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Different recovery paths

With the US still sluggish and Western Europe back in recession, four years on from the 'credit crunch' the economic climate remains harsh. The West's response to sub-prime has arguably made our predicament worse; faced with widespread institutional insolvencies and high debts, governments have shielded the banks from reality, while indebting themselves even more.

In 2011, the Western economies grew by just 1.6%. This year, according to the International Monetary Fund, that figure will fall to 1.3%, with the eurozone contracting. Meanwhile, the emerging markets power on, growing 6.2% last year and on course for a 5.3% expansion in 2012.

Within these broad brushstrokes there is a division within Europe, and between Europe and the US. Willem Buiter's end of year forecast - *Prospects for Economies and Financial Markets in 2013 and Beyond* - for Citigroup shows an American revival and a slow economic death for Europe. The growth gap between the US and the eurozone will be some 2.5% in 2012, and is forecast to widen by 2014 to some 3.4%, and this is expected to continue for the rest of the decade.

The compound effects of this for year after year are dramatic. A moribund Europe will be left behind in a world dominated by the US and China, with a string of emerging powers gaining ground but still far behind.

The Citigroup report predicts that the eurozone's nominal GDP will slip from 78% of US levels this year to 66% by 2025, that China's nominal GDP will probably surpass the euro area in 2017 or 2018, and that India will overtake Germany by 2020. On US decoupling:

"We expect very different recovery paths, reflecting differing policy choices in managing the deleveraging process, plus underlying differences in terms of the supply-side and energy availability. US real GDP per head probably will rise about 9-10% above the 2007 level by 2017 - clearly outperforming Japan's 'lost decade' (real GDP per head rose by 5% from 1992-02).

"By contrast, in the euro area, we expect continued recession in 2013 and 2014 and prolonged weakness thereafter - with ongoing financial strains and, over the next few years, Grexit (Greek exit) plus a series of sovereign debt restructurings. In the euro area and UK, real GDP per head will probably remain 3-4% below the 2007 level even in 2017 - markedly underperforming versus Japan's 'lost decade'.

"The European economies still have underlying potential to grow: but we expect that private sector deleveraging, weak banking system, early fiscal austerity and financial strains resulting from flawed EMU structures will continue to cap demand for an extended period."

Citigroup thinks that China will slow to a growth rate of 5.5% by the end of the decade and that China's nominal GDP will overtake the US by 2025. The BRICS/emerging market boom will carry on, but at a more subdued pace than previously. Brazil will overtake the UK and France next year, but growth rates of 3.5% or so (this rate also applies to Russia) mean that they will not really close the gap with the United States.

It is clear that world trade trends are likely to continue to shift towards emerging markets. *"Comparing H1-2012 with H1-2008, the value of exports by advanced economies to advanced economies has fallen by 8%, while exports from EM to EM are up 40%... share of world trade in goods that involves EM countries up from 33% in 1990 to 61% in H1-2012 ... and is likely to hit 70-75% by 2020."*

Economic power is shifting away from Europe, and China and India's rise as two of the world's largest economies highlight a new 21st century reality - size matters. For Europe to maintain their quality of life and broadly shared prosperity the eurozone will need to evolve into a more federated United States of Europe. Interesting times lie ahead. ■

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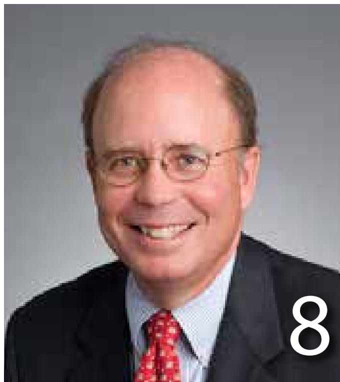

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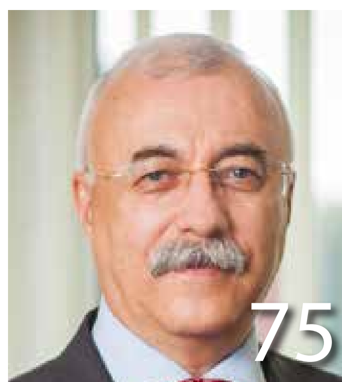

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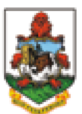

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FATCA – business support for a global solution

Keith Lawson is Senior Counsel – Tax Law for the Investment Company Institute and ICI Global. He chairs the FATCA Business Advisory Group organized by the Business and Industry Advisory Committee to the OECD

FATCA – the Foreign Account Tax Compliance Act – presents business with unique challenges and an opportunity to find global solutions to a single country's broadly-applicable tax legislation. The Business and Industry Advisory Committee ('BIAC') to the Organisation for Economic Co-operation and Development is leading the business effort to engage with governments in a mutually beneficial dialogue. The OECD is playing a key role in facilitating these discussions.

The United States enacted FATCA in 2010 to address concerted efforts by certain US taxpayers, sometimes with substantial assistance from non-US financial institutions, to avoid paying taxes owed to the US government. To achieve the US Congress' tax-compliance objectives, FATCA effectively imposes significant customer identification and reporting responsibilities on all non-US financial institutions ('foreign financial institutions' or 'FFIs') with investments in the US. Any FFI that does not comply with FATCA's requirements suffers 30 percent withholding on all payments (including dividends, interest, and sales proceeds) attributable to its US assets.

FATCA, not surprisingly, has generated considerable controversy. The complaints about FATCA include: (1) the law reflects a unilateral effort by the US to turn foreign institutions into US tax collectors; (2) some of FATCA's requirements (such as FFIs' obligations to report customer information to the US) cannot be satisfied without an FFI violating the laws (such as data privacy) of the country in which it is organized; (3) FFIs must incur extraordinary costs to implement FATCA;[1] and (4) the additional tax revenue collected by the US pales in comparison to the costs imposed on FFIs. Business, and other governments, raised these and other concerns with the US government early and often, before FATCA's enactment and since.

The US government has responded by engaging actively with business and with other governments. The extensive dialogue has allowed business to explain the myriad of general and industry-specific concerns FATCA presents. Alternative approaches for addressing these concerns have been explored in detail in numerous meetings and ongoing discussions between business and US government officials.

The preliminary results of this dialogue have been encouraging. The US government issued three documents (in the form of 'IRS Notices') indicating the US government's preliminary thinking on a wide range of issues; each Notice reflected a growing US government appreciation for business' concerns. The FATCA regulations that were proposed in February 2012 continued the positive movement. Among other things, the US government has responded to business' profound concerns that insufficient time exists to comply with FATCA's requirements by delaying many of them.

Even more encouraging was the joint statement that France, Germany, Italy, Spain, the United Kingdom, and the United States issued, on the same day that the proposed FATCA regulations were released, to develop an 'intergovernmental agreement' or 'IGA' to implement FATCA. These six countries also committed to work *"with other partners and the [OECD] . . . on adapting the terms of this Agreement to a common model for automatic exchange of information, including the development of reporting and due diligence standards for financial institutions."* This IGA approach, business quickly concluded, offers a solution to many of FATCA's most intractable problems.

The Model IGA developed by these six countries (known as 'Model 1') was followed by a second model ('Model 2') developed by the United States, Switzerland and Japan. These models simplify many of FATCA's more cumbersome requirements. One significant difference between the models is that FFIs in Model 1 countries report information about US customers to their local governments while FFIs in Model 2 countries report directly to the IRS. The advantage of reporting to local tax authorities is one of the reasons that business generally prefers Model 1.

Business' support for the IGA approach is strong. The IGAs' many benefits include:

- FFIs will be able to comply with FATCA without violating their domestic data privacy laws because the legislation that IGA countries must enact to implement their IGAs expressly will authorize the requisite tax reporting;
- FFIs generally will not be required to impose FATCA withholding on customers whose status as US taxpayers (or not) cannot be determined; and
- substantial market confusion about the 'deemed-compliant' status of retirement plans, retirement accounts, charities, and similar institutions and accounts will be eliminated by Annex II to each IGA – which will list deemed-compliant FFIs.

The movement to making the IGAs a reality has been slow, but steady. The first IGA, with the United Kingdom, was signed in September. A few more have been signed since. The US Treasury announced recently that negotiations are proceeding so well that a total of seventeen IGAs may be signed by the end of 2012. Over 50 countries, US Treasury has announced, have expressed interest in signing an IGA.

For the IGA's benefits to be realized fully, two things must happen. First, the IGA network must be extensive. Second, the IGA negotiated with each country – and each country's implementing legislation – must be as consistent as possible. Without an extensive and consistent IGA network, business will confront too many burdens to implement FATCA in anything approaching a cost-efficient manner.

Perhaps the easiest way to illustrate the problems that business will confront from a sparse IGA network is to consider the reporting responsibilities of a financial services firm with global operations. Almost invariably, the FFI will have its headquarters and/or branches in one or more Model 1 countries. This FFI also most likely will be reporting under Model 2 because Switzerland and a few Asian countries that are important financial centres have indicated a preference for this second Model.

Unless IGAs are adopted almost universally, and quickly, it also is quite likely that a global financial services firm will have branches in countries that do not have an IGA. In non-IGA countries, the FFI will be required to apply all of FATCA's requirements (often called 'straight FATCA').

In actuality, the problems of applying three different FATCA methodologies – Model 1, Model 2, and 'straight FATCA' – almost surely will be far more substantial than many suspect. Among other things, no country has enacted (or, as this article is being written, even introduced) FATCA implementing legislation, no country has signed a Model 2 IGA, and the final FATCA regulations have not been issued. Inconsistent requirements, and the delays in receiving clarifications to the ambiguities that surely will arise, are inevitable. Moreover, new issues will emerge as different business units within FFIs study how the detailed rules apply to them.

"The critical next step is a coordinated effort to maximize the consistency between the legislative and regulatory steps that countries take to implement their intergovernmental agreements"

A global solution is required. If other countries enact their own versions of FATCA, as some have suggested, the need for global consensus will be all the greater. Thankfully, the OECD has emerged as a key driver for an informed multilateral dialogue. The United States, despite the unilateral start to the FATCA debate, is playing a key role as well in developing a consensus on many FATCA issues.

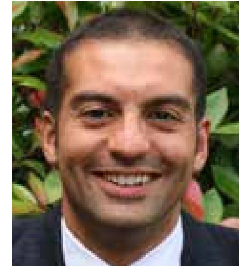
An important step in this global initiative took place in September, when officials from the United States and its five 'joint statement' partner countries provided business with a detailed briefing at the OECD's Paris headquarters. In conjunction with this September meeting, tax officials from OECD member countries met with the FATCA business advisory group organized by BIAC to discuss uniform reporting formats and transmission protocols. The reporting format discussion continued at two subsequent meetings in October and December. While more work needs to be done, the opportunity provided to business to comment on the reporting formats developed by the United States has been most welcome.

The critical next step is a coordinated effort to maximize the consistency between the legislative and regulatory steps that countries take to implement their IGAs. BIAC has urged the OECD to work with its member countries to facilitate a comprehensive discussion with business on these implementation issues. For the process to succeed, however, business must engage fully. The members of the business advisory group come from many regions, countries, industries, and disciplines.

This project cannot succeed without active participation by a wide range of industry experts. The potential costs to business of disparate FATCA rules are extraordinary. If FATCA's burdens are to be manageable, business must maintain a knowledgeable and creditable response. ■

1. These cost include: hiring US tax experts to explain FATCA and assist in building compliance systems; searching existing account records for US persons; modifying account opening procedures to identify US persons; building systems to report account information about US clients; and building systems to withhold on account holders whose status as US or not cannot be determined (so-called "recalcitrant account holders").

20 years of the single market in Europe: achievements, challenges and recommendations



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The European single market is the cornerstone of European integration. It adds €600 billion a year to our economy, and since 1992 it has helped create almost 3 million new jobs in Europe. With a market comprising 30 countries and 500 million citizens, annual cross-border investment flows of €430 billion and 70% of member states' exports being destined for other EU countries, the benefits from closer integration are undeniable.

Nevertheless, barriers to the free movement of people, goods, services and capital still represent an untapped economic potential of between €275 and €350 billion. As an example, services account for more than 65% of EU GDP and 70% of total employment, with 9 out of 10 jobs created in services sectors. Yet, cross-border services only account for 5% of EU GDP, compared with 17% for goods. The current difficult economic situation has also created serious challenges coming from protectionism trends, weaker political support and disenchantment among citizens. This could put at risk the benefits achieved and stall further progress.

The single market is the most important driver for renewed growth, innovation and job creation. BUSINESSEUROPE has always been fully committed to making it work better for a more competitive Europe. However, the EU needs to remove remaining barriers and address decisively outstanding challenges to unleash its full potential.

Recent EU actions

In 2012, the European Commission launched a round of initiatives to improve the functioning of the single market on the occasion of its 20th anniversary. The Communication on a *Better Governance for the Single Market* (COM(2012) 259 final)[1] presents a wide action plan to make the existing single market *aquis* work better in practice. The Communication sets out a course of action to achieve swift progress in areas with the highest growth potential, to be set and reviewed on a regular basis, based on economic indicators.

The priority areas identified for 2012-2013 are key services sectors (wholesale and retail trade, business services, construction and financial intermediation), the digital economy, energy and transport. Within these areas, Commission and member states should ensure proper implementation of relevant pieces of legislation, in particular by adhering to a number of procedural checks and commitments. Another aspect of the strategy consists of analysing the state of integration and concrete functioning of the single market.

BUSINESSEUROPE believes that the European Commission approach to concentrate on the areas with the highest potential for growth is the right one. The selection of specific measures to be consequently undertaken must be based on economic evidence and have the greatest positive impact on growth and global competitiveness, while improving the overall functioning of the single market.

As a follow-up to the Communication on Governance, in early November 2012 the European Commission published for the first time Country Reports[2] describing the *"single market performance"* for the 27 EU member states taking into account a number of selected indicators, based on Eurostat[3] and other sources. Among others, they assess values related to:

- The fundamental freedoms of movement (of goods, services, capital, labour)
- Government effectiveness (quality of public administration in general)
- Implementation (transposition and compliance deficit, etc.)
- Use of single market tools (Points of Single Contact, Internal Market Information system, Solvit, etc.)
- Workers' free movement (eg. recognition of professional qualifications)

A final section is devoted to the results of a Eurobarometer survey to measure the public's awareness and perceptions of the single market.

At the end of November 2012 the Commission also adopted the first *Annual Report on the State of the Single Market Integration* (COM (2012) 752/2)[4], aimed at measuring through concrete benchmarks how well the single market functions. The Report presents data on intra-EU exchange in goods, services, capital and labour. Consistent with the objectives of the Governance Communication, it also describes the market

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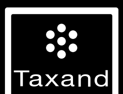

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"The single market is an asset which should be used as a springboard to meet the challenges and seize the opportunities of the global market"

performance and obstacles to EU integration in areas with a high potential for creating growth and jobs, namely services, energy, transport and digital markets. Here, the Commission also provides member states with policy recommendations, generally related to improving transposition, high-quality implementation, removal of national regulatory barriers and opening to competition.

One of the overall outcomes of these initiatives is the availability of more concrete, factual indicators on how single market rules are applied in practice, which was underdeveloped so far. This is an improvement from a business perspective as it helps compare the member states' performance, thereby increasing peer pressure. These indicators will also make it easier for the Commission to monitor progress and define remedial actions.

Building strong political support is however crucial to make a success of these initiatives, and requires strong cooperation and continuous dialogue among member states, EU institutions and stakeholders. Respecting smart regulation principles, early stakeholder involvement and comprehensive impact assessments are essential in this respect.

Business views and recommendations

BUSINESSEUROPE stands firmly behind the single market, as Europe's primary tool to get out of the crisis and increase its worldwide competitiveness. The single market is an asset which should be used as a springboard to meet the challenges and seize the opportunities of the global market.

Focus on what is needed to further integrate the single market and improve its functioning often does not require introducing new legislative measures, but rather ensuring that the rules in place work better in practice and are correctly applied in all member states. Therefore, the right balance should be struck between measures to further improve the implementation and enforcement of existing rules and new policy initiatives.

Ensuring good governance of the single market is another fundamental element. It implies ensuring timely transposition and effective implementation of well designed legislation, but also better monitoring and showing results in a transparent fashion. The Internal Market Scoreboard, as well as the new annual integration reports and country specific recommendations can be extremely helpful, if they are followed up by strong EU intervention when necessary.

In the global context, swift action on the measures that can improve the EU's global competitiveness is needed. As the EU is facing challenges with market access, IPR protection, services liberalisation and the proliferation of subsidies in areas like procurement or big infrastructure projects, BUSINESSEUROPE strongly supports further regulatory cooperation with EU's main trading partners. In terms of dialogue, cooperation with the US should be stepped up not only to promote bilateral trade but also to strengthen global rules vis-à-vis emerging markets. Cooperation with the large emerging markets and the neighbourhood countries is also important.

When looking at the specific areas with a high potential for growth and job creation, BUSINESSEUROPE presented the following, more detailed recommendations:

- Establish a well-functioning single market for all service sectors:

  Fully implement, apply and enforce the services directive in all member states, which alone can bring additional gains up to 1.8% of EU GDP (about €330 billion).

  Remove all remaining burdensome, discriminatory and unjustified national requirements applicable to service providers, such as residence or economic needs tests, and avoid the introduction of new ones.

  Modernise and further simplify administrative procedures for service companies through better functioning Points of Single Contact, which positively affects the creation of new business and can provide gains up to 0.21% of EU GDP.

  Reduce the number of regulated professions, prioritising professions and sectors which have the largest growth potential and are most regulated or only regulated in one Country, and ensure easier and faster recognition of professional qualifications.

- Create a true digital single market:

  Tackle barriers preventing the digital economy from producing full benefits for consumers and businesses. Completing the digital single market by 2020 will boost EU GDP by more than 4%[5].

  Create a good digital environment which allows companies to create and offer products in a user-friendly manner throughout the EU, and improve accessibility through wide coverage of a robust high-speed broadband infrastructure.

  Boost consumer and business confidence in cross-border e-commerce by addressing the excessive fragmentation of applicable rules (eg. different VAT regimes, data privacy, payment systems, consumer protection and product information), and apply an 'e-commerce test' to all relevant new legislation, both at EU and national level.

  Tackle the challenges relating to online payments, delivery, interoperability and mutual trust simultaneously, including by ensuring the availability of efficient dispute-solving mechanisms.

Reform the copyright system in order to create a real single market in this area, including for cross-border licensing and collective management of rights.

Promote the development of e-procurement, to improve efficiency, transparency and competition. Its current take-up is slow with no more than 5% of EU procurement procedures allowing for electronic processing.

- Complete the internal market for transport:

  Build on market-based solutions to guarantee access to all transport markets and remove regulatory, administrative and technical barriers in all modes of transport.

  Raise awareness of the importance of transport and ensure that European initiatives incentivise and not penalise industry to take the right steps towards the development of a sustainable and competitive transport system.

  When choosing the type of initiatives to reduce transport emissions, take into account that the development of sustainable transport requires a mix of initiatives to work in combination with each other (liberalisation, connecting infrastructure networks, energy-efficient and clean transport, ICT solutions, administrative procedures...).

  Ensure a high level of public commitment in infrastructure investment, including sufficient funding at both EU and national level.

- Develop a comprehensive, predictable and affordable energy policy:

  Promote cross-border trade and investment, and enhance financial risk-sharing facilities to leverage the €200 billion investment in energy infrastructure needed by 2020.

  Remove regulatory barriers, incentivise new entrants through the full implementation of the energy liberalisation packages and enforce coordination of market rules.

  Ensure overall policy coherence by strengthening the coordination of energy and climate policies at EU level.

Conclusions

Based on the concrete experience of companies, BUSINESSEUROPE recommends that the way forward to further integrate the single market focuses on the following key aspects:

- **Smart regulation:** European laws should serve people and businesses. Smart regulation is about the whole policy cycle – including implementation, enforcement, evaluation and revision. The financial and economic crisis has shown that regulation has an important role to play. It must be well designed to reach its intended objectives and to deliver sustainable prosperity and consumer protection.

"Completing the digital single market by 2020 will boost EU GDP by more than 4%"

- **Implementation and enforcement:** the entry into force of a piece of EU law in some cases means that the national legal frameworks need to be adapted, and that additional steps - like for example the creation or dismantling of agencies or the availability of new resources - are needed. This is an aspect of implementation where national practices vary widely. In case of crucial initiatives, where implementation requires more than pure legal transposition of rules, the 'mutual evaluation' process set out in the services directive should be applied.

  This will encourage dialogue among member states on how certain rules are implemented, increase mutual trust between authorities and improve understanding of different legal systems. In addition, it will enhance peer pressure for specific implementation processes and persuade member states on the need to take more ownership of the single market.

- **Transposition:** when including EU directives into their national legal frameworks, member states should first of all ensure they respect the timing indicated for transposition. Even more importantly, they must respect the substance of the directive, avoid ambiguities or additional requirements ('gold-plating') which could lead to additional unnecessary costs for businesses.

- **Mutual recognition:** trust is a key element of a well-functioning single market. Whether we talk about goods, qualifications, services or people, true free movement entails an element of mutual trust and recognition between member states. This principle should be respected and more widely applied in all areas of single market policy.

- **Problem solving:** despite the improvement, single market rules are often not applied correctly in specific cases. This is frequently due to their complexity and the fact that they apply in different legal systems. Thanks to their adaptability and flexibility, informal problem solving tools are usually the best way to tackle these situations.

