to a progressive rate of up to 15% but, key for the foreign investor, allowances and deductions are available which allows for the opportunity to structure remuneration tax efficiently.

Legal obstacles

So, there clearly is an argument in favour of doing business in Iraq, but what happens if you encounter problems? The enforcement of contracts is a prime example of one of the biggest concerns to potential investors.

While Iraqi governing law determines whether there has been a breach of contract, it is the jurisdiction law that provides for where any problems will be resolved. Also, contracts can specify a governing law that is not subject to Iraqi law, the only exception being contracts involving government entities. Jurisdiction options then range from using the local courts, to local and foreign arbitration, and then, finally, foreign courts.

The quickest route is to use local courts, but typically these are not appropriate for dealing with more complex or high value disputes. Local arbitration, on the other hand, is not used very often and the difficulties of enforcement means this approach is not recommended.

Issues are also associated with foreign arbitration as Iraq is not a signatory to the New York Convention. In fact, to date, there have been no reported cases of successful enforcement of a foreign arbitration in Iraq. However, foreign courts offer some clear principles for enforcement and there are some examples of success. They work on the basis of reciprocity, and providing the judgement applies to a signatory of the Riyadh Convention (of which Iraq is a member), taking a dispute to the foreign courts is the preferred method of resolution.

"Iraq has one of the fastest growing economies in the world, with GDP growth reaching 12% last year... keeping pace with the emerging BRIC economies"

Dealing with risk

Although the security situation is improving, addressing security risks around individuals and property remains important.

Dr Mowaffak Al Rubaie, National Security Advisor of Iraq, believes risk management needs to take numerous forms, including economic, commercial, internal and social. Also, political risk can apply both to the government and to boards of directors, where the need to manage shareholders via a carefully orchestrated programme of activity remains critical for overseas investors entering the region.

The Transparency International's Corruption Perceptions Index 2011 ranks Iraq 175th out of 183 countries in terms of its level of corruption. Therefore, it is important to work with local partners who have both a relationship with, and understanding of, the local market.

A growing economy and bright future

While there are some risks associated with operating in the region, the government has stabilised recently, so the wider economic and market fundamentals are becoming healthier. Iraq has one of the fastest growing economies in the world, with GDP growth reaching 12% last year, outstripping the powerhouses of China and USA and keeping pace with the emerging BRIC economies.

The majority of the country's strong economic performance can be attributed to the prominence of its oil and gas sector. Iraq has the fourth largest oil reserves and the eleventh largest gas reserves in the world and, according to BP, Iraq's projected oil production growth is the highest in the world at 20.5% per annum.

Also, the country is benefiting from an upsurge in foreign direct investment, which increased by 43% in 2010-2011 to reach a figure of $55.6 billion last year. Iraq also benefits from an increasingly active labour force, and at 32 million, it has the third largest population in the MENA region.

The opportunities for foreign investment and growth in Iraq are clear, and with the right management a business can maximise on these opportunities. Some may be deterred by the perceived risks but, with so much on offer, if competitors are bolder the biggest risk could be not taking the risk at all. ■

Acquisition of a business from insolvency proceedings in Germany

In Germany, the acquisition of a business from insolvency proceedings is becoming increasingly popular. Our author, Dr Stephan Brandes, is partner of SZA Schilling, Zutt & Anschütz Rechtsanwalts AG in Frankfurt/Germany and practices in the areas of corporate law, M&A and insolvency law. His practice also encompasses representation in litigation and arbitration in corporate and post-M&A disputes. He is the author of numerous publications on corporate law (inter alia *Münchener Kommentar zum AktG*)

In Germany, the acquisition of a business from insolvency proceedings is becoming increasingly popular. With the Act for the Facilitation of the Reorganization of Enterprises (*Gesetz zur Erleichterung der Sanierung von Unternehmen – ESUG*), which entered into force on March 1, 2012, the legislator strengthened the rights of creditors in insolvency proceedings and, thus, also accounted for concerns of foreign investors regarding German insolvency law. This is true, in particular, with regard to the selection of the insolvency administrator which, prior to the legal reform, occurred at the sole discretion of the insolvency court.