  A good example is SOLVIT, the EU on-line problem solving network aimed at solving problems that citizens and businesses encounter because of the misapplication of single market law by public authorities, without having recourse to legal proceedings. Also, non-judicial dispute resolution instruments can be of help to businesses and

consumers when disagreements arise on the application of relevant single market rules, which can be particularly complex in case of cross-border transactions.

- **Information:** member states remain important actors in providing information about the EU. Information campaigns addressed to local authorities, companies and citizens throughout the European countries therefore need to be carried out at the national level. ■

1. http://ec.europa.eu/internal_market/strategy/docs/governance/com_2012_259_en.pdf
2. http://ec.europa.eu/internal_market/top_layer/monitoring/governance_en.htm
3. Eurostat is the EU statistical office, providing statistics that enable comparisons between European countries and regions.
4. http://ec.europa.eu/internal_market/top_layer/docs/monitoring/integration-reports/121128_integration-report-2013_en.pdf
5. Study by European Policy Centre and Copenhagen Economics, "The Economic Impact of a European Digital Single Market", March 2010.

The MFF: chronicles of a disagreement foretold

Jorge Núñez Ferrer is an Associate Research Fellow at the Centre for European Policy Studies

That the negotiations on the Multiannual Financial Framework (MFF) for 2014-2020 ended on November 23rd without securing an agreement should not have come as a surprise to anyone. Still, there was something different in the air this time round, marked by the relatively amicable way in which the disagreement was handled, in contrast to the acrimony and angst of the failed negotiations seven years ago under the Luxembourg Presidency. At this stage, it is likely that no Head of State held any illusions that an agreement would be reached. Such good-natured discussions, however, may turn ugly in subsequent meetings when the pressure to reach agreement mounts. In 2005, the then UK Prime Minister Tony Blair warned that the EU should never again enter into such destructive negotiations, but the risk of repeating that painful experience – or an even a worse one – is high.

Something missing in the Commission proposal...

It is convenient to blame the crisis for the breakdown in talks, but one must look further to explain the situation today. In 2005, Europe was basking in economic growth, but the criticisms levelled against the budget proposals were very similar. The issues raised then have not been adequately addressed. Are the Commission proposals so bad? Well, they are certainly not good enough, and we can trace the origins of their shortcomings to the budget review itself. It offered the perfect opportunity to analyse individual sub-budget lines and cut underperforming and obsolete lines with a view to streamlining operations. The opportunity was not seized, however, and the analyses and discussions remained at a very superficial and lofty 'eurospeak' level. The largely undefined 'value added' of expenditure was used equally to criticise and defend the different EU policies.

This exercise brought us little new on budget reform, because large policies cannot be judged as a package – only the individual components can be. In the absence of a proper analysis of the benefits of individual actions financed through EU policies, the review lacked the groundwork and thus any solid grounds on which to propose a significant restructuring of the budget. As a consequence, rather than eliminating questionable interventions, the Commission just added a long list of actions related to its increasing competences in the areas of energy, transport, research, etc. In short, it created a bureaucratic compromise that made space for important new priorities, but at the same time protected the traditional agricultural and structural funds.

The proposals also reflected current thinking within the Commission, selectively borrowing sentences from the budget review to pretend that the views of civil society had been taken into account. Among certain constituencies, in fact, the review process may have damaged the image of the Commission, as many felt that their opinions had not received serious consideration.

Tony Blair's speech of 2005 deserves a second reading today (good political speeches on the EU budget are rare). It was powerful and contained unquestionable truths. In summary, he said that the EU budget is out of touch with reality, disconnected from the needs of the European Union as an economic and political union facing an increasingly complex world. The difficulties the EU has had in coming to grips with the economic crisis and the evident uselessness of the budget as a tool to deal with these challenges should have sent a strong message to the European institutions and the member states on what has to be done.[1]

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Unfortunately, the member states have placed a different construction on the crisis and its implications for the EU budget. For some, it simply confirmed their belief that the budget is a wasteful instrument. For others it is seen as a financial pot to cushion the crisis. Sadly, the idea that we need to fundamentally restructure the logic of the budget to make it a powerful long-term investment tool is not widely appreciated.

Negotiating boxes and Herman Van Rompuy's surprise entrance

As the budget process proceeded, it slowly became clear that there was little chance that the Commission proposal would be found acceptable. Worryingly, the first Council compromise 'negotiating box' prepared by the Cypriot Presidency was far from satisfactory. Its proposals took a step backwards from the Commission proposal, reducing lines with a long-term investment objective, such as the Connecting Europe Facility, while protecting traditional expenditures. The proposals did not even touch the size of rural development funds.

But then, in a welcome and surprise development, Herman Van Rompuy, an additional 'technocratic' Council President, entered the fray. Realising that the Cypriot proposal was highly unlikely to succeed, and that it threatened to inflict damage on the most valuable areas of the budget, namely RDI and the Connecting Europe Facility, he magically launched a new proposal containing further cuts and an astonishing level of detail (suggesting that the work must have been started well before it was announced).[2]

Van Rompuy's first negotiating box had many merits, not least for being the first to seek to cut expenditure where it makes sense, for example in the Common Agricultural Policy and the Cohesion Funds. It has served as a far more useful negotiating base than the Commission's proposal or the Cypriot compromise, and has probably contributed to the relative calm of the discussions.

Where should we go from here?

Van Rompuy's strategy to protect core budget lines has been weakened by the insistence of some countries to protect the CAP and limit cuts to structural funds, including cuts to wealthier regions. France, as usual, insists on protecting the interests of the farm lobbies, and preserving a policy that suffers from a large deadweight loss. It is not that an agricultural policy is not useful, but the present allocation of funding is far from optimal and regressive.

Large, well-targeted reductions could be managed without significantly affecting the sector. France is worried that the cuts are occurring simultaneously with an increase in payments to new member states, which means that cuts would affect it proportionally more. Perhaps it is high time to resuscitate the concept of co-financing, particularly for wealthier member states.

More cuts are needed, but where? Apart from agriculture, there are a number of actions across the budget where the value-added is highly questionable. Approximately €50 billion are destined to go to richer regions in Europe, some of which may be directed into investments of European importance, but much can be reduced. It is telling is that the proposed cuts of these funds by Van Rompuy have now been reduced. If net contributors are so strongly committed to cutting the budget, then why not start with those?

Perhaps the time has also come to streamline the EU's operations. Granted, the Union is facing complex and difficult challenges, but its resources are spread across every imaginable domain. Furthermore, to please member states, over 30 agencies have been created and scattered across Europe, some of which are useful and important, such as the food safety agency or Eurocontrol, but others are much less so. For example, gender equality is undeniably an important goal and one worthy of promotion and regulation at the EU level, but can one justify the costs of devoting an entire agency to it? Or the agency for vocational training? Vocational training is to be designed by local authorities and based on national and regional needs. Is there a real need for a separate agency? The same questions are valid for other areas such as culture.

There is a need to bring refocus the attention of the EU institutions and policies on the core areas of the internal market, trade and energy, using some of the savings to expand the headings where common action creates savings at European level (something useful in times of crisis) and where joint action brings the highest long-term benefits for Europe. This is where a serious budget review would have been truly instrumental.

If there is a will, there is certainly a way to cut and to make the budget better and more effective, but all countries need to make concessions, with the largest costs falling on the wealthier member states. We also need to seize the opportunity created by the fact that net contributors are focusing strongly on the overall size of the budget and not, for once, constantly repeating the word net balance.

Is there going to be an agreement?

It is likely that there is eventually going to be an agreement on the budget, but one that is far from satisfactory and probably with a bottom line slightly lower than the one rejected by the Council last week.

But what happens if there is no agreement or if the European Parliament vetoes the agreement? The figures for last year of this MFF (2013) would apply provisionally in 2014 for as long as there is no new agreement (plus an inflation adjustment of 2%). This would of course wreak havoc with regional policy planning, etc., but it is all the rest that would be rather ironical: all rebates, VAT concessions, etc. for net contributors would no longer apply ... except for the UK rebate, which remains as a permanent feature. Not only would the rebate apply in full, but the ceilings and limitations imposed for this period would also end, giving the UK an even larger rebate.

Is this a good reason for Cameron to cause the budget negotiations to fail? Unlikely, because perpetuating the budget dispute is not even worth the extra rebate and may completely alienate the UK from the rest of the EU, in particular if an agreement is reached to cut the MFF

substantially. And will the EP veto the result? This move is also highly unlikely, because the agreement would reflect a very difficult compromise, and the European Parliament would not reap any benefit from reopening Pandora's box.

When is this going to end?

The good news is thus that there is most likely going to be a budget agreement before the summer, and possibly even earlier.

The bad news is that the EU budget will probably remain largely disconnected from the fundamental needs of the European Union. The instrument will continue to please particular lobbies and interest groups, whose contribution to Europe's future wealth and sustainability can be seriously questioned. But it will not be able to respond to crises and will be useless as an instrument to address imbalances in the eurozone. It will continue to be financed through absurd, opaque and largely incomprehensible contribution mechanisms, as there is little chance to introduce more meaningful resources. And last but not least, it will continue to inspire more headlines about waste and corruption, further alienating citizens of many countries from the European ideal; in other words, 'business as usual'.

"… the EU budget is out of touch with reality, disconnected from the needs of the European Union as an economic and political union facing an increasingly complex world"

This grim prospect also explains the sudden idea to create a eurozone budget, a kind of EU budget that matters … as opposed to 'the budget that matters little'? Maybe it is high time to exchange the one we have with such a budget, but unfortunately, there are no takers among our leaders, whose ears are mostly attuned to the voice of organised lobbyists and interest groups. An EU budget that would benefit all of us in the long-term does not cultivate strong and politically meaningful support groups. ■

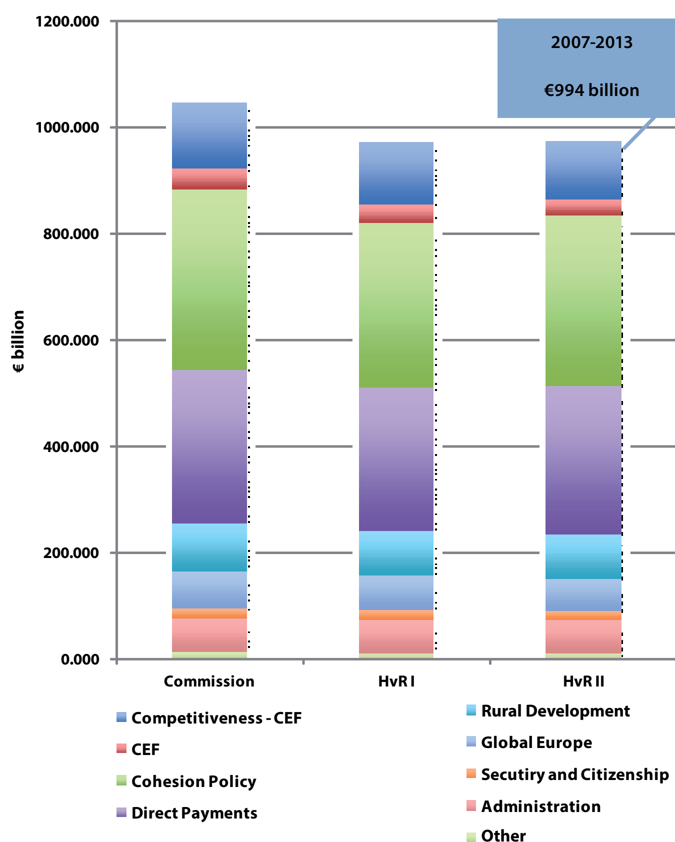
1. See, for example, J Núñez Ferrer and D Tarschys (2012), Investing where it matters: An EU budget for long term growth, CEPS Task Force Report, CEPS, Brussels.
2. See annex for a review of the figures.

Annex
The budgets compared: Commission and Van Rompuy's I and II negotiation boxes (€ million)

***Adjusted to 2011 prices.**
**** Author's adjusted figures for 2007-2013, represent similar categories. Table does not include all subcategories.**

	2007-2013*	Commission Proposal	HVR nego-box 13 Nov.	HVR nego-box 22 Nov.
Competitiveness	**91,495**	**164,316**	**152,652**	**139,542**
Of which: Connecting Europe Facility	12,783	40,249	36,249	31,249
Cohesion Policy	**354,815**	**338,994**	**309,495**	**320,148**
*Of which: for poorer regions***	195,744	162,600	156,236	161,427
*Of which: for transition regions***	25,290	39,000	29,187	31,393
*Of which: for richer regions***	53,867	53,100	47,505	50,872
*Of which: Cohesion Funds***	67,921	68,700	65,928	66,341
Natural Resources	**420,682**	**389,972**	**364,472**	**372,229**
Of which: CAP Direct Payments and market related expenditure	304,830	286,551	269,852	277,852
Of which: Rural Development	95,741	91,966	83,666	83,666
Security and Citizenship	**12,366**	**18,809**	**18,309**	**16,685**
Global Europe	**56,815**	**70,000**	**63,690**	**60,667**
Administration	**57,082**	**63,165**	**62,629**	**62,629**
Compensations	**0,920**	**0,027**	**0,027**	**0,027**
TOTAL	**994,176**	**1,045,282**	**971,274**	**971,928**
Other, outside MFF	**40,838**	**46,268**	**37,582**	**36,883**
TOTAL II	**1,035,013**	**1,091,551**	**1,008,856**	**1,008,810**

Sources: European Commission; www.europolitics.info, www.u4unity.eu (VR_NG_Analysis); and www.euractive.com



Note: Does not include figures outside the MFF.

Source: Author's own rendering.

Is ‘internal devaluation’ the right approach for the eurozone?

Raoul Ruparel is Head of Economic Research at Open Europe

With the final budgets and growth forecasts now published, 2013 is shaping up to be a very difficult year for the eurozone – even despite a seemingly less volatile environment. In particular economic growth across the currency bloc looks to be stagnating with even Germany, the supposed economic powerhouse, facing the prospect of only 0.4% growth in the next calendar year. Notably, the plans for fiscal consolidation and internal devaluation are coming under increasing scrutiny.

In our recent paper, *‘Can struggling eurozone countries achieve the necessary ‘internal devaluation’– and at what political cost?’*, we assessed the current approach to crisis and provided a comparison to areas where such ‘internal devaluation’ is often seen to have been a great success – namely the Baltic states in the aftermath of the financial crisis. In this article I will lay out the key findings of the report and build upon its conclusions.

Why internal devaluation?

The standard approach to wide and deep economic reform combines structural reforms with a looser monetary policy – ie. a currency devaluation. Unfortunately, this option is not open to those countries in the eurozone, so the adjustment must be achieved by nominal prices, wages and asset values falling.

A similar outcome is achieved, albeit in an often more expensive and tricky way for three key reasons. Firstly, it involves changing many prices (and wages) across the economy, rather than just one (the exchange rate). Secondly, prices and wages are often *“sticky downwards”*, this is because the process often involves firing workers, cutting pay or even shutting businesses – all of which have significant social and political fallout. Thirdly, in heavily indebted economies, although prices and wages may fall the burden of international debts does not.

These three factors can be seen at play in the eurozone, particularly in the ‘austerity’ programmes in Greece, Spain, Italy and Portugal.

How much internal devaluation is needed in the struggling eurozone economies?

The divergence in competitiveness between the eurozone economies is now well known and has become a hallmark explanation for the eurozone crisis. Graph 1 highlights that by 2008 German real unit labour costs were almost identical to those in 1999 (although they have subsequently risen by close to 10%). By contrast, Irish real unit labour costs had risen by some 46% by 2008 but by 2011 were only 31% above their 1999 level.

What level of divergence is sustainable in a single currency?

The follow on question is then, what level of unit labour cost divergence is acceptable or sustainable within a single currency? This is incredibly tough to answer but looking at other currency unions (or single currency areas) notably the US and Germany a range of between 10% and 15% difference between the strongest and weakest regions emerges as manageable. Crucially, these other currency unions had a combined fiscal budget, which the eurozone lacks, but this at least provides us with a scale upon which to measure the level of divergence.

Graph 2 shows the differences between the ‘peak’ labour costs in the Portugal, Ireland, Italy, Greece and Spain (PIIGS) countries and in Germany (during the existence of the euro). It also demonstrates how much internal devaluation had been achieved by 2011 and shows the IMF forecasts for 2012 (although given that many countries are off track from their reform programmes we believe meeting these targets is unlikely in many cases). The shaded area shows the range at which labour cost differences could usually be maintained in a currency union. But again, given the unique structural flaws of the eurozone, the levels may in fact be even lower.

There are a few interesting points which can be drawn from this graph. Firstly, it’s important to keep in mind that Greece is far from achieving the 2012 levels laid out in the green bar above. The significant delays due to the two elections this year have put pay to any chance of this target being met; as such significant adjustment is still needed.

Secondly, Spain appears to have good progress and now has relatively less additional reduction to achieve than Italy, Portugal or Greece (given its starting point), although the rapid rise in unemployment suggests it has paid a price for this.

Thirdly, the graph does not bode well for Italy particularly given the escalating political crisis. So far, Italy has made little effort to reduce its costs and the reformist zeal of any future government is unclear at best. Despite having the smallest gap to be closed, Italy can ill afford to fall further behind other eurozone countries in terms of competitiveness. The

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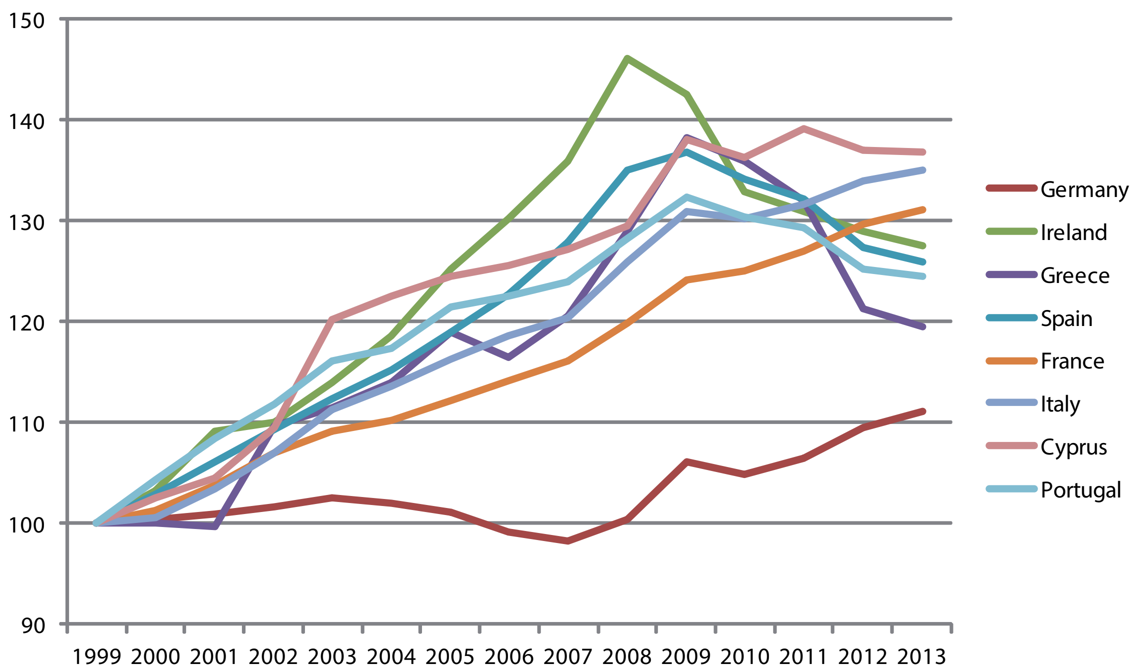
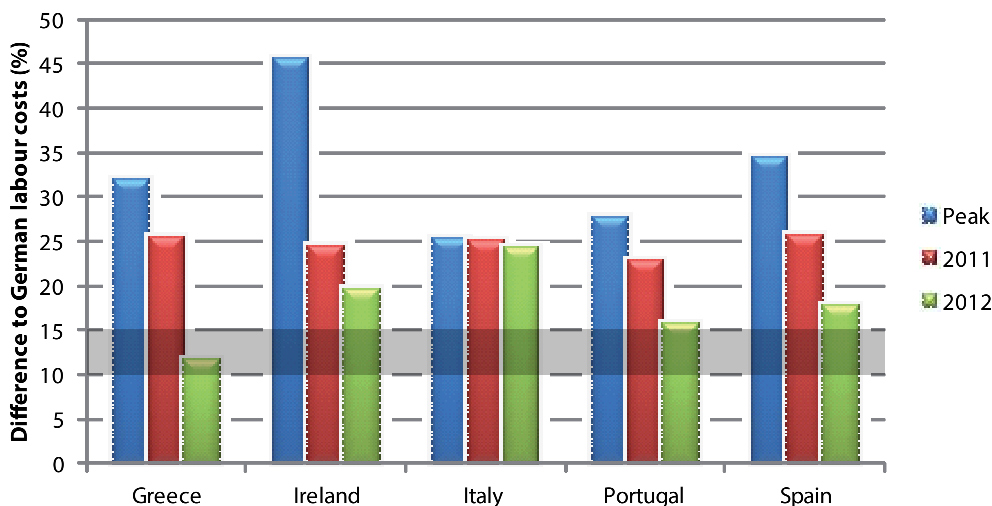
Graph 1: Real unit labour cost trends selected euro members (1999=100)



Source: Eurostat and Europe Economics (updated by Open Europe)[1]

Graph 2: Degree of internal devaluation required to return unit labour costs to German levels



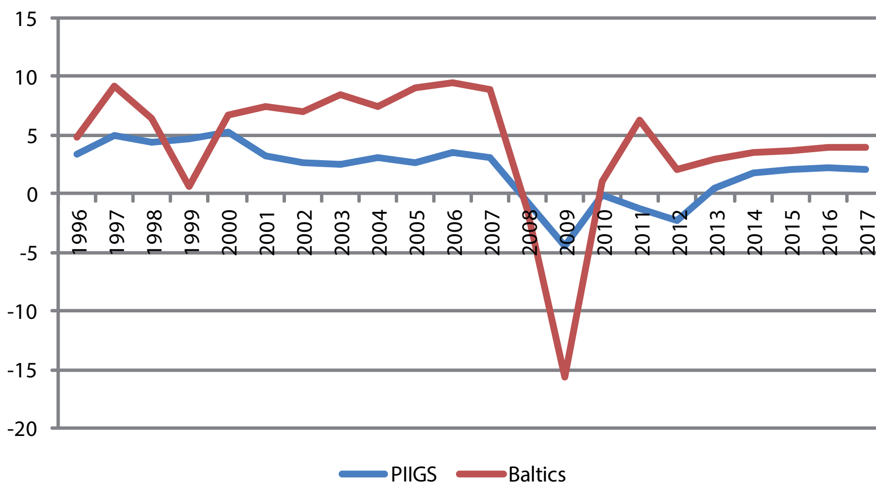
Source: Eurostat and Europe Economics. All "Peak" years are 2008 except Greece, which is 2009, while 2012 figures are forecasts[2].

additional fact that little has been done to improve the business climate or reduce bureaucracy significantly only worsens the picture for the Italian economy.

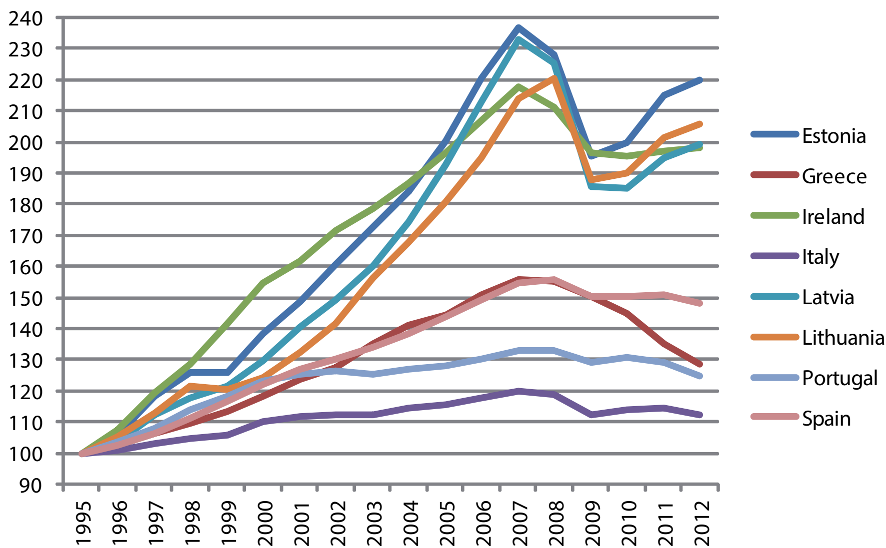
Lastly, Ireland has clearly made the most substantial adjustment, although it had the farthest to go. It's worth keeping in mind that Ireland's ability to make such an adjustment and the reason behind the rapid rise in labour costs are likely due to similar factors (flexible labour market, low regulatory burden, and skilled labour force). Looking at the substantial differences between countries within a single currency and with the broader impact of the crisis in mind (high unemployment, rising social unrest in places and often fractious political debates), it leads one to ask, in what sort of environment can internal devaluation be successful? Do the struggling eurozone countries fit that mould?

What can the Baltic experience teach us?

The most often cited example of where internal devaluation has been a success is that of the Baltic countries (Latvia, Lithuania and Estonia). Following the financial crash the Baltic countries found themselves with plummeting domestic demand, troubled financial sectors, falling exports and limited access to credit (both public and private). The fall in GDP was inevitable due to the boom (based on short term cheap capital). The decision they faced was how to best deal with it and recover. Ultimately, they had two choices: currency devaluation (by breaking their euro peg)



Source: IMF WEO



Source: IMF WEO (April 2012)

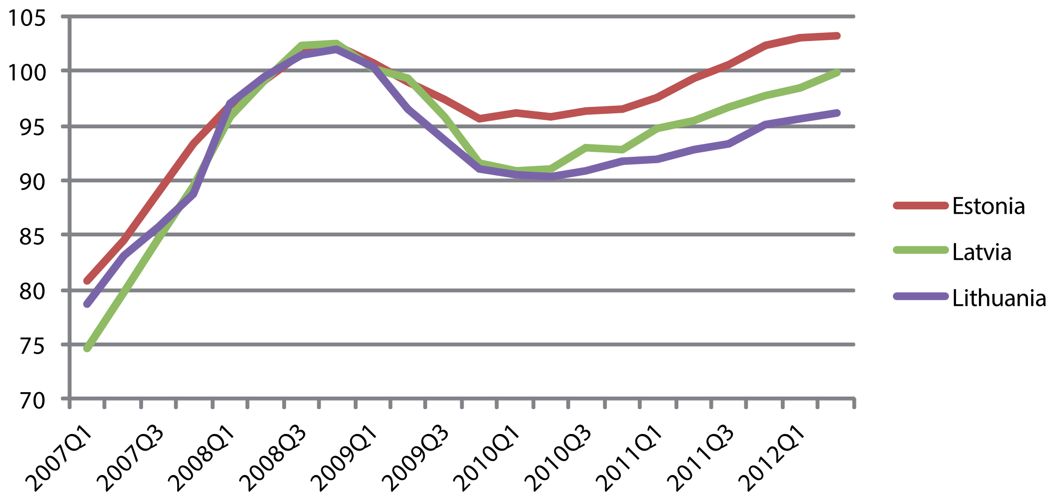
or internal devaluation. They chose the latter. They are now experiencing fairly rapid growth, with many predicting a similar outcome if the eurozone stays the course on internal devaluation.

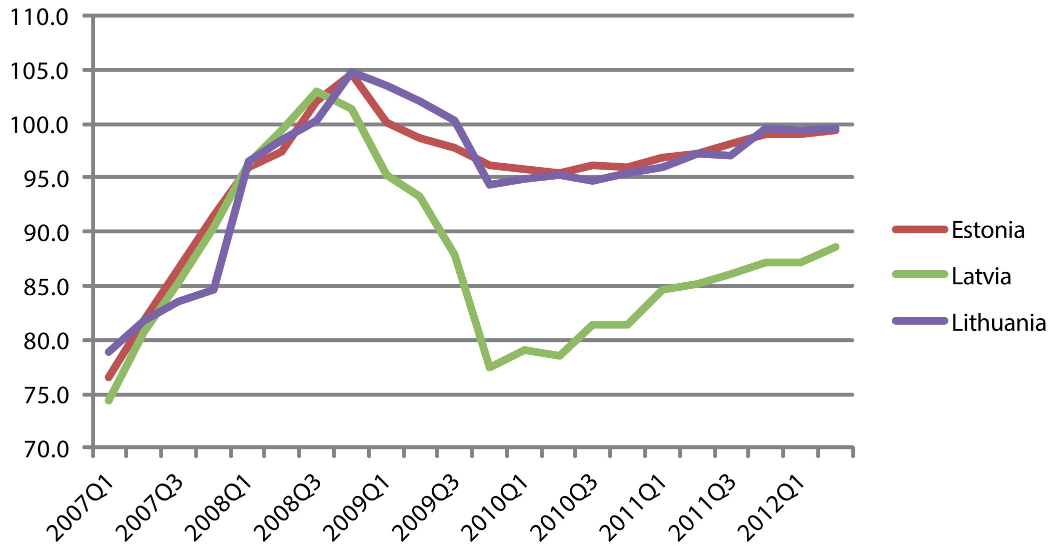
The first lesson is simple: large degrees of internal devaluation are economically possible under the right conditions – notably: a flexible economy, manageable debt and sufficient buy-in from the population. Without the right conditions though, it can be incredibly painful for the economy and the wider population. The second lesson is that in purely economic terms, internal devaluation may be better for the long term health of an economy than currency depreciation as it makes the economy both more robust and more competitive. It's not, in other words, a shortcut – this is particularly relevant when the long term currency setup for these countries is always seen to involve some form of integration.

But there are a few key differences between the experiences of the Baltic states and those of Portugal, Italy, Greece and Spain.[3]

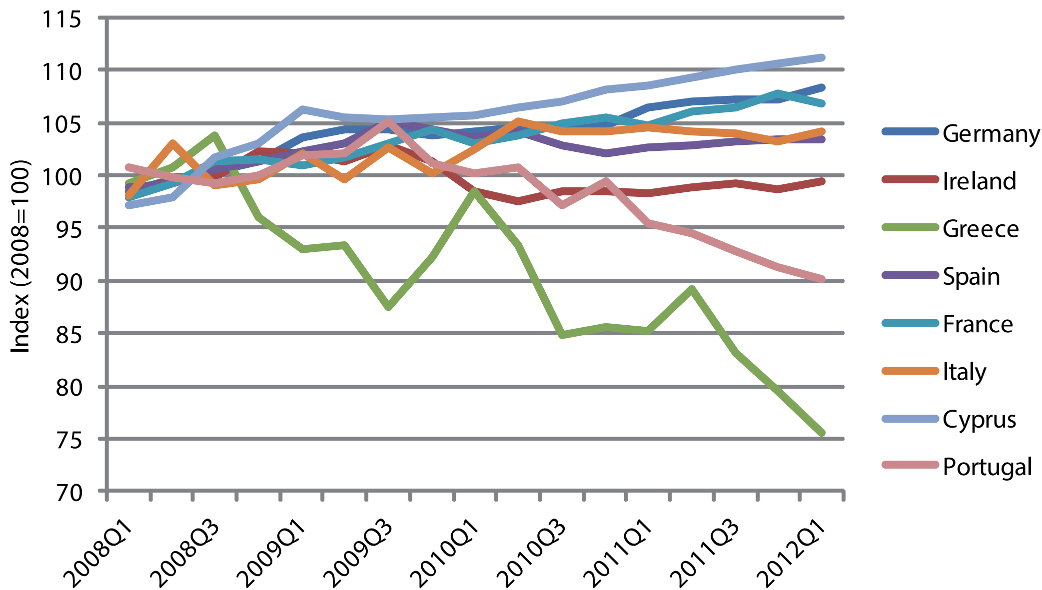
First, from 1996 to 2007 the Baltics grew at an average of 7% a year, while the PIIGS grew at only 3.6%, with some states showing much lower growth (Italy and Portugal) as highlighted by Graph 3. This matters for fundamental political and cultural reasons: a significant contraction in wages and GDP had less perceived effect in the Baltics since the population had yet to consider such a high standard of living as the new normal.

To illustrate just how an important difference this is with respect to the willingness of citizens to stomach internal devaluation: between 2007 and 2009 Estonia, Latvia and Lithuania saw their real GDP contract by 17%, 20% and 15% respectively. However, this only took these countries





Source: Eurostat Labour Cost Index (2008=100)



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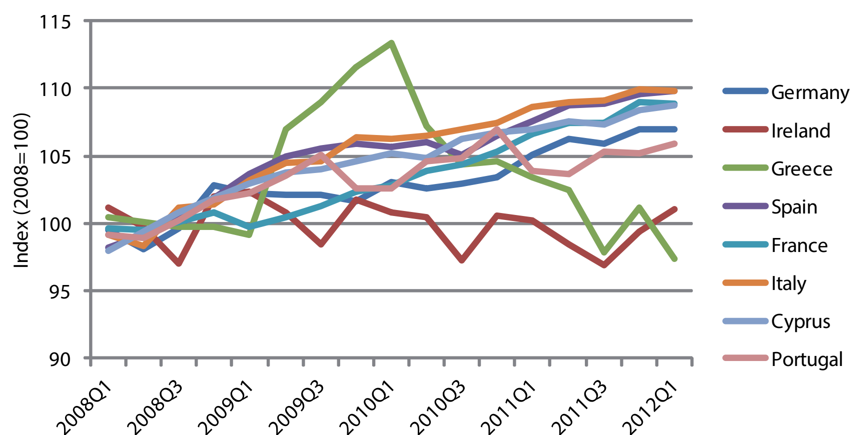
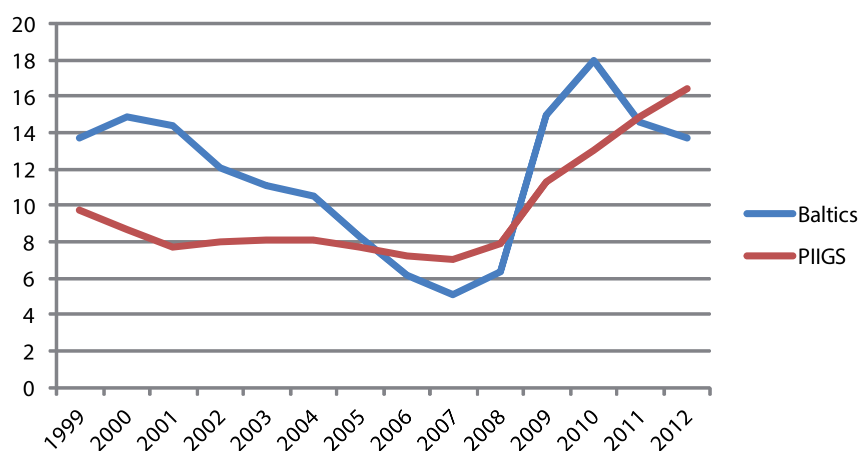
Graph 8: Private sector internal devaluation



Source: Eurostat Labour Cost Index (2008=100)

Graph 9: Unemployment rate (%)



Source: IMF WEO

back to the real GDP levels seen in 2004/5. Conversely, the 17% contraction in Greek real GDP by 2013 (as is expected by the IMF) puts Greece back at 2002 levels. Similarly, a 20% reduction in the Portuguese economy, would take it back below its 1995 level, a reversal of 17 years. In the case of Greece and Portugal, this means a decade or more completely lost. Meanwhile, graph 4 demonstrates that Ireland's GDP path looks much more like the Baltic countries than the other peripheral ones, providing an answer as to why it was able to achieve such rapid adjustment.

The eurozone economies in question have become used to their high standard of living for a long time and have also become accustomed to other features of rich countries such as an expansive welfare state and high levels of public services (both of which are being cut at the same time as internal devaluation is being imposed).[4] Contrary to this, the Baltic economies saw a similar boom and bust in the early 1990s and the population is more accustomed to greater levels of political and economic volatility.

Another important aspect of the Baltic experience was that the internal devaluation approach has buy in across the whole economy. Unfortunately, so far this does not seem to be the case in many of the eurozone countries. Comparing graphs 5 and 6 to 7 and 8 makes this clear.

The impact of having 'buy-in' across the economy for a policy such as internal devaluation should not be underestimated.[5] It could have maintained political stability and had less of a distortionary effect on the economy, particularly in terms of capital allocation. It is also particularly important in economies such as the struggling eurozone states where the public sector represents a large part of the economy (often well over 50% of GDP) and employs huge numbers of people – many of whom are well represented by often powerful and vocal unions.[6]

There are plenty of other factors to consider with respect to the Baltic experience as well. In particular, these countries had relatively low debt levels compared to the PIIGS (Estonia at 5%, Latvia at 17% and Lithuania at 15%) when their adjustments took place, allowing for more fiscal manoeuvre than is currently open to the eurozone states. They also managed to rapidly increase their exports in the ensuing years due to a recovery in emerging markets and, at the

time, the eurozone riding out the initial financial crisis fairly well. There was also some emigration during this period for the Baltics which helped manage the per capita fall in GDP somewhat.

Clearly, the case of the Baltic states show that large scale internal devaluation is both economically possible and desirable in terms of boosting economic growth. But internal devaluation also produces a politically explosive combination of falling wages, rising unemployment and potentially plummeting real GDP – all leading to a reversal in living standards.

This is likely to be acceptable in countries where there has been recent rapid economic growth and where the current generations are used to political and economic instability. If this is not present it is possible that internal devaluation pursued at a rapid pace and often along with fiscal consolidation, could have negative social and political effects which will ultimately hamper any economic benefit.

Can the eurozone populations' stomach internal devaluation?

One key final similarity between the Baltics and the PIIGS is the significant rise in unemployment which the internal devaluation has caused.

The extent that these job cuts were needed to enforce the necessary wage decreases and productivity increases highlights the key problem of downward wage rigidity in many of these economies. Meanwhile, the increase in the labour cost index for the Baltics, despite persistent unemployment (see Graph 5), shows how difficult it is to make these adjustments permanent.

This also highlights the significant pain involved with internal devaluation in the eurozone. This is made all the more difficult given that, in many cases, the policies are being largely driven by politicians and officials in foreign capitals, who cannot be voted out of office, cutting across

"The first lesson is simple: large degrees of internal devaluation are economically possible under the right conditions – notably: a flexible economy, manageable debt and sufficient buy-in from the population. Without the right conditions though, it can be incredibly painful for the economy and the wider population."

these countries' very democratic settlements. Naturally, there is no way to say for sure when the political limit for cuts and austerity is reached.

However, polls in the PIIGS show a clear trend of declining support for the EU and an erosion of public trust in political institutions both at the European and domestic level. Combining this with protests on the streets of Athens and Lisbon, and regional discontent in Spain illustrates how that limit may be approaching.

Necessary but not sufficient?

Overall then, although internal devaluation is workable in certain situations and has the potential for long term benefits it is not clear whether it is being done in the correct policy package or at the right speed in the eurozone. Therefore although internal devaluation is necessary (as these countries need to return to competitiveness) it is unlikely to be sufficient to solve the eurozone crisis, no matter how the issue develops, the eurozone will also have to find ways to tackle issues such as a one-size-fits-all monetary policy, ailing banking sector and the lack of political and fiscal cohesion. ■

1. The figures for 2012 and 2013 are forecasts and are based off current policy proposals. Since many of the cuts and reforms aimed at achieving these levels of devaluation may not be achieved it is possible that the actual reductions of the next couple of years could be substantially different than these predictions.

2. The figures for 2012 are forecasts and show the expected level of labour cost reduction which these countries should have achieved by the end of this year.

3. The broad policy approach in the Baltics and in the PIIGS now is very similar. Such an approach is often the response to a crash in real GDP but can also further the steepness of the decline (in exchange for a quicker rebound). The main reason for looking at real GDP of the two groups is to illustrate the potential impact such a policy could have and the difficult circumstances surrounding it. It also speaks to the standard of living to which these countries had become accustomed to.

4. The real GDP graph provides one further point worth considering, although the Baltics are growing quickly they did experience significant drops in GDP which are yet to be recovered – in fact the IMF forecasts do not see real GDP returning to its peak until 2016/7. This ultimately suggests it may be too early to fully judge the impact of the internal devaluation approach in the Baltics.

5. The Labour Cost Index compiled by Eurostat shows the short term developments in the total cost, on an hourly basis, of employing labour.

6. It's not immediately clear why the private sector is yet to show a similar adjustment, despite significant pressure, but it could be that firms have focused more on reducing the number of workers rather than cutting salaries (this fits somewhat with the increasing unemployment seen in these countries). The index also incorporates indirect labour costs such as taxes and social security contributions. In many cases these have been increased and may counteract some of the adjustment. It may also simply be because the public sector saw much more rapid increases over the past decade and therefore may find it easier to reduce wages quickly but should also take more of the burden.

Only citizens should determine whether there is a European 'demos'

Patrick van Schie is a historian and director of the Telders Foundation, the Dutch liberal think tank, affiliated to the political party VVD. He wrote this contribution in a personal capacity.

The euro crisis draws heavily on the mutual involvement of citizens from various EU member states and, as such, on a European affinity among citizens, which is not generously on hand to begin with. In southern member states that were seriously affected by the economic and financial crisis - like Greece and Spain - huge sacrifices are demanded from the citizens, among other things so these countries can be maintained as members of the eurozone (even though also without pressure from Brussels, they obviously would need to reform their economies). In the northern member states – like Germany and the Netherlands – there is growing resistance against more guarantees, loans, extended repayment terms or other forms of financial support to southern member states, also because the citizens of the northern countries have little faith in their politicians' solemn oaths that this support will eventually be returned.

It is precisely under these circumstances that proposals to intensify the European integration are heard from all corners. German Chancellor Angela Merkel is pushing for some form of European Political Union. This is grist to the mill of those who have always argued that an Economic and Monetary Union would never work without a political 'roof' over it.

This autumn, the chairmen of the liberal and green groups in the European Parliament, Guy Verhofstadt and Daniël Cohn-Bendit, put forward a plea for a 'federal' Europe where within the European Commission shall operate as a European government and which will transfer much more authority to Brussels. While the governments of all member states of the European Union are struggling to get their finances in order and attempt to curb their expenses in connection with this, the European Commission, supported by a majority of the European Parliament, is asking for substantially more money for the next seven years.

Some are of the opinion that the latter is quite justifiable. Coen Teulings is the director of the Netherlands Bureau for Economic Policy Analysis (CPB) – an organisation not to be confused with an actual planning bureau, but rather an institution that assesses economic scenarios – and he argues that the expenditure of the European institutions at approximately 1% of the GDP is exceptionally minor, compared to the expenditure of the federal government in the United States, which spends about 20% of the GDP. In the United States it is therefore no problem whatsoever that California is bankrupt, because this is covered by Washington. Teulings therefore fails to understand why an outright Greek bankruptcy is made into so much of a problem in Europe.[1]

Teulings is a competent economist, well-respected in his country. Still, by making the comparison as such, he inadvertently exhibits outright incomprehension prevalent among many politicians, administrators and 'experts', about the resistance among citizens against more Europe.