"The concept of self-administration, the rule in US-practice and the exception in Germany so far, was strengthened"

Under the new Act, it is possible already in the course of the institution proceedings (*Eröffnungsverfahren*), ie. the period between the filing of the application for the institution of insolvency proceedings and the order opening the proceedings (*Eröffnungsbeschluss*), to establish a preliminary creditors' committee which has been conferred an important participation right regarding the selection of the insolvency administrator. The concept of self-administration (*Eigenverwaltung*), ie. the continuation of business operations by the previous or a new management under supervision, which is the rule in US practice, but which in Germany has rather been the exception so far, was also strengthened.

Deal structure

Usually, the investor acquires the assets which the business of the insolvent enterprise comprises (including the entire technical know-how and the goodwill of the enterprise), by way of individual transfers of title (asset deal). The advantage of this structure is that undesired assets and contractual relationships can (largely) be excluded.

In principle, it is also possible to acquire, by way of a share deal, the insolvent shell of the enterprise itself, which is then disencumbered in the course of insolvency plan proceedings (*Insolvenzplanverfahren*). Because of the required cooperation of the shareholders and the usually high complexity of the transaction, this structure could only rarely be found in practice. However, following the entry into force of the ESUG, the insolvency plan proceedings also allow for the transformation of creditor claims into company shares (debt equity swap). This can be a way to overcome resistance from existing shareholders.

Risks and opportunities of an acquisition from insolvency proceedings

The benefit of a purchase from insolvency proceedings is the acquisition of a largely disencumbered enterprise at an attractive price. In the case of an asset deal, all liabilities, ie. those that were created or caused, respectively, in the period prior to the institution of the insolvency proceedings, remain with the insolvency administrator.

In some cases, this even applies to such liabilities which in the case of an acquisition outside of the insolvency proceedings would mandatorily transfer to the acquirer by operation of law, such as the liability for pension obligations originating from the period prior to the institution of insolvency proceedings, or the liability for unpaid taxes of the insolvent enterprise.

In contrast, it is not possible for the acquirer to avoid, for example, his statutory co-liability for environmental risks, for anti-trust violations on the part of the insolvency debtor or the repayment of subsidies received by the insolvency debtor without legal justification. The acquirer can only guard against such risks with suitable indemnification clauses in the purchase agreement.

As is the case with an acquisition outside of insolvency proceedings, the employees of the insolvent enterprise are transferred to the acquirer with all pertinent rights and

obligations. However, insolvency law provides the acquirer with attractive opportunities for the realisation of significant cost savings. This is true, for example, for the use of transfer companies which take over part of the employees on the basis of funding granted by the state, as well as for the termination of employment relationships by the insolvency administrator on the basis of a reorganisation concept for the enterprise prepared by the acquirer.

Implementation of the transaction

The success of the transaction depends on the acquisition process being professionally managed and quickly completed by both sides. Usually, both sides will be interested in a timely completion of the process, in order to avoid the loss of important customers and employees, the jeopardising of the good name by negative press reports and the endangering of suppliers as a consequence of follow-up insolvencies. The involvement of competent advisers is indispensable.

A due diligence is usually conducted also in the case of distressed M&A processes. For this purpose, the process can be streamlined, as it is usually not necessary to conduct a corporate due diligence or a review of discontinued contractual agreements. In addition to operational issues, from a legal perspective, the most relevant aspects will be those contractual relationships that have to be assumed as well as statutory liability risks. Usually, employment law is one of the focal points of the examination.

It has to be taken into account that the insolvency administrator himself usually comes from outside the enterprise. The acquirer has to be prepared, in particular in cases where key employees, including the former management, have already left the insolvent enterprise, that the insolvency administrator will not be able in the available time period to compile all documents that are relevant for the valuation of the enterprise.

In contrast to M&A processes outside of insolvency proceedings, the acquirer cannot make provisions for these risks by agreeing on an extensive catalogue of warranties and representations. In practice, this is usually not accepted by the insolvency administrator. Where the latter is prepared to grant warranties and representations at all, these are usually restricted to the standard title warranties and, in addition, are subject to limitations of liability and short limitation periods.

In this respect, the insolvency administrator will usually argue that because of his lack of knowledge of the business he was in no position to issue any warranties or representations and that, besides, the risks were already reflected in the discount from the purchase price that is common in insolvency cases.

The insolvency administrator is usually interested in agreeing on a fixed purchase price. Subject to certain requirements, variable purchase price elements are also accepted. This applies, for example, to the valuation of inventories and – in cases where no title warranties are granted – to some extent also in respect of the fixed assets. Agreements on earn-out clauses or the retention of part of the purchase price are subject to negotiation. ■

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