Politicians, administrators and experts in favour of increased central European income and authority are concerned with necessary steps on a path already taken. Among them are some that have their own interests in mind – after all, the European Commission and the European Parliament have every interest in expanding their power at the expense of other tiers of government – but apart from this, a sincere conviction is manifest that a number of problems can only be solved on a European scale and that a monetary union will automatically require more economic and political integration.

Regardless of the question as to whether the supporters of a 'giant leap forward' in European integration are right in terms of its current advisability – which is by no means certain – a technocratic approach as such, will not suffice. The great 20th century liberal philosopher of science Karl Popper has dismantled the image of history as an *"inevitable necessity"* – in the European metaphor: a train with an irrefutably fixed destination, with no intermediate stops or the opportunity to take an exit or return – ; history knows no (higher) purpose, but is the outcome of human decisions, which might also have turned out different.[2] Before him, proponent of social liberalism and sociologist Leonard Hobhouse had already exposed thinking in terms of 'unavoidable' developments as rhetorical trickery: *"Intellectually, this method is one of confusion; morally, it is paralyzing to the will."*[3]

Indeed, politics would in large part be reduced to a pointless activity, or to having merely marginal effect, if it would not include more than doing what unavoidably should be

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"The essence of a democracy is that the voters have the final say and that those in power, regardless of what they think of such a pronouncement, should acquiesce to this"

done anyway. Furthermore, politics in a democracy is much more than one-way traffic in which politicians 'explain' their policies to citizens. Politicians will have to convince citizens and this will only succeed with the power of substantive arguments. Ultimately, the citizens are boss in a democracy; at least that is how it should be. There is no indisputable right. In a democracy it is about who is put in the right, about which story citizens attribute the most value to and above all, about the question which values citizens attach to most.

Supporters of increased European integration are often convinced that resistance against this, displayed by citizens, arises from ignorance or narrow-mindedness. When citizens reject their proposals – for instance if they oppose an increase of the European budget, or additional loans to member states in trouble, or the objective of a federal Europe – then they have simply been insufficiently informed or misinformed, as it is then called.

The obvious remedy for this would seemingly be 'increased provision of information'. If, after such an 'information campaign', citizens persist in their opposition, many politicians will become irritated. They will subsequently 'reach the conclusion' that the citizens apparently are either ignorant or misled by 'populists'. If citizens are too ignorant – and proving themselves susceptible to the voices of so-called 'populists' in this manner of reasoning is soon regarded as a sign of minor intellect – we need not ask them anything anymore.

Failure to consult the French and Dutch electorate about the Lisbon Treaty, after these voters had rejected a virtually identical text for a European constitution in 2005, falls into this category. Brussels and the government leaders of the member states at the time were of the opinion that the citizens of France and the Netherlands should have said 'yes' then and that sensible voters could do little else but say yes. In their eyes it was, in fact, impossible that citizens would dare to say 'no' to their wonderful treaty just like that.

In a democracy, however, there is not just one 'correct' answer. The essence of a democracy is that the voters have the final say and that those in power, regardless of what they think of such a pronouncement, should acquiesce to this. Ultimately, the real opportunity to say 'no' is what distinguishes a democracy from a dictatorship.

European integration, with the exception of some countries like Denmark and Ireland, has come about without the involvement of the voters. As long as things revolved around breaking through trading obstructions and thus establishing an internal market, this was not much of a problem. However, through the course of time, one thing has led to another, as it was envisioned by various early builders of Europe and as a result of spillover effects or purposeful political decision-making, many policy domains have more or less been Europeanized.

Governments and national parliaments can then no longer, or only within certain boundaries, decide on such matters. Moreover, a complete system in which money is circulated has been constructed, from agricultural and cohesion funds to the more recently installed safety nets under the monetary union (various actual bailing out constructions that are in violation of the EMU treaty).

In the greater majority of EU member states, the citizens were never asked what they thought of the transfer of authority to Brussels and whether they would be willing to 'show solidarity' with Europeans outside their country's borders. The formal defence of many politicians and other supporters of more Europe is that in national elections, the citizens gave the mandate for such decisions to their governments and members of parliament. These supporters further argue that the citizens were also given the opportunity to take part in the decisions through the European Parliament.

However, in national elections, issues concerning European integration are hardly ever addressed; for instance when the EMU was established with the Treaty of Maastricht in 1992, the political parties in most member states had not even touched upon this whole project in their programmes for the preceding parliamentary elections. In addition to this, the European Parliament has a problem with legitimacy. The low turnout figures for the elections of this body show that many citizens do not consider themselves represented by it; besides, these turnout figures paint a doctored picture, because of the compulsory attendance that some countries have (for instance Belgium and Italy).

Moreover, the composition of the European Parliament increases this lack of legitimacy, because in many countries the most prominent parties merely nominate Europhiles in various gradations as candidates. Would you like to continue with European integration, would you like to integrate even faster or would you like to take a giant leap towards federal Europe?; these are just about all the flavours that the citizens may choose from for the European Parliament in most member states.

The fact that a greater majority in both the European Parliament and the European Commission in unison request for a substantial rise of the budget for the next seven years, while in the national member states governments with more or less success and especially the citizens are forced to tighten their belts, is evidence of to what extent the 'Brussels' community is living in a different world, where there is little insight in or sympathy for everyday life.

Pleas for a relatively much larger budget – in comparison with the member states – for the central bodies in Europe, aiming towards the American situation, fail to recognise

an essential difference between the United States and the European Union. In the United States there is a clear American identity, shaped in the 'melting pot' the country has always been and strengthened by a shared history. The European Union does not have such a shared identity. It is felt by those people earning a living in Brussels and a small percentage of inhabitants of the EU member states, but for by far the majority of inhabitants the national identity is the determining factor. This identity directly restricts the solidarity that is felt and that may be expected across the borders of the nation state.

"Solidarity in a democracy should be the outcome of an independent social development and not the result of pushing and pulling from above"

Bigger budgets for the European Commission, a European deposit guarantees system, amendments to the EU treaty that are contemplated to strengthen the monetary union and a European Political Union all imply that more mutual European 'solidarity' is asked of the citizens. Van Rompuy (president of the European Council), Barroso (president of the European Commission), Juncker (president of the Eurogroup) and Draghi (president of the ECB) demand 'fiscal solidarity' even openly now and in the scope of this, they try to force an 'integrated budgetary framework' and a 'fiscal capacity' on the government leaders. It is conceivable that identity and the question as to how far solidarity will extend along with this, will change in the future; these are no irrefutable factualities.

However, in a democracy this should be the outcome of an independent social development and not the result of pushing and pulling from above (which, in fact, is often counter-productive). In other words, it is up to the citizens to determine if and to what extent they support further European integration. Henceforth, a new treaty or a treaty amendment should therefore be put before the voters in all member states in a binding referendum, before it may come into effect.

Had this path towards treaty amendment been followed only after approval from the citizens of the participating member states in the past, the gap between Brussels and the citizens of the European Union would not have grown the way it has. Then the integration would either not have gone so far that the citizens regard it as unacceptable, or the citizens would have committed themselves to further steps through the referenda and they would not have felt as if politicians had imposed something on them.

Many will confront me, as a liberal, with the fact that liberals have a preference for representative democracy, where citizens assign the decision-making to parliaments and forms of direct democracy are avoided. The system of representation is indeed most appropriate for all sorts of daily decision-making; most citizens probably would not wish to be bothered with the multitude of guidelines or legislative proposals passing through parliament in Brussels or in the national capitals.

However, in case of treaties with a constitutional character – of which the EU treaty that lays down authorizations and in fact determines the proportions of the 'demos' is a pre-eminent example – the foundation of the democratic society is at issue. Who, in fact, are the citizens altogether? What are the boundaries of society and what the rules of play there within? In whom is vested the sovereignty?

Since seventeenth-century liberal philosopher John Locke, the answer to the last question has always been crystal clear for liberals: the sovereignty is neither vested in God, nor the monarch, but in the people. It is therefore not up to the monarch (the government) or parliament to shift this sovereignty. Locke expressed this as follows:

> *"The power of the Legislative being derived from the People (...), the Legislative can have no power to transfer their Authority of making Laws, and place it in other hands (…). The Legislative neither must nor can transfer the Power of making Laws to any Body else, or place it anywhere but where the People have."*[4]

If the European Union ever wishes to become a union of citizens, it should take to heart this lesson in its entirety, including the subsequent requirement of binding referenda in case of treaty amendments. No democratic regime will survive if it continues to ignore its citizens; for the European Union, this will be no different.[5] ■

1. Coen Teulings in the Dutch TV-programme 'Buitenhof' on 25 November 2012.
2. Karl Popper, The Poverty of Historicism, 1959.
3. Leonard Hobhouse, The Metaphysical Theory of the State. A Criticism, Honolulu/Hawaï, 2004 [originally 1918], p 16.
4. John Locke, Two Treatises of Government, Cambridge, 2000 [originally end of 17th century], § 141-142, p 363.
5. More on the validity of the referendum from a liberal tradition: Patrick van Schie, 'Citizens and the Casting Vote. The Referendum's Place within Liberal Ideology', in: Fleur de Beaufort and Patrick van Schie (eds.), Democracy in Europe. Of the People, by the People, for the People?, Brussels and The Hague, 2010, pp 49-67. The text can be downloaded from www.teldersstichting.nl, click above right on 'English' and then down the following page on 'Publications in English'.

Fiscal discipline in the monetary union

Charles Wyplosz is Professor of International Economics at the Graduate Institute, Geneva, where he is Director of the International Centre for Money and Banking Studies

For the euro to survive, the recession must be halted without piling on more debt. This column argues that the unpalatable conclusion is that public debts must be written down. The massive moral hazard problem this will cause must be dealt with by making sure that public debts will never again be allowed to grow to unsustainable levels. To this end, decentralised US-style fiscal discipline is needed.

Three years into the eurozone crisis and public debts are still rising, including in the three countries currently subject to rescue programmes. More countries – Spain and Italy for sure, France quite possibly – are inching towards rescues. These nations have three things in common:

- They share the common currency;
- Their economies are in recession; and
- They have adopted austerity policies.

They are also trapped in a 'circle of impossibilities'.

Circle of impossibilities

If they are to remain in the eurozone, these nations must exit recession. This, in turn, will require an end to austerity policies[1] . But given their massive indebtedness, they cannot embrace expansionary fiscal policies; even abandoning austerity may be impossible. One solution would be more lending from other eurozone governments, but in today's climate such lending would surely come with austerity conditions that would defeat the whole purpose.

So how do we break out of this circle of impossibilities?

In my recent work, I argue that high public debts form the quagmire that is dragging down eurozone members[2]. These debts blossomed since the global crisis began in 2008, but many members ran budget deficits for decades. We have to accept that many EZ nations have been fiscally undisciplined. This leaves us with two very different but profoundly connected issues:

- The legacy of unsustainable public debts;
- The need to establish fiscal discipline in the eurozone.

The debt legacy problem

The debt legacy shuts off key exits from the circle of impossibilities. After all, governments with much lower debts would have the fiscal space needed to end austerity and pursue expansionary policies. How then can debts be lowered fast enough to save the euro?

One solution would be a burst of inflation. That cure, however, is worse than the disease. The only remaining solution is debt restructuring. And it would be a solution since a vast body of literature[3] shows that defaulting countries quickly recover market access. Sovereign restructuring sounds radical, but much less so if it is seen as (i) an act of desperation arising from an unprecedented situation, and (ii) something that will never happen again.

The 'never again' requirement is the connection between legacy and the fiscal discipline exigencies.

The fiscal discipline problem

We need to do better than we have done since 1999. The future of the monetary union hinges on establishing sure-fire fiscal discipline. This is not a new problem. Every federal country, in effect every monetary union with federal features, faces the same necessity. This means we have countless policy experiments to learn from. Two polar cases are instructive.

- The German centralised discipline model; and
- The US decentralised discipline model.

While the German Länder are fiscally sovereign formally, discipline is imposed, monitored and enforced centrally[4]. The federal government imposes rules such as the 'golden rule' and more recently the debt-brake rule that came with

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"The future of the monetary union hinges on establishing sure-fire fiscal discipline. This is not a new problem. Every federal country, in effect every monetary union with federal features, faces the same necessity"

the 2009 constitutional change. Through many informal channels, the centre exerts pressure on the Länder and it can take the recalcitrant ones to the Constitutional Court. Despite this, failures have occurred. Since 1945, two Länder (Bremen and Saarland) have been bailed out.

The US model is the other polar case. As in Germany, US states are fiscally sovereign. During that nation's first 60 years, the US experienced countless bailouts[5]. All that stopped when the US Congress rebelled in the 1840s and rejected bailout demands. Since then, the US has effectively operated a no bailout rule. The states soon realised that the regime had changed and guess what? All but one of them adopted stringent fiscal rules that they enforced in their own state-level supreme courts. Incentives matter. With a couple of post-Civil War exceptions, 150 years have passed without bailouts.

Why the eurozone needs the US model

The US model is better adapted to Europe for two reasons.

- It fully respects fiscal sovereignty at the sub-central level.

This is important since EZ parliaments are very unlikely to give up even a centimetre of fiscal sovereignty.

- The US model works better than German model.

This is shown in the following table that exhibits debt-to-GDP ratios for the 50 US states and for the 17 German Länder.

	Germany (17 Länder)	US (50 states)
Minimum	6.7%	2.3%
Maximum	66.9%	19.6%
Average	31.7%	8.3%
Total	24.2%	7.7%
Standard deviation	17.0%	3.9%

Average state debt in the US stands at 8.3% of state-level GDP; the corresponding figure for German Länder is 31.7%. Crucially, the highest US state-debt-to-state-GDP ratio is 19.6% (Massachusetts) while Bremen's stands at 66.9%.

The eurozone's Stability and Growth Pact belongs to the German model of centralised discipline. Its rules are centrally imposed as is the monitoring and implementation (which are in the hands of the European Commission) with all of this refereed by the European Court of Justice. Not surprisingly, this system led to EZ bailouts just as it led to Länder bailouts. Three EZ bailouts have happened already and more are waiting in the wings.

Stability and Growth Pact: the history of failure

The Stability and Growth Pact is best thought of as an accident of history. It was adopted in 1997 without debate. As the euro's launch date approached, a concerned Germany proposed the pact as the practical way of implementing the Maastricht Treaty's Excessive Deficit Procedure. This was a take-it-or-leave-it request from Germany; it was a condition for abandoning the Deutsche mark. Naturally, Germany's solution for the eurozone embraced the model it knew best. Other EZ governments accepted it without much thought. Public opinion was either unaware or unable to master the technical considerations.

The Pact has failed over and over again. Each failure lead to reform that seemed to strengthen it. These efforts, however, were thwarted by the inescapable fact that EZ members are fiscally sovereign. Until sovereignty is removed, the Pact stands no chance of being effective.

The saddest part of this track record of failure is that the Maastricht Treaty included a no-bailout clause. Why did this explicit clause fail to produce the incentives created by the informal US clause? The short answer is 'doubts' - doubts that the clause would be implemented. And the doubters were proved right, starting with the May 2010 Greek bailout.

How decentralised discipline could work

The future of the euro requires fiscal discipline. Fiscal discipline will only be achieved with a decentralised arrangement. The reason is simple. In today's political reality, fiscal sovereignty is non-negotiable. That means the German model is out and the US model is the only way forward. Two steps are needed:

- We need to move from the German to the US model; and
- We need to make the no-bailout clause the centrepiece of the eurozone.

How to proceed?

In the US, the no bailout rule came first; incentives then took over, leading to fiscal rules. Having effectively removed the no bailout rule, we cannot rely on incentives but, fortunately, we now have national fiscal rules. Indeed the Fiscal Compact – under the official name of Treaty on Stability, Cooperation and Governance – requires each member country to adopt its own fiscal rule.

In the eyes of its founding fathers, the compact is one additional layer of the Stability and Growth Pact. From the perspective of the centralised versus decentralised debate, it is immediately apparent that the compact is a decentralised solution of the US type, even if the decentralised solution is centrally imposed. Inadvertently, we have moved in the right direction.

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Firming up the 'no' in 'no bailout'

What is missing is the no bailout rule. While it is already in the European Treaties, it's credibly was shattered by the Greek, Irish and Portuguese packages. The task facing EZ leaders is to rebuild the credibility of the no bailout clause. This will be difficult. Traumatic events and extremely public discussion will be necessary. Debt restructuring by several eurozone nations would provide one such vehicle. Such defaults would be so fraught with domestic and international political turmoil that future eurozone policymakers would do whatever is necessary to avoid finding themselves in the same situation in the future. The never-again pledge, in other words, would quickly gain credibility.

Any doubts? Just imagine what would have happened had the no bailout rule been invoked in May 2010. Greece would have gone to the IMF and defaulted on its smallish public debt of 120% of GDP. By now, the crisis would be over. ■

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A version of the editorial was previously published on www.VoxEU.org

Takaful in the GCC: sustaining the growth momentum

Sohail Jaffer is Deputy CEO at FWU Global Takaful Solutions

The GCC has proven to be a fertile ground for takaful, with continuous growth at double digit rates for over a decade. The industry has now obtained significant market share versus conventional insurance in most GCC countries, and the region also holds the highest number of operators globally and counts 77 takaful companies.

Growth drivers for the shariah compliant insurance in this region are multiple; besides the economic growth and the increasing disposable income, awareness of need for insurance and financial protection is also on the rise, creating a customer base for shariah compliant products, especially those who were reluctant towards conventional insurance. The segment completed its expansion across the GCC with the licensing of the first takaful operator in Oman last year; Al Madina Insurance Company is to be offering shariah compliant insurance this year in response to the increasing demand for such alternative products in the Sultanate.

Recent reports about takaful performance showed a general slowdown in its global growth but the GCC remained the dominant market in terms of volumes, with Saudi Arabia alone producing 51.8% of total global contributions that amounted in 2010 to $8.3 billion as per the *World Takaful Report 2012*.

Family takaful: the opportunity for new growth dimensions

Although takaful contributions have grown their market share of the GCC insurance market, family takaful remains insignificant at 5% of total contributions, but studies show that it is undeniably the line of growth for the future. The underpenetrated life insurance market in the region has an immense growth potential for family takaful products. The segment is already witnessing stable growth with the increasing awareness of financial planning and protection needs.

The Alpen Capital *GCC Insurance Industry Report 2011*, has predicted a sizable growth for the GCC life insurance segment, per capita income is increasing and the demographics are favourable: the region has a very young population with approximately 70 per cent in the 15-64 years bracket and according to World Bank forecasts, the total population of the GCC will grow by an average of 2.4 per cent per year in the next 5 years taking it to 45.6 million in 2015. As this young population in the region matures the demand for financial products would see a tremendous increase.

"Our forecasts show that life insurance density will grow at a CAGR of 22.2 per cent from 2011 to 2015 increasing to $113.5 from $50.8," the Alpen report noted. Family takaful will certainly

hold a significant share of the predicted life insurance potential, especially since awareness of takaful products and shariah compliance affinity has been on the rise. There are plenty of opportunities for takaful operators to explore in the family takaful segment, and pensions, and wealth management solutions are still underdeveloped especially in the investment-linked and annuities product categories.

"GCC takaful market companies have attractive cross-border growth opportunities in Africa, Europe and in Asia"

Expansion to new emerging markets

GCC takaful market companies have attractive cross-border growth opportunities in Africa (for example countries such as Egypt, Libya, Tunisia, Morocco, Kenya and South Africa), in Europe (including the UK, France, Germany and Turkey) and in Asia markets like India and Indonesia. Islamic finance is expected to receive a boost across the MENA region after the recent political developments triggered by the so called Arab Spring.

Other firms have seen opportunities in markets such as Lebanon, which posted 102 percent growth in takaful contributions during 2010. Southeast Asia also presents sizable potential for the segment's expansion. A report by actuarial consultants Milliman forecasts strong growth for takaful in southeast Asia, suggesting it could become three times as large as the Middle East by 2015.

Ernst & Young also forecasts that Saudi Arabia's share of the global takaful market will drop to 44 percent this year as newer markets grow faster, and the trend of new markets outpacing traditional ones could continue in coming years.

Distribution through bancatakaful: a growing force

Bancatakaful, the distribution channel of Islamic insurance products by banks, has grown more popular across the GCC and proven to be the most efficient channel, especially for family takaful products that are increasingly offered as financial planning solutions and offered mainly under bank wealth management sections.

Today bancatakaful is an attractive and cost effective way of selling takaful products, but banks are now looking for takaful partners that can offer them products built around customers, such as bundled protection coverage - travel insurance with additional protection for travel, credit life insurance to insure repayment of loans. Further, more tailor made products are being introduced, such as ladies plans, and affluent plans with individualized protection including critical illness cover, travel cover, and children protection.

Even in the sales process, a new trend in banacatakaful is rising in the GCC where many takaful operators prefer to inject their own sales force in bank branches instead of providing product training to bank staff, in order to avoid misselling and offer targeted solutions to customers.

Inconsistent regulatory systems challenging takaful expansion

The highly fragmented legal and regulatory landscape in the region still poses a serious challenge, with the absence of a unified set of laws and regulations applicable to takaful and retakaful, and a passporting concept similar to that in the European Union, which could enable an entity licensed in one GCC state to operate in another GCC state.

Takaful providers still have to comply with the regulatory requirements of each individual GCC state. This can create significant challenges for takaful and retakaful operators to achieve sufficient scale in order to have the necessary critical mass to be competitive with their secular counterparts. The capitalisation requirements and associated costs and expenses in establishing and licensing an operator in each individual GCC state can be a significant burden to the establishment of a regional takaful or retakaful operation.

The industry's big challenges include limited investment avenues, shortage of qualified talent, training of sales professionals but also raising product awareness and making consumers realise the importance of saving over the long term. So, bringing awareness, efficient customer service and operational efficiency coupled with current growth trajectory can all boost further takaful expansion.

Conclusion

There is no doubt that takaful is entering a stable development stage and has already marked its presence on the global map. The market opportunity is significant, according to a report last year by Swiss RE; *"conventional insurance still accounts for 83.1 percent of all premiums written in Muslim countries"*, it estimated.

However, the growth momentum is slowing down in main markets, and industry statistics show increasing pressure on the sector to boost efficiency, roll out new products and explore new markets. ■

Ethics training and government transparency needed to fight corruption, survey reveals

Ethics training can be a major tool in fighting corruption in developing countries, according to the results of the latest quarterly World Economic Survey (WES) by the International Chamber of Commerce (ICC) and the Institute for Economic Research (Ifo) in Munich.

The survey's findings, based on responses to an ICC Special Question, also revealed that transparency in government procurement is the most important factor in fighting corruption.

The results of the ICC Special Question in the Q4 WES survey were based on the views of 1,156 experts polled in 124 countries worldwide.

Emerging nations favour ethics training

In the first part of the question the experts were asked whether they agreed stronger emphasis on ethics and compliance training for business in their respective countries would help improve productivity and attract more foreign investment.

Although the results differed markedly according to the region it was clear experts in emerging nations overwhelmingly supported the statement.

In Africa 90% of experts agreed and in both South America and Asia the consensus level was at 88%. There was also a high level of agreement from experts in Eastern Europe and the CIS countries where the statement was supported by 87% and 85% respectively.

In Europe 48% of respondents agreed with the statement and in North America and Oceania it was supported by 31% and 33% of respondents respectively.

When the findings are tied in with Transparency International's 2011 Corruption Perceptions Indicator (CPI), they reveal a general pattern: the more corrupt a country is perceived to be, the greater the consensus that ethics training is needed to help boost the economy.

Government transparency required

In the second part of the ICC Special Question, *'Transparency in government procurement'* was clearly identified by the vast majority of experts across all countries and regions as the most important factor in fighting corruption.

"The results of the survey clearly show corruption is a major economic challenge for several countries in the world," said Jean-Guy Carrier, ICC Secretary General.

"Governments and businesses alike need to place the fight against corruption at the top of their agenda"

ICC ANTI-CORRUPTION CLAUSE

Highlights

- Clause to be included in contracts whereby parties commit to complying with ICC Rules on Combating Corruption or commit to put in place and maintain a corporate anti-corruption compliance programme
- Helps preserve trust between parties and prevents corruption in both the negotiation and performance of contracts

Prepared by the ICC Commission on Corporate Responsibility and Anti-corruption, and the Commission on Commercial Law and Practice

"The harm to a country's economy caused by corruption is much larger than the personal benefits obtained and leads to economic inefficiency and to prosperity losses. Governments and businesses alike need to place the fight against corruption at the top of their agenda."

ICC is a pioneer in developing practical tools to help business drive integrity in business transactions. Reacting to calls from G20 governments for business to take concrete steps in the fight against corruption, ICC has expanded its suite of anti-corruption tools that includes the *ICC Rules on Combating Corruption*, and the RESIST toolkit for countering solicitation and extortion.

Most recently, ICC introduced an anti-corruption clause for companies to insert into any contract – whereby parties agree to comply with the ICC Rules on Combating Corruption or commit to put in place and maintain an anti-corruption compliance programme.

Designed for inclusion in any contract, the clause is part of ICC's commitment to supporting implementation of the United Nations Convention against Corruption (UNCAC) and more active engagement with the Organisation for Economic Co-operation and Development (OECD) Anti-Bribery Working Group. It delivers a pragmatic response to calls from G20 leaders for the private sector to play an active role in fighting corruptive practices.

The new clause provides a contractual basis for parties to commit to complying with ICC's voluntary *Rules on Combating Corruption* or to implement a corporate anti-corruption compliance programme.

Available to download free of charge from ICC's remodelled website, the clause can support both small- and medium-sized enterprises (SMEs) and multinational companies in their efforts to prevent their contractual relationships being affected by corruption.

ICC is also currently developing an ethics and compliance training for business which will provide companies with the know-how they need to implement an effective anti-corruption compliance programme. ■

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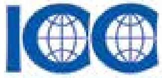

International Chamber of Commerce
The world business organization

New rules for forfaiting to enter into force January 2013

The International Chamber of Commerce (ICC) has unveiled new uniform rules on forfaiting (URF) to govern the international forfaiting market estimated at more than US$300 billion annually. The URF will enter into effect on 1 January 2013, providing a set of rules for the sale of instruments used for financing trade – which include bills of exchange, promissory notes, documentary credits and invoice purchases as well as some newer instruments.

Forfaiting facilitates the provision of finance to the international trade community and gives liquidity to instruments that would otherwise be limited to evidencing payment claims. By making payment claims easier to transfer, forfaiting enables them to be used as more than just a means of obtaining payment for goods or services delivered: they can be used to provide finance.

> *"The newly-adopted forfaiting rules are the latest example of ICC's leadership in writing rules that govern international trade and investment and highlight the crucial role forfaiting plays in securing financing for exporters and importers,"* said ICC Secretary General Jean-Guy Carrier.

The URF are the result of an ambitious project by ICC and the International Forfaiting Association (IFA) to create new rules for a multilateral trading system fit for the 21st century.

Meticulously prepared over a period of three-and-a half-years and with input from experienced professionals worldwide, the URF are destined to become the standard text for both the primary and secondary forfaiting markets worldwide.

> *"It has long been an ambition of the IFA to produce a single set of standardized terms and conditions for the two components of the forfaiting market – the primary market in which transactions are originated from exporters and other sellers of goods and services, and the secondary market where those transactions are traded between banks and other financial institutions,"* said IFA Chairman Paolo Provera.

The URF do not change the nature of the payment claim being originated or on-traded, and as such can be used alongside the full and ever-expanding range of instruments used to finance trade.

"The ICC Banking Commission is the world's essential rule-writing body for the banking industry"

The rules were adopted during a meeting of the ICC Banking Commission which took place in Mexico City from 12-15 November. Over 400 participants attended the meeting, which was the first of the commission's bi-annual meetings to be held in Latin America.

The ICC Banking Commission is the world's essential rule-writing body for the banking industry. With 80 years of experience and more than 600 members in more than 100 countries, the Banking Commission – the largest commission of ICC – has gained a reputation as the most authoritative voice in the field of trade finance.

The ICC Banking Commission produces a range of universally accepted rules and guidelines for international banking practice. ICC rules on documentary credits, UCP 600, are the most successful privately drafted rules for trade ever developed, serving as the basis of US$2 trillion trade transactions a year. ■

www.iccwbo.org

ICC Banking Commission Chair Kah Chye Tan

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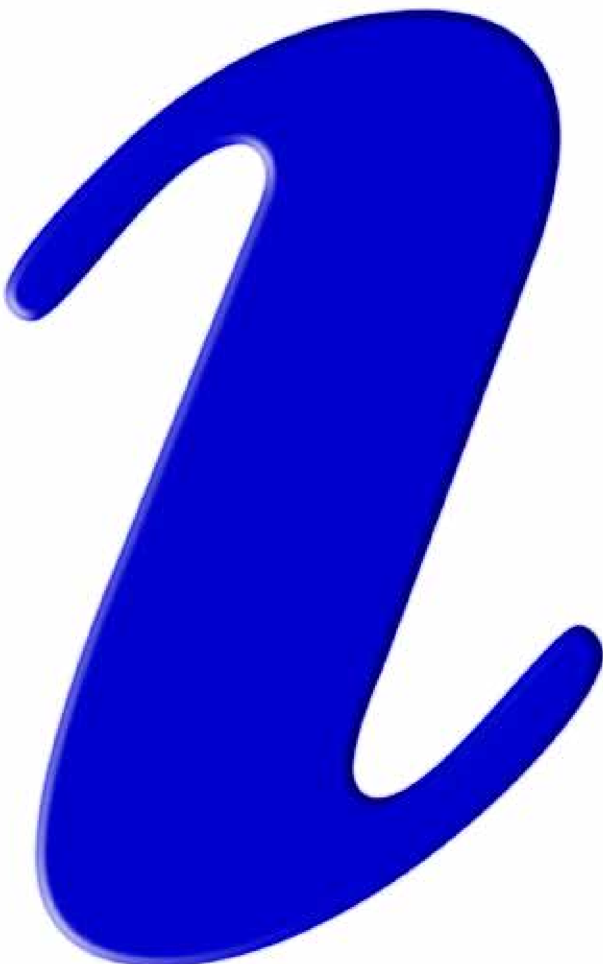
Telecoms reform set to give Bermuda the edge for e-business

Known as the *'Wired Island'*, Bermuda recognized early on in the 1980's that the country's information and communications technology (ICT) infrastructure and services would be key to its success.



Although just 21 square miles and with a population of 65,000, this British Overseas Territory set about building a sophisticated telecoms infrastructure complete with several fibre-optic redundant cables linking the Island to the rest of the world. That strategy paid off as many international Fortune 500 companies benefitting also from Bermuda's location in the Atlantic as a gateway to North, Central and South America, as well as Europe, called the island home. It is recognised as being the third largest reinsurance market in the world.

Fast forward to the 21st century where the challenges of big data along with the ongoing evolution in digital devices and technical changes to the internet, will continue to make unprecedented demands on telecom infrastructures in terms of delivering services, providing ongoing support and ensuring security, all to meet the new demands of business brought on by these technical advances.

In order to continue to maintain its competitive edge in light of these global telecommunications challenges, the Bermuda Government has been preparing for a major reform of the telecommunications industry and significant progress has been made regarding regulatory reform over the past several months.

The passing of the Electronics Communications Act and the Regulatory Authority Act in November 2011 are indicative of the government's commitment to establishing a framework that would enable the telecommunications industry to compete in the 21st century. The regulatory authority is being set up to ensure transparency, consistency and accountability within the marketplace and to stimulate competition.

This legislative step was an important one which will lead to the issuance of Bermuda's first Integrated Communications Operating Licence or 'ICOL'. This move will benefit Bermudian businesses and consumers by increasing competition which, in turn, will bring greater efficiency and more innovation to the sector under a modernised regulatory regime.

At the time of the drafting of the existing Telecommunications Act 1986, given the state of technologies at that time, it was natural and appropriate to provide different classes of licences for different services.

For example, video services were not provided along the same highway as voice services.

Today, it is difficult to naturally separate the provision of voice services, from video services, from data services. The new regulatory structure takes into account current technology developments and is positioned to rapidly adjust to the ever-changing nature of the telecommunications industry.

In September 2012 three Commissioners were appointed to serve on the Board of the Regulatory Authority (RA) and in January of 2013, the first Chief Executive of the RA is expected to be appointed.

The RA Commissioners will require some time to prepare for their new responsibilities and therefore, to ensure an orderly transition, the decision was made to defer the date on which the new laws become fully effective and the Authority assumes responsibility for regulating the sector in the first week of January 2013.

In order to ensure that the ICOLs are in place by 1 April 2013, a 'pre-consultation' process was initiated that ran from October through December 2012. This process was intended to gather initial feedback from the public and industry on three critical elements of the reform process.

The first pre-consultation concerned the scope and form of the Integrated Communications Operating Licenses that will be granted to the existing Public Telecommunications Services and subscription radio and television licensees.

The second pre-consultation addressed the electronic communications networks and services that will be authorised under a class license or granted license exemptions.

And the third pre-consultation involved an economic analysis of the relevant electronic communications markets and an assessment of the need for regulation where market failures have been identified.

The comments received during this pre-consultation process were given to the RA which will carefully review this information, and use it as a major input in preparing the

"In order to continue to maintain its competitive edge ... the Bermuda Government has been preparing for a major reform of the telecommunications industry"

consultation documents that must be issued, shortly after the RA Commissioners take office.

This pre-consultation step should enable the RA to narrow the issues, and focus the next phase of consultations on the most complex and controversial matters.

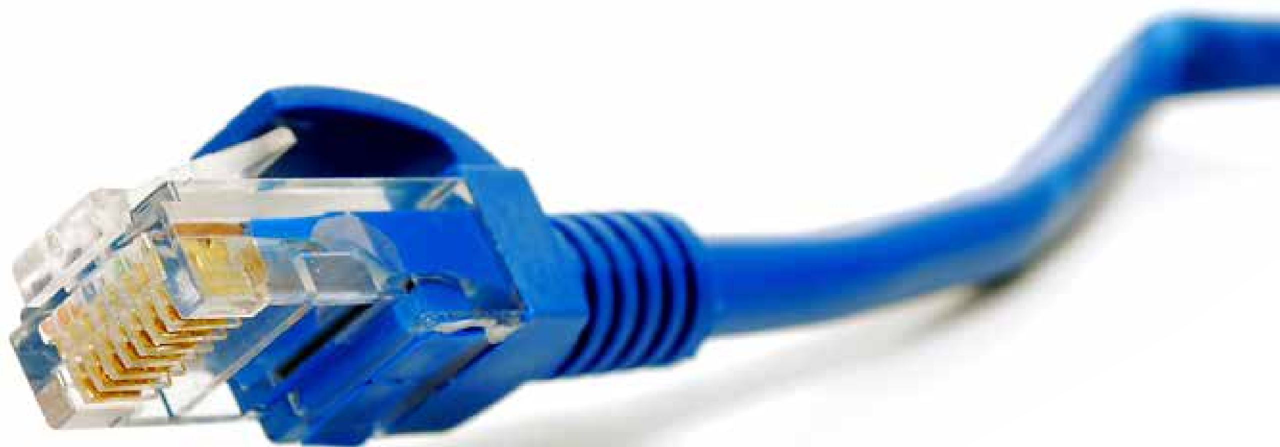
The process should make it possible, by 1 April 2013, for the Bermuda Government to convert existing licenses to ICOLs, and for the RA to issue general determinations establishing the class licensing regime and identifying those ICOL holders that will be required to implement ex ante remedies before they are permitted to enter new markets.

News of Bermuda's pending telecommunications reform has been well received. Recently, one of the carriers, Link Bermuda, announced a multi-million dollar upgrade to build an island-wide fibre-optic cable network to offer up to 100 MB internet speeds. There are signs that further investment by others is on the way.

In addition, the Bermuda Government is also developing privacy legislation and hopes to achieve the balance of protecting sensitive personal information and respecting international privacy principles, while acknowledging diverse global economic ties.

The advent of cloud computing has many cloud providers and their clients looking for jurisdictions that can offer security and privacy protection, while providing significant bandwidth, redundant fibre-optic networks, hosting and business continuity capabilities.

As Bermuda can provide these services, it is easy to see why companies continue to domicile in Bermuda as the future of e-business on the island looks bright. ■



The next productivity revolution: the 'industrial internet'

Marco Annunziata is Chief Economist and Executive Director of Global Market Insight, General Electric Co.

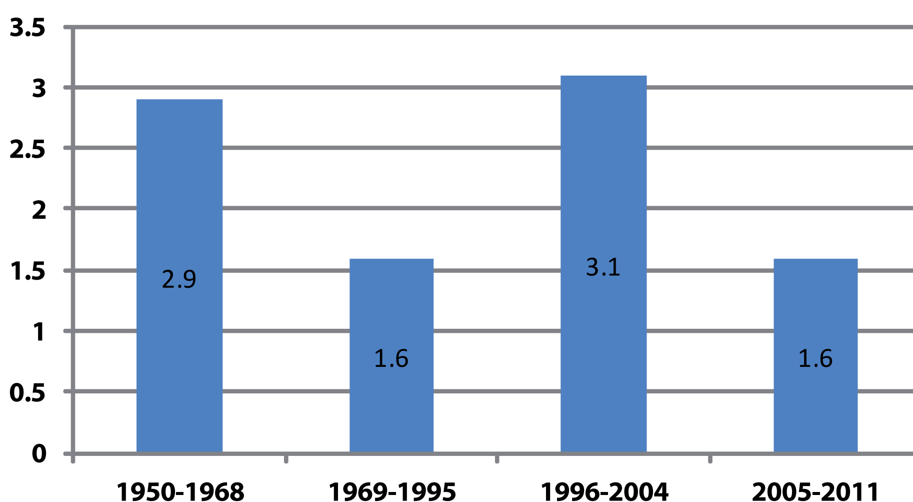
Today's technological innovation is regarded by many as all about social media and entertainment, with no impact on economic growth. This column argues that such scepticism is premature. A closer look at selected industries suggests that the 'industrial internet' - a network that binds together intelligent machines, software analytics and people - through accelerated adoption of sensors and software analytics, will have a powerful impact on productivity and growth.

The largest advanced economies are struggling with weak growth prospects and daunting fiscal challenges. Looking at the macroeconomic equation, there is no easy way out. Looking at the microeconomic level, however, suggests that it is innovation that might come to the rescue.

Game over for productivity growth?

US labour productivity surged to an annual average of 3.1% between 1996 and 2004, nearly double the rate of the previous quarter-century; empirical evidence suggests that the Information and Communication Technology (ICT) revolution was an important driver of this productivity boost, which benefited both manufacturing and services[123]. Then it fizzled out. The deep 2008-09 recession and subsequent weak recovery, as well as the dramatic reduction in employment levels, make it hard to draw any meaningful conclusions from the swings in productivity growth rates of the last few years (labour productivity growth accelerated sharply in 2009-10 and then collapsed in 2011) - but overall, labour productivity has averaged a meagre 1.6% since 2005. The sceptics argue that technology has exhausted its growth-enhancing potential, that innovation is now mostly about social media, entertainment and silly games, with no ability to boost living standards. In a recent provocative piece[4], Robert Gordon has argued that the recent waves of technological innovations are simply not as transformative as those of the industrial revolution, and Martin Wolf[5] of the *Financial Times* commented: *"Today's information age is full of sound and fury signifying little."*

Figure 1. The US productivity decline and rebound



The next wave of innovation

This scepticism might be premature. In a recent report[6], my co-author Peter Evans and I have looked at the productivity-enhancing potential of the 'industrial internet', a network that binds together intelligent machines, software analytics and people. The declining cost of instrumentation is beginning to enable a much wider use of sensors in machines ranging from jet engines to power generation turbines to medical devices. Software analytics can then leverage the enormous amount of data generated in order to optimise the performance of individual machines, fleets and networks.

This means, for example, having a better insight in the performance of a jet engine and being able to anticipate mechanical failures so that maintenance can be performed in a pre-emptive way, minimising the delays that occur when the problem emerges shortly before take-off. It means being able to track the exact location of medical devices in a hospital and whether they are in use or idle, so that patient admissions and medical procedures can be scheduled more efficiently, yielding better health outcomes to more patients at lower cost.

The potential benefits are sizeable. Just a 1% gain in fuel efficiency over fifteen years would yield $30 billion in savings in aviation and $66 billion in the power generation industry, while a 1% efficiency gain would yield $63 billion in the healthcare industry and $27 billion in the rail industry. Our study focuses on the sectors where General Electric has a strong presence, because those are the sectors we know best and where we are seeing these gains materialise. But the industrial internet has the potential to impact a much wider range of industries, as well as services.

The industrial internet's impact on economic growth

As the industrial internet spreads, it could have a major impact on economic growth. Forecasting productivity is an extremely difficult exercise. But looking at the potential efficiency gains in individual industries, we feel it is not unreasonable to posit that the impact of the industrial internet might be comparable to the first wave of the internet revolution.

In the US, if the industrial internet could accelerate annual labour productivity growth by 1-1.5 percentage points, bringing it back to its previous peaks, it could give a crucial boost to US economic growth. And the benefits would not be limited to the US. In fact emerging markets, where investment is likely to increase at a fast pace in the coming years, have the opportunity to become early adopters of the new technologies. Given EM's greater share in the world economy, this would quickly amplify the impact on the global economy.

Turning point

The technologies underlying the industrial internet have been in the making for some time. Why get excited about it now? The cost of instrumentation is declining, making a wider use of sensors economically viable, and is matched by the impact of cloud computing, which allows us to gather and analyse much larger amounts of data at lower cost. This creates a cost-deflation trend comparable to that which

"... the impact of the industrial internet might be comparable to the first wave of the internet revolution"

spurred rapid adoption of ICT equipment in the second half of the 1990s.

The mobile revolution will compound this effect, making information sharing and decentralised optimisation easier and more affordable. Industrial internet technologies is set to accelerate.

Enabling conditions

Reaping the full benefits of the industrial internet will require a set of key enablers and catalysts:

- Investment to rapidly incorporate the new technologies into the capital stock.
- Strengthening cyber security to manage the new vulnerabilities of a more internet-heavy industrial system.
- Development of a strong talent pool, which will include new professional roles combining mechanical, industrial and software engineering expertise.

More jobs?

The last point is especially important. Every wave of innovation raises a concern that higher productivity will simply mean fewer jobs. In today's context of high unemployment, this concern is especially acute. As in the past, technological innovation will make some jobs redundant. But it will create new ones and, if the impact on global growth is as strong as we believe, it will certainly create more jobs overall. But the education system will need to ensure that the supply of skills matches the evolving demand.

Conclusion

The industrial revolution unfolded in waves over a very long period of time. The internet revolution is following a similar pattern, and we think the next, most powerful and disruptive wave is arriving now. The efficiency gains that are coming within reach in individual industrial sectors suggest that the potential impact of the industrial internet on productivity and GDP growth is substantial. In 1987, Robert Solow famously quipped: *"you can see the computer age everywhere but in the productivity statistics"*. Ten years later, productivity growth surged. Today's widespread scepticism might prove similarly premature. ■

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A version of the editorial was previously published on www.VoxEU.org

EXECUTIVE DEVELOPMENT

EVOLUTIONARY REVOLUTION

Evolution, revolution? Whatever is happening,
Jørgen Thorsell, Justin Bridge** and **Fiona Gardner
describe big changes in the way we are
developing executives

Dramatic revolutions that happen with a "bang" are often less dangerous than evolutionary changes that creep in over time. Such incremental changes often go unnoticed – with catastrophic consequences.

Think of Kodak and the evolution of digital technology. Kodak did not recognise and adjust to the mortal danger digital cameras and mobile phones posed to its business until it was too late. In January 2012, after 131 years being regarded as one of the world's most unbreakable companies, Kodak filed for bankruptcy.

There is a parallel change, albeit somewhat less devastating, underway in executive education. In their article "Customised Executive Learning" in the January 2012 edition of *Global Focus*, Gert-Jan van Wijk and Jamie Anderson argued that new ways of developing executives are about to take over from the more traditional methods championed by business schools and academic institutions.

This is especially true for many advanced global corporations, which have for some time distinguished executive development from executive education and begun to favour the former as a means of enhancing business impact through executive learning.

What's the difference?

While executive education is rooted in business schools' classic methodology of teaching theoretical knowledge based on proprietary research, executive development has a behavioural focus and is aimed at improving the performance of managers, executives and their businesses regardless of the theories and teachers employed.

Corporations have long struggled with and complained about the task of transferring knowledge gained through executive education into meaningful actions and impact "on the job". This is not because the knowledge is not valuable but because achieving significant, immediate and sustainable impact on the business is of even greater importance.

It is generally believed that the expense of gaining knowledge cannot be fully justified unless that knowledge is provided in the specific form and context required by the recipient to make a sustainable difference in his or her workplace.

And since executive education tends to take place in classrooms detached in time and space from the workplace, the likelihood of the knowledge being immediately relevant is low.

Over the past ten years or so, executive development has matured to meet the demand for immediate job relevance and sustainable impact. By making the executives' own current job challenges the starting point of the learning journey, executive development provides a learner-led process that enables individual executives to realise what they must do to increase their impact and, even more importantly, how they can do it.

But, though a behavioural focus is a key feature, the approach is not solely about behaviour. The learner-led process still offers relevant theories and best practices to deepen an executive's understanding of his or her situation and provide a range of different perspectives and insights. However, rather than being presented carte blanche, these are provided according to each executive's unique challenge so theory and best practice insights are both immediately applicable and focused on results.

In a nutshell, modern executive development creates impact by supplying knowledge, insights and learning just-in-time to an individual executive's specific job-based circumstances, making it immediately relevant and stimulating sustainable behavioural change. Thus, the classic challenge of transferring knowledge into meaningful action and impact is met.

If leadership is a relationship

Executive coaching, with its ability to enable executives to improve on-the-job performance, has gained tremendous popularity in the corporate world since the 1970s. In a recent global study (Mannaz, *Global Leadership Survey*, 2011), coaching was identified as the most powerful executive development practice alongside leaders teaching leaders and action learning.

Coaching is a good example of the modern concept of executive development because it provides just-in-time learning geared to the individual and is also highly relevant to his or her current professional reality.

Recently, more methodologies and technologies have emerged that move the effectiveness of executive development forward.

Among the most interesting are those that involve both the leader and his or her team in the learning initiative.

Traditionally, leadership has been considered a matter of personal traits, either learned or inherited. This idea has been supported by research that propounds the notion of the leader as a lone beacon of inspiration. Consequently, both executive education and development initiatives have, for the most part, been delivered to executives in isolation from their people and job reality.

However, there can be no leaders without followers (and vice versa) and this makes the relationship between the leader and his or her people a central pillar of leadership. It follows that effective leadership development is contingent upon the development of an effective leadership relationship and as such must involve both the leader and direct reports in the development process.

Over the past 20 years, "360-degree" survey instruments have elicited qualitative and quantitative feedback from an executive's team and his or her superiors and peers. By using them the relationship dimension of leadership has (to some extent) been included in leadership development.

However, our long experience using 360-degree instruments suggests that most feedback on the results of such a

“Building a programme of leadership development that accelerates the execution of corporate strategy and improves leadership performance is like killing two birds with one stone”

survey is given to the recipient without the real-time sharing, intellectual involvement and emotional commitment of the respondents.

Not only does this leave the feedback open to (mis) interpretation but it can also lead to a ‘witch hunt’ as recipients endeavour to track down ‘who said what’.

Even worse, 360-degree feedback is often ‘sanitised’ to prevent such retribution, leaving it so bland that it leads to no more than a shrug of the shoulders and the observation that ‘no-one’s perfect’.

Involving team members in the leadership development process also not only encourages them to share responsibility for enhancing the leadership relationship but also avoids the ‘not invented here syndrome’. This is often faced by executives who come back from transformational development programmes and try to sell ‘new world’ ways of doing things to colleagues who are still living in the ‘old world’.

In summary, we see that today’s advanced corporations demand that the entire ‘eco-system’ around each leader is meaningfully involved in executive and other development initiatives. They realise that true leadership development requires all relevant parties to commit to developing leadership relationships, not just the individual leader in isolation.

Killing two birds with one stone

Another significant trend is the integration of leadership development and strategy execution into one coherent, accelerated process.

If leadership is the single most important factor in successfully implementing a new strategy (and experience suggests it is) it follows that leadership development initiatives should be closely connected with the process of doing just that. Building a programme of leadership development that accelerates the execution of corporate strategy and improves leadership performance is like killing two birds with one stone.

In our experience, integrated development kicks-off with top executives deciding what ‘best leadership’ should look like when they begin the journey of implementing a new corporate strategy. Then all managers, with the requisite support and preparation, conduct the process of identifying and closing the gaps between current leadership capabilities (both for themselves and also within their team or teams) and those demanded by the new strategy.

Getting much more for much less

The economic crisis that began in 2008 has engendered an understandable theme in executive development: corporations are demanding much more from executive development but are prepared to pay much less for it. And while this has placed enormous pressure on providers of executive learning, it has also driven numerous innovations, many of which have been technology based.

However, it is still early days in the development of technology-based tools and concepts for facilitating and enabling behavioural change. In particular, e-learning programmes still struggle to capture the full commitment and attention from the learner in the way a face-to-face programme can.

Despite this, we are likely to see considerable advances in the world of virtual learning in coming years, which will enable a far deeper level of trust building and better two-way communication in the virtual setting, leading to greater commitment and learning.

A unique way of taking the best from a number of technologies and adapting it to an on-the-job, learner-centric and multi-location approach is a methodology called ‘Flexible Learning’.

Through it, clients, both individual and teams, experience more learning for less money. We discovered the key to success is to minimise face-to-face interventions while maintaining the same high learning output.

Flexible Learning achieves this via a virtual kick-off followed by an e-based competence screening for each participant. This helps them realise – for themselves – the competency gaps they have and which they need to close. For each individual a set of focused learning sources (e-learning modules, literature and webinars to name a few) is then identified according to their unique learning objectives.

What is around the corner?

As the evolution of executive education and development gains momentum, it is interesting to anticipate what awaits us in the future. While most executive learning and development experts agree innovation will continue to be driven by an urge to improve the impact of executive learning for less expense, they expect this innovation to be focused on the nature of the content, not how it is delivered.

However, in our view, the field of content is not where the next significant breakthroughs in executive development will come.

Instead, we expect to see innovation in the creation of sustainable on-the-job learning, delivered in a way (and in a learning environment) where all parties in the leadership equation take an active role.

The key challenge is how to capture job-based, participant-led learning in a qualified and meaningful way. The key question is how to make on-the-job learning a deliberate act

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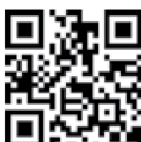

that will serve as a fact-based platform for more learning that is relevant to and can be readily shared with other managers. Social media may be a feasible solution here.

From our studies in effective leadership development (*Innovation in Leadership Development 2009 and the Mannaz Global Leadership Survey, 2011*) we have recognised the importance of learning being readily available to individual managers just-in-time to meet their specific, role-based needs. This objective is still a long way from being met and we are seeing the more traditional approaches of mentoring and coaching growing in demand.

However, we believe more platforms need to be discovered and developed in order to fulfil the need for learning 'right when you need it'. According to the same studies, the concept of real-life/real-time experiential learning is regarded as one of the most powerful approaches to executive development. Consequently we expect the demand for this approach to grow as well.

Executive development is not only about improving leadership and management competency in an organisation; it is also about creating an impact on overall business performance. Therefore, we foresee another significant push for more sophisticated ways of ensuring both direct and indirect impact on performance. This raises the perennial question: how to measure the effect of executive development.

We believe this will not be limited to mere bottom-line number crunching but will be inspired by work at the frontiers of behavioural science and how behavioural change is measured.

A revolutionary evolution?

Recently, we have been working with one of the world's largest multinationals investigating ways to 'refresh' its development programmes. Its learning and development executives have asked potential vendors only to document the depth of their expertise in designing and delivering programmes of experiential learning. They did not expect any suggestions for learning solutions.

"In our view, the field of content is not where the next significant breakthroughs in executive development will come"

We are now into a stretching and mutually enriching design process with this organisation that will bring executive development to new heights and widen the gap with executive education even more.

This is how the frontiers of executive development are being pushed to new levels; leaving us in little doubt that executive development is in the midst of an exciting evolution that to some might appear quite revolutionary. ■

ABOUT THE AUTHORS

Jørgen Thorsell, Justin Bridge and Fiona Gardner are respectively CEO, Managing Director and Consultant at Mannaz, a consultancy specialising in capability development of executives and key employees.

Mannaz was founded in Denmark in 1975 under the name DIEU (Danish Engineers' Post Graduate Institute) and is among Europe's largest and oldest companies in this field.

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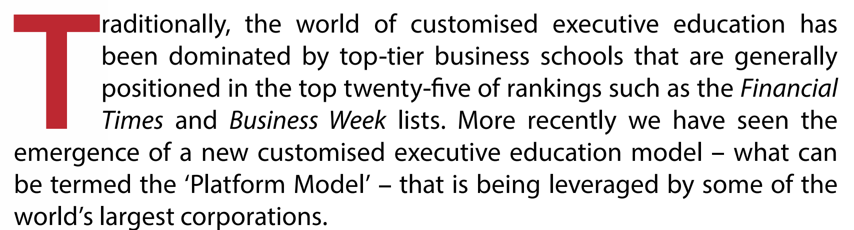
Customised executive learning

A BUSINESS MODEL FOR THE 21ST CENTURY

A new design for tailored executive education is emerging - Gert-Jan van Wijk and Jamie Anderson report on the Platform Model



Traditionally, the world of customised executive education has been dominated by top-tier business schools that are generally positioned in the top twenty-five of rankings such as the *Financial Times* and *Business Week* lists. More recently we have seen the emergence of a new customised executive education model – what can be termed the 'Platform Model' – that is being leveraged by some of the world's largest corporations.

The Platform model for executive learning recognises the existence of what has become a two-sided network, entailing a triangular set of market relationships. On one side of this network are the individuals and firms that possess specialist skills and expertise, and on the other side are organisational clients seeking learning solutions. The need for these two groups - the network's 'sides' - to interact with each other efficiently has created the opportunity for the emergence of intermediaries – what technology-based industries commonly call platform providers. The Platform embodies an architecture - a design for services, and infrastructure facilitating network users' interactions - all at low delivered cost. Platform providers can be small, such as Netherlands based 'the world we work in' or substantially bigger: such as Antwerp management school, the Lorange Institute of Business, Mannaz of Denmark and London-based Duke Ce.

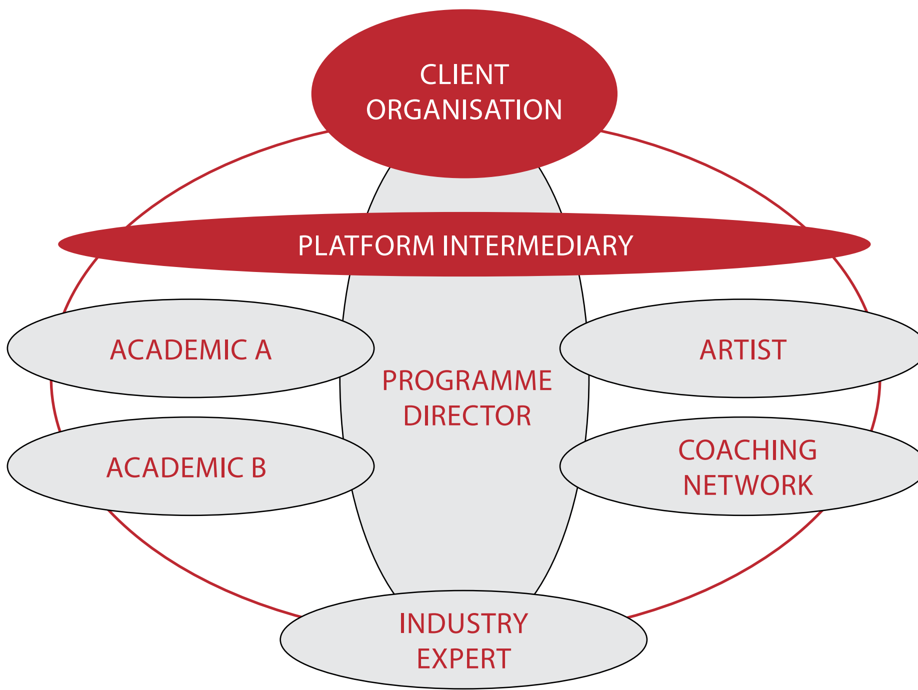
The platform is a boundary-less organisation, which drives executive learning ROI, through customisation, real action learning assignments and teamwork of faculty who integrate the learning. These characteristics are not the exclusive domain of platform intermediaries, but we have witnessed that executive education buyers increasingly value these characteristics in their decisions to source executive learning. This development potentially creates a disruptive effect in the market, and will require top-tier business schools to re-evaluate their approach. The implications reach beyond the world of executive education to all professional services, such as consulting and advertising, where intelligent networks of independent people co-creating solutions with clients could be the future of competition.

The Platform Model

Platform intermediaries build client relationships by becoming trusted advisors, and act as open gateways to introduce corporations to a linked network of professionals. The platform model transforms executive education into executive learning: the architecture ensures that all design, development and delivery activities are aimed at the participants of the programme, rather than faculty teaching or facilitating the programme (see example at Diagram 1 – overleaf).

Program design within the platform ecosystem focuses on outcomes and learning processes rather than business/academic content. Furthermore

Diagram 1
The Platform Model



Clients have also become familiar with the benefits of working with professional practices outside the academic domain. They recognise that their executives' development needs cover the physical, emotional and spiritual, as well as the intellectual. In order to meet these demands a broad range of professionals from literature, the performing arts, media, wellness and sports bring expertise to address broader learning needs. Clients understand that 'non-academic' programme elements can create a high impact, if they are well integrated in the overall design and linked to the academic contribution. The role of the platform intermediary is to bring entirely different worlds, mindsets and people together and ensure that everyone involved can translate their profession to the business world, and understand their role in the overall programme.

the platform ensures that all programmes are sourced by faculty who are interested in the client's business reality and show a willingness to collaborate with others to create an integrated programme. Finally all people involved realise that learning comes from facilitated action learning in which participants are given the concepts, tools and skills to apply in real business challenges.

Drivers of the Platform Model

The Platform Model is primarily driven by a changing client demand for return on investment (ROI). In recent years client demand has evolved around demonstrating the ROI of executive learning through the enhancement of the practical skills of executives and the implementation of tangible business results. The requirement to prove ROI has led to a much closer involvement of buyers in the design of programmes and generally a higher level of sophistication amongst clients. They know what creates a real impact and they will demand it regardless of departmental or institutional domains.

This increasing sophistication of client demand pushes the world of customised executive learning to customise and innovate beyond the boundaries of a single institution or knowledge domain. The client may request different providers to work together, previous consultants' work to be integrated, or certain professionals to be included in the offering because of their know-how, skill or relationship with the company.

Concurrently we have observed clients asking to integrate divergent management disciplines, research areas, and learning methodologies. Increasingly the skills of open collaboration and innovation have become differentiating capabilities of a customised executive education provider, because in practice these capabilities can hardly be attributed to a single institution.

The Platform Model has been underpinned by an explosion in the number of intellectual free agents who desire to collaborate openly with other individuals and institutions. These free agents are knowledge workers who determine their own work portfolio and integrate their own work/life tradeoffs, without a contractual commitment to a single employer. In the executive education world the free agent has often once worked for a business school, where the classic divide between tenure track academics, non-tenure track faculty and 'administrative staff' often limits career possibilities.

Academics who haven't chosen the tenure-track route, can be marginalised or even forced-out of traditional business school hierarchies, regardless of their executive education capabilities. Talented executive educators often choose a free agent role wholly or partially outside the boundaries of the business school. Their commitment and values are with the clients, the learning process, the delegates and their disciplinary know-how, and they value the collaboration in the kind of open network offered by the platform model. In turn, this networked collaboration has been empowered by the pervasive spread of low-cost information and communication technologies, such as the communication service Skype and the file sharing service Dropbox, that are enabling virtual teams to deliver integrated educational offerings.

> ***"... all people involved realise that learning comes from facilitated action learning"***

Textbox 1
Comparing the business school and Platform Model for executive learning

Compare and contrast easily creates 'archetypes'. This text box paints the 'black and white' picture of the two models. Many organisations display features of both models.

Dimension	Business school	Platform Model
Reputation	Brand as quality guarantee	Track record of professionals and intermediary referrals as quality guarantee
Boundaries	Clear institutional boundaries	Immediate access to professionals
Purpose	Primary aim is research	Primary aim is a program with impact
Starting point	Academic content led	Broad range of perspectives and professionals included underpinned by academic insight
Orientation	Teaching, faculty orientation	Facilitation, participant and result orientation
Connections	Connecting disciplines	Integrated holistic learning experience
Collaboration	Collaboration has no incentive	Multiplicative effects of open collaboration
Proposition	Leading edge knowledge and 'right' answers	Further strategy execution and people development
Ownership	Proprietary	Shared

Guiding philosophy of the Platform Model

Ultimately many of the tangible building blocks of a more traditional organisation such as buildings, physical infrastructure, systems and job contracts have been replaced by intangible pillars like trust, relationships, collaboration, agility and quality of execution.

These pillars are solely dependent on the capabilities and commitment of the professionals involved – it relies upon 'locking-on' clever people through a deeper sense of commitment, reciprocity and shared purpose rather than 'locking-in' faculty through formal contracts and formal performance measurement tools. In this sense all the professionals are viewed as clients rather than resources. The ability to accelerate change and transform client organisations must be reflected in the transformation of all professionals involved.

The platform model is underpinned by independence, and the role of the intermediary between the two sides of the network is to be impartial and authentic. The approach is solutions oriented and focused on achieving the best outcomes for clients and partners. A prerequisite is that the platform *"creates an environment in which…clever people can thrive"* (2007, Goffee & Jones).

The possibility that people will thrive is enhanced if the platform can link the professionals directly to their commitment, development and values. The underpinning core values of this organising model are trust, transparency and continuous learning.

Limitations of the Platform Model

Successful platform intermediaries excel at what Ghoshal (1999) called: *"managing the intangibles: people, process and purpose"*. The Platform Model strengths (speed, entrepreneurship, agility and passion) are based on these pillars. Simultaneously it also shows the limitations of the Platform model:

People: Relationships and (virtual) collaboration are the cornerstones of each team working on a client project. The subtle difference between real open collaboration and 'going through the motions' is sometimes hard to detect. Yet 'going through the motions' clearly is not good enough. The Platform model is built upon working with professionals who are usually self aware, (overly) confident and deeply uncertain and anxious to deliver good performance, and do at least as well as their peers on the programme. Client expectations, participant evaluations and the free agent status may add to this insecurity. In order to deliver excellent programs all these anxieties need to be overcome individually as well as a team. It requires careful relationship building, continuous encouragement and mutual feedback.

Process: Excellent programmes rely on clear and well-run support processes executed by colleagues often in the early phases in their careers. The collaboration between faculty and programme coordinators is as crucial as between faculty and the result of anything less than flawless teamwork is immediately visible in the delivery of the programme. Since the platform members are involved in various different networks with different procedures, it requires an extra effort to get them to understand the administrative processes, focus attention on building a relationship with coordinators and adhering to these processes.

Purpose: With distributed leadership, open boundaries and sometimes little management in place, all the emphasis in the platform is focused on creating immediate outcomes for clients. As professionals are typically paid on a per diem basis, it can be a challenge to get people involved in the longer term continuity of the platform. Creating rituals, a brand and meaning beyond today's work is complicated by the fact that many are dispersed around the globe. The moments of togetherness, celebration and loss are rarely shared by

the whole community, whilst we know how powerful these are to build community. Can we really talk about community here? Are we entering new eras of community building?

The dilemma for business schools

Traditional top-tier business schools face a number of dilemmas in responding to the Platform Model. Top-tier business schools typically draw from their internal faculty pool for the teaching of executive education programs, with the belief that academic faculty best understand the latest insights and are best placed to explain these insights to an executive audience. Indeed, one of the main differentiators communicated by top-tier business schools has been the leading edge research of their core faculty.

Not surprisingly, most business schools are strict with regard to who can teach on executive education programmes. Many top-tier institutions forbid the use of external faculty and especially non-academics (ie. non-PhD qualified consultants or practitioners) thereby severely limiting access to the wider fields of knowledge offered by free agents.

Unlike the non-hierarchical philosophy underpinning the Platform Model, academic faculty at top-tier business schools typically monopolise the ‘intellectual’ design of executive education programmes. This approach can be limiting for a number of reasons: academic faculty are experts in a specific management discipline and often tend to frame client issues through their own field of interest; academic faculty can be reluctant to collaborate and share their intellectual content with other faculty on a programme, making integrated design difficult; research-oriented more traditional learning approaches such as lectures and case studies, and; formally trained academics can be dismissive of learning approaches that have not been academically validated, which can be rather limiting when integrating approaches. It is instructive that very few top-tier business schools include teaching performance as a key element of faculty evaluation.

“Clients recognise that their executives’ development needs cover the physical, emotional and spiritual, as well as the intellectual”

Some long-established business schools have taken the path of more open collaboration, with Duke University’s off-shoot Duke CE probably the most widely recognised in this respect. But the vast majority of business schools are still grappling with proprietary approaches more appropriate for the industrial era than the 21st century knowledge economy.

Conclusions

It has been our aim to describe an emerging model for delivering customised executive learning programmes, which is gaining significance in the world of management development. The continuing proliferation of intermediaries that bring together free agents and clients to deliver customised executive learning programs will pose an increasing challenge to the dominance of the proprietary model of most top-tier graduate management schools. Especially, in these dire economic times, the platform model’s approach has the potential to outbid the top-tier Business Schools and gain a foothold in the market for executive learning. They may then establish what the Business Schools’ current advantage is: a brand that makes them a trusted advisor and provider of services. This could potentially be a disruptive development for business schools. ■

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Coaching in workplace brings documented ROI

Coaching is becoming quite commonplace in the corporate world. Organisations of all shapes and sizes, and in all markets are experiencing the real results that coaching brings. Case studies from all sectors have documented high levels of satisfaction and return on investment.

Recent examples include Banner Health, Roche-Turkey, and United Nations Secretariat. All three were awarded the 2012 ICF International Prism Award by the International Coach Federation (ICF) for their successful use of coaching as a leadership strategy. Read on to learn more about their coaching programmes. Also in 2012, the Royal Australian Navy was awarded an honourable mention - their story is also highlighted below.

Banner Health

Federal reforms and a wavering economy have bombarded the healthcare system in the United States, but despite the challenges, coaching has helped Banner Health flourish. Banner Health is one of the largest, non-profit healthcare systems in the US. Their massive coaching programme has offered leadership development to more than 2,000 employees. *"For us, leadership is a direct connection to patient care and excellent clinical results,"* said Kathy Bollinger, president of Banner Health's Arizona West Region.

Roche-Turkey program representatives Esra Aksuyek, PCC, and Berrin Yilmaz

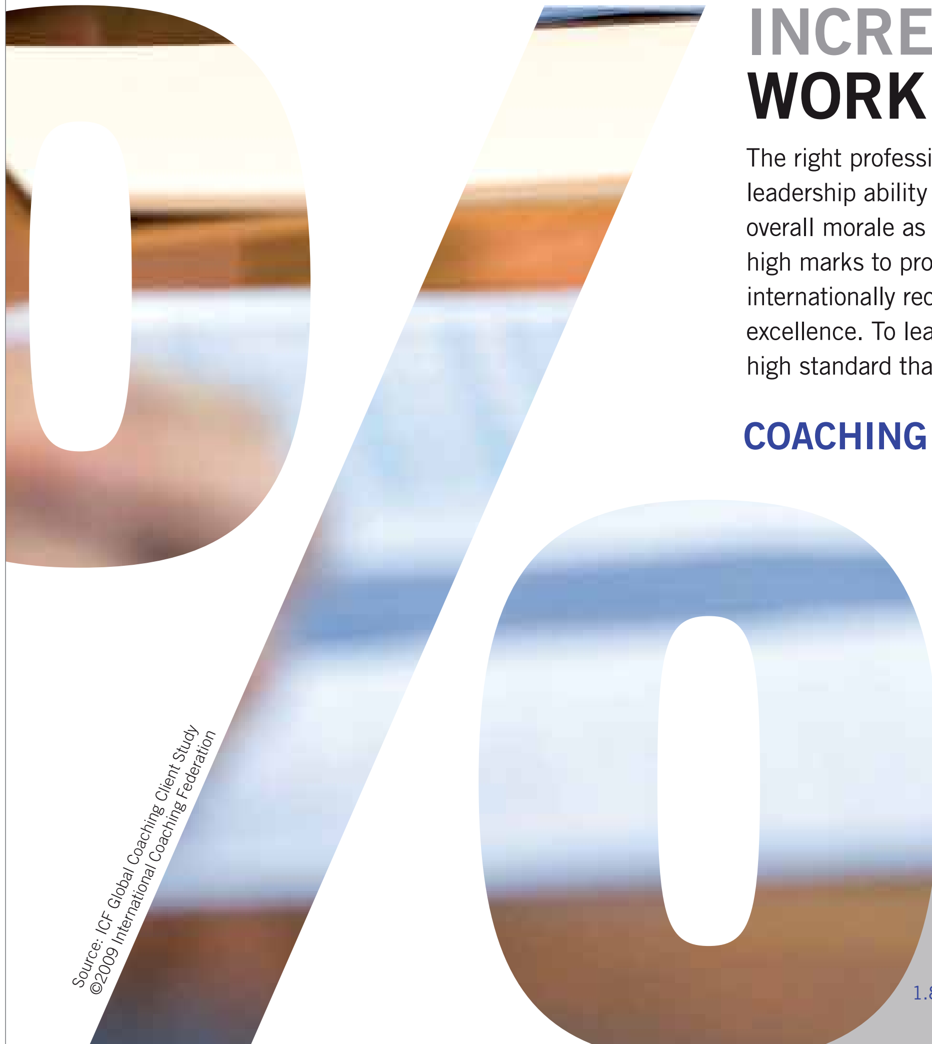
Banner offers one-on-one coaching session and several classroom opportunities. Among those group learning options are 'Coaches Corner,' a monthly tool for everyday leadership and the 'Leaders as Coach' class, a four hour course that goes over the levels of listening, powerful questions and introduces the coaching competencies. There are nine internal coaches who offer coaching in addition to their current Banner duties. *"Banner's community of internal coaches grows in a very intentional pay-it-forward way."* Bollinger continued, *"As we train internal coaches, they engage in coaching and the community grows."*

Banner employees have seen improved conflict resolution, enhanced teamwork, improved productivity, improved patient satisfaction, and better clinical outcomes. *"At Banner, coaching has become an essential tool for helping new leaders acclimate to our culture and accelerate their development,"* said Ed Oxford, Banner Health senior vice president/chief talent officer. *"Existing leaders also benefit from coaching by enhancing their leadership effectiveness and integrating what they've learned into their daily practice, which has produced positive measurable results throughout Banner."*

Roche-Turkey

Roche-Turkey, a subsidiary of a multi-national pharmaceutical company, had high hopes that fell short in 2009 after a lacklustre evaluation. A highly regarded human resources consulting firm demonstrated that the company's employee engagement was 'indifferent' or lacklustre, but they felt they had great potential to become an emerging market leader. So Roche-Turkey decided to pursue an option that's still considered new for corporate development in Turkey: professional coaching. The result was so effective that other companies in Turkey have inquired about how they too can create a coaching culture.

"It was an honour and privilege to be involved in this company's coaching initiative from the beginning," said Esra E Aksuyek, PCC, collaborative creator of their coaching programme. Roche-Turkey offered coach



Source: ICF Global Coaching Client Study
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INCREASE IN
WORK PERFORMANCE

The right professional coach can build employee confidence, leadership ability and a workplace environment that boosts overall morale as well as productivity. Employers worldwide give high marks to professional coaches credentialed by ICF, the internationally recognized authority on coaching standards for excellence. To learn more about ICF-approved coaches and the high standard that defines them, visit **coachfederation.org/value**.

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United Nations Secretariat program representatives Jeri Darling, Fatemeh Ziai, and Maria Hutchinson

training and individual coaching to high potential leaders, and they were groomed to become 'internal' coaches. The next step was offering 45 high potential employees 12 coaching sessions with their internal coaches or an external coach. Two years after their mediocre evaluation, they had surpassed their goals.

The HR consulting firm re-evaluated Roche-Turkey in 2011, and instead of being categorized as 'indifferent,' they were rated as a 'high performing' company. They found employee engagement increased by 11 percent, employee turnover was reduced by two percent, and the employee talent pool increased by 22 percent. They said coaching skills are used in daily business dealings, when managing their departments, and when facilitating meetings. Employees are more open and trusting. Instead of making assumptions, they ask clarifying questions and honour other people's opinions. Aksuyek said, *"To observe changes and benefits that developed as the company moved more deeply into a coaching culture was extraordinarily rewarding."*

"A professional coach can help organisations and individuals within organisations achieve strategic business objectives"

United Nations Secretariat

The United Nations faces the worst natural disasters and man-made emergencies, so effective leaders are vital to their success. Coaching came to the United Nations Secretariat as an action plan to help managers deal with a tremendously complex global operating environment. But coaching did more than help them deal with complexity; it re-shaped the culture of the organisation. *"You have a growing group of people - a very diverse group as you can imagine - from across the organisation bringing the lessons learned from the program into their work, practicing new behaviours... This all creates a more positive work environment,"* said Sandra Haji-Ahmed, Former Director of OHRM's Learning, Development and HR Services Division.

In 2009, Encompass, LLC began developing a coaching programme for the United Nations Secretariat to increase managerial capability and enhance the delivery of the Secretariat's strategy. Various workshops and one-on-one sessions were offered to senior directors and managers. In all, more than 1,000 employees have been coached.

The programme appeared to have the greatest impact on job satisfaction but also demonstrated a strong positive influence on cost effectiveness, efficiencies and productivity. The impact study revealed increased recruiting efficiency by 100 percent, increased team productivity by 7.5 percent,

The top nine questions to ask a potential coach:

1. Are you a member of the ICF?
2. Do you hold an ICF Credential?
3. What is your coaching experience (number of individuals coached, years of experience, types of coaching situations, etc.)?
4. What is your coach-specific training? (Enrolled in an ICF approved training programme, other coach-specific training programme)?
5. What is your coaching specialty or areas in which you most often work?
6. What specialized skills or experience do you bring to coaching?
7. What is your philosophy about coaching?
8. What is your specific process for coaching?
9. What are some coaching success stories (examples of individuals who have succeeded as a result of coaching/how the coach added value)?

2012 ICF President Janet Harvey, MCC, and Commander Grant Dale, Director of Navy Leadership and Ethics, Royal Australian Navy

reduced direct conflicts by 7.5 percent. There was an 87.6 percent return on investment (ROI), which indicates for each dollar invested in coaching there is a $1.88 return.

Honourable mention: Royal Australian Navy

In 2009, The Royal Australian Navy shifted their focus. They wanted to move their culture from one of 'can do at any cost' to focusing on 'balancing the needs of people and task to achieve the mission.' To accomplish this goal, they focused on a leadership development program, which offered a three-day workshop that fed into individual and group coaching options. The coaching programmes were adopted to accelerate the transition of learning into the workplace and achieved an astounding ROI of 723 percent. A total of 460 people were coached and the results included improvements in trust between ranks, the effectiveness of communications, and the sense of professionalism held by Navy personnel.

"Since introducing the Executive Coaching programme we've seen a significant and a positive shift in Navy's leadership culture," said Director of Navy Leadership and Ethics, Commander Grant Dale. *"The recognition of the Prism Award reinforces the importance of coaching to the transference of learning into the workplace and as an essential component of developing and maintaining strong leadership in an organisation."*

Past winners of the ICF International Prism Award include: Deloitte, JOEY Restaurant Group, BC Housing, Verizon Business, IBM, NASA (APPEL 4-D Systems), the BBC, Genentech, TINE Group, Solaglas Windowcare, ibm.com North America, SYSCO Food Services of Canada, MCI and University of Texas at Dallas. You can learn more at Coachfederation.org/prism.

Interested in bringing coaching into your organisation?

A professional coach can help organisations and individuals within organisations achieve strategic business objectives. The value brought by professional coaching may include: increased business performance; higher employee retention and morale; greater employee commitment; leadership development; conflict reduction; and team building skills. A professional coach will support your organisation, your staff, and other stakeholders in finding creative solutions and strategies to achieve specific business goals.

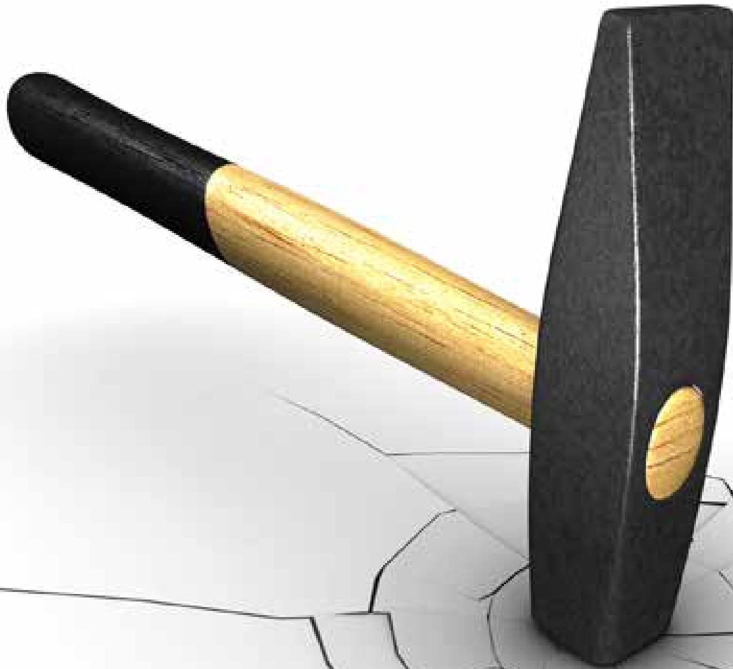
The process of selecting a coach among the vast network of professionals operating around the world can seem overwhelming. To aid in the procedure, all ICF Credentialed coaches are searchable through an online directory, the ICF Coach Referral Service (CRS). CRS is an ideal tool to jumpstart your search - it is a free public resource that allows clients to tailor their search for a qualified coach based on specific criteria, be it the coach's professional experience and direction, or a certain coaching method or language preference.

When in the process of selecting a coach, clients usually interview at least three different coaches to find their perfect match. They will ask a specific set of questions relating to their requirements and look at the coach's experience. Ultimately, the client has to find confidence in a coach, while at the same time the chemistry also has to be right. The personality between client and coach doesn't have to match – sometimes opposite personality types will bring the best results.

To avoid hiring coaches who may solely be relying on skills they have acquired while performing other careers, coaching clients prefer proof that their coach has been trained properly as a coach. Research shows a growing desire by clients for coaches to be able to clearly demonstrate their coach specific training and experience.

According to results of the 2012 *ICF Global Coaching Study*, 76 percent of all respondents agree that, *"The people and organizations who receive coaching expect their coaches to be certified/credentialed."* This is consistent with previous findings from the 2007 *ICF Global Coaching Study* that showed that 52 percent of respondents reported that, *"The people we coach increasingly expect us to be credentialed."* and the 2010 *Global Consumer Awareness Study* that showed that 84 percent of participants agree on the importance of certification/credentials. ■

Employee training and development is essential. But how can companies ensure it is effective and worthwhile? Lindsay Ryan provides some guidelines



HIGH IMPACT

IMPROVING THE IMPACT OF CORPORATE EDUCATION PROGRAMMES

Most organisations realise they need to spend money on employee training and development but few of them optimise their programmes and return on training expenditure.

Even organisations among those highly regarded for investing in their employees admit privately there is more they could do to make their employee learning and development programmes more effective. As with most things, the better the upfront planning and preparation, the greater the impact and outcomes from a corporate education programme.

With appropriate planning, an effective corporate education programme can play an integral role in helping an organisation achieve its strategic goals as well as:

- retain existing employees
- attract new employees
- develop the skills and capabilities of employees as well as the organisation as a whole
- develop and facilitate succession planning
- facilitate innovation and ideas for new products, services, customers and processes.

Rather than being reactive in delivering corporate education and training programmes, a more measurable and effective outcome will be achieved by being strategic during the planning stage.

A strategic approach to corporate education

When approaching corporate education and employee training from a strategic perspective, the starting point is to determine an organisation's strategic direction and goals over the forthcoming three years.

From these goals, the organisation needs to explore scenarios of possible future requirements and issues the organisation may have to contend with and the range of knowledge, skills and capabilities it needs to succeed in these different scenarios.

With most advanced economies experiencing an ageing workforce organisations need increasingly to develop their future leaders and capabilities from within. As such, organisations need to step up their preparation and implement succession plans for key leadership and operational roles with an emphasis on developing the skills and capabilities of people within the organisation.

Employee learning and development needs to be treated as a strategic investment and all expenditure on corporate education programmes should align with the goals and strategic direction of an organisation.

To ensure the most effective outcomes from corporate education and training programmes it is important to secure the support of the CEO, senior managers and line managers. Therefore, when a training proposal is developed it should be presented as a business case so that key stakeholders can better understand and be encouraged to support the proposed programme.

"With appropriate planning an effective corporate education programme can play an integral role in helping an organisation achieve its strategic goals"

A business case does not need to be a complex document. Instead, a concise paper can provide a context and the reasoning for a particular programme and its link to the organisation's strategic goals.

A business case of one or two pages can outline:

- the learning objective/s
- reasons for the programme, including new knowledge or skills required or current skills gaps
- implications if the programme does not proceed
- budget, timeframe and any special resources required
- key stakeholder involvement, including CEO, executives and/or line manager/s
- expected outcomes, including estimated return on training investment
- how the programme will be evaluated

Line managers' role in corporate education

A study by KnowledgeAdvisers in the US (*"Scrap learning and manager engagement"*, Chief Learning Officer, 29 March 2011) found that after participating in a training programme only 9% of people actually applied what they learned with positive results. Over three-quarters of participants applied 50% or less of what they learned.

The study found that participants fall into three categories:

- Participants make no attempt to apply what they learn
- Participants attempt to apply their learning but with no worthwhile results
- Participants apply what they have learned and get some positive results

KnowledgeAdvisers claims the success of any corporate education and training programme starts with the line manager.

The line manager needs to consider the case for training:

- Assessing the suitability of each employee to attend a specific programme
- Determining whether the timing is right for each employee
- Meeting with each employee and jointly establishing an expected learning and performance outcome and an action plan describing how the outcomes can be achieved
- Assisting employees to prepare for the learning event

After a training event, the manager should meet with each employee to review his or her action plan and provide feedback on the employee's performance.

“CEOs want more tangible information about the impact a programme has on their employees and the organisation”

KnowledgeAdvisers emphasises the importance of a pre-training meeting and action plan developed jointly between the line manager and the employee. Without the plan, the outcome is likely to be a low return on investment as there is no context for the training programme and no adequate means of determining the outcome.

Evaluating corporate education programmes

While most corporate education and training programmes receive some form of evaluation, CEOs increasingly want more than traditional information such as the number of employees who attended a programme, how many completed it, the overall satisfaction with the programme and, sometimes, feedback on the venue and/or catering.

This information does not help CEOs to see the value they are getting from investing in the learning and development of employees. Instead, CEOs want more tangible information about the impact a programme has on their employees and the organisation.

In 1959 Donald Kirkpatrick introduced his four-level evaluation model: Reaction, Learning, Behaviour and Results. Most organisations would use at least part of the Kirkpatrick model to evaluate their corporate education programmes, especially levels one and two.

Dr Jack Phillips built on Kirkpatrick’s model with the Phillips ROI (Return on Investment) evaluation. This incorporated evaluation planning prior to a programme followed by data collection during a programme and data analysis at its end to compile a formal report that measures a programme’s impact.

However, the ROI approach can be time consuming and expensive relative to the cost of a programme and is mainly suited to bigger budget, strategic and highly visible corporate education programmes involving large numbers of employees.

Success Case Method

The Success Case Method is another means of evaluating corporate education programmes that is practical and relatively low cost. The Success Case Method evaluation is based on a recognised and validated research method developed by former university professor Robert Brinkerhoff.

It involves all participants, or a representative sample of them, in a corporate education or training programme responding to a quantitative survey, usually online.

Ideally, an independent evaluator should facilitate the survey so participants can respond honestly and confidentially as the survey asks for their name and contact number for possible clarification or exploration.

The quantitative survey usually reveals a standard distribution of responses that indicates most people gained some knowledge and applied some elements of a programme. However, there are usually people at the two ends of the responses: those who gained a considerable amount from a programme and are applying their learning and those who claim they found the programme of no value or they already knew all the programme content or they are not applying any learning.

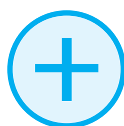
These two extreme clusters of respondents are then interviewed by an independent evaluator to explore the factors that enabled or enhanced their learning experience and the barriers that restricted their learning and the impact of the programme.

The Success Case Method broadens the focus from an evaluation of a programme’s content and delivery method to an evaluation of how effectively an organisation uses the learning from it.

Often the high impact, or lack of impact, from a corporate education and training programme has little to do with the actual programme content, learning materials or facilitator.

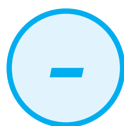
A recent executive education programme evaluation using the Success Case Method, found:

- the learning and transfer of knowledge is greater where the organisation had provided or created opportunities for employees to apply their learning
- the sooner an employee is able to apply their learning the greater the retention and use of their new knowledge and skills
- a key barrier to effective employee learning is the lack of support from their line manager.



9%

A study by KnowledgeAdvisers in the US found that after participating in a training programme only 9% of people actually applied what they learned with positive results...



50%

... but over three-quarters of participants applied 50% or less of what they learned

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The evaluation also identified the topics and modules of least and most value to the employees and how the employees are applying their learning to their job.

The factors contributing to a successful programme are then written into a series of case studies for the CEO and senior managers to provide specific examples of how various employees are applying their learning, how the programme has helped them in their job, how it has enhanced their skills and knowledge, and how the programme has had a positive impact on the organisation.

Similarly, case studies are compiled that identify barriers to the application of the learning in the organisation so the CEO and senior managers can take steps to alleviate those barriers in future corporate education and training programmes. ■

ABOUT THE AUTHOR

Dr Lindsay Ryan is Director of Corporate Education Advisers, an Australia-based corporate learning consultancy. He is the author of Corporate Education: A Practical Guide to Effective Corporate Learning published by Griffin Press, Australia, 2010; ISBN 978-0-646-52812-0. Dr Ryan is also Visiting Fellow in Corporate Education with Birmingham City Business School in Britain.

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Creating innovative leaders of the future with quality management education

Quality MBA education has evolved with the changing needs of an increasingly global and competitive economic environment, says Vanessa Harwood-Whitcher, Chief Operating Officer of the Association of MBAs.

In a world of change and economic uncertainty, accredited business schools recognise the need to adapt and innovate to ensure that management education remains relevant. The MBA programmes of today will help develop effective and responsible leaders of the future by encouraging innovative and entrepreneurial thinking.

As an ever increasing number of MBA programmes become available across the world, it is even more important that the top business schools have an internationally recognised stamp of quality in the form of accreditation, to distinguish the world-class MBA from the quick online fix.

As the Association of MBAs celebrates its 45th anniversary, it is an interesting time to look at how the MBA has become an integral part of postgraduate business education and how it has evolved to become the defining management training to prepare 21st century leaders and entrepreneurs for today's complex economic, social and cultural environment and the geo-political landscape.

The Association of MBAs was created by MBAs for MBAs. Initially founded as a membership organisation in June 1967, by a small group of MBA graduates from the USA and UK, its mission was to help the development of existing business schools, support the founding of new schools of business and encourage employers to take on MBA graduates.

In 1983, the Association of MBAs introduced an accreditation programme to champion the MBA as a brand and to introduce a quality assurance process to ensure standards were maintained among the growing number of business schools starting to offer MBA programmes. The Association of MBAs became the benchmark by which business schools were measured, initially in the UK, and then in different countries across the world as accreditation grew internationally.

What AMBA achieves with accreditation is two-fold. Firstly, the Association of MBAs accreditation sets an international standard; ensuring key quality indicators for postgraduate business education are benchmarked globally. This is done through a rigorous and independent assessment process of the MBA programmes.

Secondly, accreditation ensures the business schools are progressive, committed to change, and to developing the MBA so that it continues to be innovative and creative in model and delivery.

Forty-five years on from the early days of the MBA, the Association of MBAs has accredited MBA provision at an elite group of 200 business schools who provide more than 700 MBA programmes in 75 countries. Our accreditation criteria means that only the world's best business schools gain AMBA accreditation.

As business has become more global we have also seen business schools across the world understand the need for an internationally recognised benchmark of education standards in the form of accreditation. With initial growth of MBA accreditation in UK and Europe, the shift then changed to an increasing number of schools in the emerging economies offering high quality MBA programmes, including China, India, Eastern Europe and Latin America.

We have also seen a change in MBA student enrolments globally. While the economy and other factors have meant that the numbers of MBA enrolments in the UK and some European countries have either declined or stayed level in recent years, there has been huge growth in students taking MBAs in other parts of the world.

Business schools in China and Hong Kong saw an 85% increase in part-time MBA applications and average part-time enrolments shot up by 40% according to the Association of MBAs' 2012 Intake and Graduation Report. On average each school in China enrolled around 450 MBA students in 2011 – more than twice as many enrolments as UK schools.

The MBA market in Latin America also expanded between 2010 and 2011, with an average increase in enrolments of 20% year on year. For the first time, the 29 business schools in Latin America and the Caribbean with Association of MBAs accreditation enrolled more MBA students than all the business schools in the UK, making up a quarter of all accredited MBA enrolments worldwide.

"The MBA has become an integral part of postgraduate business education and ... has evolved to become the defining management training to prepare 21st century leaders and entrepreneurs for today's complex economic, social and cultural environment"

The uncertain job market has also had an impact on the mode of study with more people choosing to study part-time or distance learning MBA programmes. In fact, for the past three years, there have been more distance learning MBA students studying in the UK than full-time students. There are now more part-time programmes offered by accredited business schools throughout the world than all other modes of study combined. Globally, two-thirds of enrolments onto accredited MBA programmes are onto non-full-time courses: outside North America, the majority of MBA students choose not to study full-time.

Another trend has been for more and more business schools to also offer MBA programmes in different countries. Almost a third of all accredited UK business schools now run MBA programmes overseas, for example in Jordan, Singapore, Dubai or Barbados. European business schools have also

Association of MBAs Innovation Award finalists with Kris Akabussi MBE – from left to right - Susan Cooper, Cathal Brady, Carlos Palhares, Sameer Hajee

begun running satellite programmes. There are more than 40 accredited MBA programmes provided outside Europe. Overall, more than 15% of all business schools with AMBA accreditation offer MBA programmes outside their home country.

Whatever the trends in mode and delivery of study, one thing is consistent and that is the accredited business school's commitment to future proofing their postgraduate management education to develop and prepare students to be innovative and entrepreneurial leaders.

The business schools with AMBA accreditation recognise the importance of introducing creative, new teaching and concepts to their MBA curriculum, and AMBA recognises these with our annual MBA Innovation Award.

INSEAD's Sci-tech Commercializer MBA won MBA's Innovation Award in October 2012. The Deputy Dean of Degree Programmes, Peter Zemsky says business schools have a key role to play in encouraging and fostering innovation amongst their students to develop effective leaders of the future.

"Leaders need to innovate in order to sustain and promote growth in business, ultimately impacting not only the organisation but also the economy and society itself. The MBA provides an environment in which students can test and exchange ideas, understand the complexity of business in today's fast-changing world and understand the impact of their decisions on society as a whole," says Zemsky.

INSEAD's Sci-tech Commercializer MBA recognised the need to learn in real-time through involvement with real projects. The programme is a partnership with SATT LUTECH and involves workshops, bootcamps, classes and competitions centered around entrepreneurial development and technology start-up creation.

Filipe Santos, INSEAD's Associate Professor of Entrepreneurship says: *"The students love the experiential learning aspect of this programme. They are not simply hearing about theories and working on published case studies. Instead they are being challenged to roll up their sleeves and create real companies."*

From left to right: Sir Paul Judge, President of the Association of MBAs, Filipe Santos, Associate Professor of Entrepreneurship, INSEAD, Kris Akabussi MBE

Dr Ian Sutherland, Deputy Dean for Research at IEDC-Bled School of Management who's Arts and Leadership MBA was one of the four finalists for the MBA Innovation Award, says that the global and economic changes make it essential for business schools to innovate.

"Educational institutions have a profound responsibility to be places of new knowledge creation and dissemination and to help our students make meaningful contributions to the betterment of the world. While we are guardians of knowledge traditions, we are also gardeners of new skills, ideas, and most importantly helping our students grow in ways which not only keep pace with change, but are responsibly, ethically and critically part of it," says Dr Sutherland.

IEDC Bled's Arts MBA Programme is an example of the Slovenian business school's commitment to engaging their students at very deep levels of experiential learning and self-reflection. Dr Sutherland feels the arts offer students an opportunity to experience creativity and challenge as they learn about leadership and management.

China's top business schools are becoming more widely recognised internationally. In 2006 there were two schools in China and Hong Kong with Association of MBAs accreditation, now there are 20. In 2012 Wuhan University Economic Management School's Executive MBA was a finalist for the MBA Innovation Award.

The business school has had to compete on a national scale as well as now internationally. Yu Jingjing, Associate Director of Wuhan's Economic and Management School says being innovative has played an important part in raising brand profile in such a competitive marketplace. *"The only way for us to survive is to adapt and innovate, especially in faculty development and providing more value to our students and alumni. We always aim to develop executives with profound humanities quality and ethical behaviour."*

Wuhan is a long established university with a strong background in humanities and social sciences. It played to its strengths in developing an Executive MBA that integrated China's traditional humanities and philosophy into its management education.

"Students get a new level of ideological thinking which improves their overall humanities and leadership qualities," Yu says.

A new generation of entrepreneurs are also being produced from accredited MBA programmes. Professionals are choosing to study for an MBA to bolster their business skills, so they have the tools and the confidence to then set up a new venture or change career and sector.

This year's MBA Entrepreneurial Venture Award winner, Cathal Brady says that an MBA is a bit like many of the start-up incubators. *"It gives a great overview of several aspects of*

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business life and gives lots of in depth knowledge of the more important ones."

The graduate from UCD Michael Smurfit Graduate Business School in Ireland came from a technical background professionally so says he found the experience he gained from his MBA in accountancy, strategy, business management and marketing invaluable.

"The knowledge I gained gave me huge courage when dealing with accountants, lawyers, marketing people and customers. I would not have got this in my working life at that time."

Initially his MBA helped Brady move into a completely different industry for five years before he then started Ultan Technologies a software development company in Dublin. This new insight about how people use software products helped him get back into software and spot a business opportunity that he says he would not otherwise have spotted.

Brady says that the MBA taught him to see that you don't have to set up your own company to be entrepreneurial or innovative. It is equally important to have those qualities in larger organisations and that larger organisations should be encouraging it in their employees.

"The companies that encourage their workers to look for new ways to do things and to look for new lines of business are the ones that flourish."

Susan Cooper, a Cass Executive MBA graduate, was a lawyer for a large London firm before undertaking her MBA.

"I got to the point in my career where I was at a bit of a cross roads. I wanted to take stock of what I was doing and make sure that anything I did was going to make me more marketable in the workplace," she says.

Cooper, who knew from quite early in her career that she wanted to set up her own business says the MBA *"gave me a really good insight into the different areas of business and in particular a good overview of the disciplines, which meant that when I came to start my own company I felt very confident that I had a good understanding of all the different areas within business."*

While at Cass, Cooper says it was her choice of the New Venture Creation Programme elective that helped give her the confidence to start out as an entrepreneur: *"it very conveniently brought all the different elements of the MBA together in the context of setting up a new business and made the whole process seem less daunting."*

It is not only innovation and entrepreneurship at the heart of accredited MBA programmes; the business schools also include sustainability and responsible management into their core curriculum.

The Association's partnership with PRME informs our accreditation criteria to include specific requirements for business schools to demonstrate learning outcomes and a curriculum focused on ethics, sustainability, responsible risk management and governance, environmental and social impact.

At our international conference for Deans and Directors and more recently at our conference for Asia Pacific schools in November, these topics were high on the agenda, with business school leaders agreeing that sustainability needed to be at the core of the MBA programme.

AMBA accreditation criteria also require MBA students to have a minimum of three years' work experience. We strongly advocate the MBA as a post-experience degree, as a great deal of the value it offers is the element of learning from peers – prior management experience and bringing real-life examples to class to debate with fellow MBAs is invaluable.

Whatever the future holds for business and the economy, the top management schools, providing accredited MBAs, are committed to developing responsible and entrepreneurial global leaders of the future. ■

For more information on the Association of MBAs and its accredited business schools go to www.mbaworld.com

WORLD COMMERCE
REVIEW

AWARD

Best Global Distance Learning 2012-13

World Commerce Review is pleased to announce that The University of Wisconsin - Whitewater has been awarded the Best Global Distance Learning Award for 2012/13.

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

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

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

Learn about an MBA programme before learning from it

Deciding on a business school is an especially complex process. In an interview with World Commerce Review, the Dean of the College of Business and Economics, University of Wisconsin-Whitewater, Christine Clements, examines the most important factors.

What makes an MBA programme a quality choice?

The University of Wisconsin - Whitewater has earned the *World Commerce Review's* Best Global Distance Learning Award for 2012-2013. The college recognizes that as managers make decisions about furthering their educations, they will encounter dozens of options for degrees including traditional, executive, and online programmes. These talented business leaders want to choose carefully as they commit to one college for a decision that impacts their whole lives.

With so many options in MBA programmes, what factors are most important?

Buyers use the words 'quality' and 'value' to describe products from soap to automobiles. Consumers understand those terms in their tangible contexts of suds and safety ratings. But these terms present more difficulty when services are involved. Purchasing insurance or vacation packages presents more challenging evaluation processes than choosing goods. Services are more difficult to compare than goods because much of service buying is based on the intangibles of reputation, referral, or unsubstantiated trust.

Among services, deciding on a business school is an especially complex process. Buyers will make one extended commitment to an MBA curriculum. Their choices will affect their future knowledge and skill, their career advancement opportunities, and even their self-respect and confidence. MBA programme costs are substantial and vary widely, and price is rarely a proxy for quality. So as candidates screen various offerings, what factors should they weigh in their decision-making?

How important is accreditation?

Accreditation is a crucial piece of information. Some business schools are regionally accredited while others have international accreditation. One of the most rigorous accreditation bodies is AACSB International (the Association for the Advancement of Collegiate Schools of Business). Only 5% of business schools worldwide meet their criteria. Earning this accreditation assures potential managerial students that a team of business school deans has evaluated the college on many different standards including mission-based strategic planning, current and meaningful curriculum, faculty qualifications, and students' meeting established learning outcomes.

Are all MBA curricula basically the same?

MBA programmes have considerably different approaches to how and what students learn. Some MBA programmes are designed for cohorts, and students all take the same functional area classes. Every student completes the same set of courses to degree. Though this type of programme is very efficient from a production standpoint, it leaves students no opportunity for choice and specialization. MBA programmes that offer emphasis areas provide specialized knowledge, giving graduates an employment edge in fields such as human resources, finance, marketing, supply chain, or information technology.

Can online classes be as good as face-to-face classes?

Online offerings give busy managers the opportunity to complete MBA degrees if they expect to be transferred from one location to another, even if those transfers may be global. Where there is Internet access, they can continue their progress towards their goals. Even if they expect to stay in their current locations, managers regularly face unpredictable schedules that limit their ability to attend classes consistently, whether in the evening or on the weekend. Work travel is another impediment to executives' ability to finish advanced degrees in face-to-face formats. Online programmes appear to solve many logistical problems, but evaluating quality in these programmes can be challenging.

How can advancing executives evaluate the quality of online MBA programmes?

Managers who are interested in enrolling in online MBA programmes can use the same criteria for initial screening as they used for face-to-face programmes:

- Is the programme accredited by a business-specific accrediting agency? What is the rigor that agency employs, and what other colleges are accredited by the agency?

- Does the curriculum address the specific topics of interest to the management student?

But unique questions arise in evaluating the quality of online MBA programmes:

- Are admission processes and coursework requirements as rigorous as the classroom versions of MBA programmes? They should be.
- Who are the faculty? Is the online faculty the same as the face-to-face group? Are they teaching full-time and qualified with terminal degrees?
- Have all faculty been trained for online teaching, and how are they evaluated? While online teaching is definitely not 'less' than face-to-face teaching, it is different from face-to-face teaching and requires a level of technological expertise, attention to detail, and immediacy of response that classroom teaching may not necessarily demand.
- Is the institution offering its MBA as a for-profit or not-for-profit enterprise? Especially in the US, for-profit online education providers have proliferated widely over the last decade. The profit status of a school will affect the price that students pay. Sometimes costs are hidden in special fees outside of regular tuition. Potential students should look at the entire price and compare across types of schools as they make these important choices impacting their futures. More expensive does not equate with better quality.

The University of Wisconsin – Whitewater's Online MBA Programme was honoured to earn the *World Commerce Review's* Best Global Business Learning Award for 2012-2013. In reviewing the evaluative criteria for online MBA programmes, talented executives will find that the University of Wisconsin – Whitewater adheres to the most rigorous standards:

- Its business programmes are all AACSB International accredited.
- The Whitewater programme offers seven different emphases including specializations in finance, human resource management, international business, information technology management, management, marketing, and supply chain management. These emphases ensure that MBA students will have the necessary functional background to be successful as generalists but also specific knowledge providing them with the knowledge and skill to move seamlessly into specialized areas.
- Admission processes are well defined and are the same as the college's face-to-face MBA programme.
- Graduation requirements are rigorous enough to guarantee a rewarding experience.
- Faculty are all full-time and qualified by doctoral degrees and current research in their fields.
- Each term, a team of faculty peers reviews and evaluates all online classes.

The University of Wisconsin – Whitewater invites talented business people worldwide to learn more about this award-winning Online MBA by visiting www.uww.edu/cobe/onlineMBA.

This online programme is truly *"a degree above."* ■

Learning to breathe, again!

Hannelore Forssbohm is Program Director at the Kellogg-WHU Executive MBA Program

Managers today often find themselves in a high pressure and fast-paced environment, with little time to reflect, grow, and yes, breathe.

Executive education – whether an executive MBA (EMBA), open-enrolment or customized company programs – often offers the opportunity to do just that; breathe and take control. *"By stepping out of your daily management roll, you have a great chance to gain a broader, multi-faceted perspective into your business and the business world in general,"* explains Hannelore Forssbohm, program director at the Kellogg-WHU Executive MBA Program. *"EMBA students return to their offices and are immediately able to apply what they've learned in the classroom. This eye-opening and, in some cases, life changing, experience can only happen when you allow yourself to close the office door and immerse yourself in a new challenge,"* she adds.

Indeed, as companies face the growing challenge of demographic change and globalization, life-long learning becomes a critical success factor for sustainable competitive advantage. Managers switch employers more often and are sought after globally rather than nationally. As a result, employer branding and executive development are ranked as hot topics within company leadership circles.

"As the workforce becomes more diverse, the needs for executive development have also become more heterogeneous," says Rebecca Winkelmann, managing director of Executive Education at WHU. *"Even with small to medium-sized companies, the implementation of life-long learning concepts has gained complexity. Of course, it's not only students that benefit. Companies profit through the expanded perspective with which their managers return."*

Students can take advantage of the vast theoretical and practical professor knowhow, but also the versatile experience from their very diverse counterparts who are also pursuing their EMBA degree. The program puts strong emphasis on teamwork and study groups are an essential part of the experience to prepare students for future leadership roles.

A mix of techniques, heavily focused on case study methodology, allows students to work in interdisciplinary groups and, in turn, discuss, debate and solve real-life business problems. By drawing on the participants' own professional experience an interactive learning environment

is created which promotes an exchange of ideas between students and faculty.

"At Kellogg-WHU, we take great care in assembling the study groups", adds Hannelore Forssbohm. *"It is extremely important to us that managers benefit in every way possible and absorb experiences and information from every source that is available to them – professors, fellow students and renowned guest speakers."*

The programme is aimed at those working in medium and upper management with at least five years of management-related experience. The time structure allows students to continue with their work obligations while at the same time actively participating in the program.

Attention is paid to ensure varying academic backgrounds from all walks of life including banking and finance, IT, consulting, trade, engineering, sciences and law. The result is a greater understanding of management issues across the board, increased credibility and a broadened professional network – all of which leads towards a higher degree of confidence for men and women alike.

The last five years has seen a quite a change in the corporate landscape. With the financial crisis, corporate scandals and the increasing influence of emerging markets. However,

"... life-long learning becomes a critical success factor for sustainable competitive advantage"

a top-tier EMBA Program is one that has always evolved to reflect the business environment. According to Axel Hamann, CEO/Bayer Turkey and 2010 Kellogg-WHU Graduate, *"The programme and its content provided me with a profound toolbox on every aspect of ...leadership or strategic topics... I particularly appreciated the great emphasis which was put on ethical management behaviour in the course of the programme and I am convinced that sufficient background has been provided to act responsibly in every sort of business environment."*

"Before Corporate Social Responsibility became a buzz word, Kellogg-WHU integrated ethics and social responsibility in all aspects of management knowledge that is communicated to students," says Forssbohm. *"So, no, the current frenzy hasn't had an influence on the philosophy and approach of the school – Kellogg-WHU has ALWAYS attempted to create and strengthen managers who are ethically and socially responsible. And we always will."* ■

Women Matter

Women aren't making it to the top. While just over 51% of middle management positions are held by women, they hold just under 3 percent of Fortune 500 CEO positions.[1] In the C-suite, they're outnumbered four to one.[2] And when they do make it, they earn significantly less than their male counterparts.[3]

According to McKinsey & Company's October 2007 gender diversity and financial performance report, *Women Matter: Gender Diversity , a Corporate Performance Driver*, higher gender diversity leads to a higher bottom line – simply the result of a more 'gender balanced' viewpoint in the Boardroom. In its October 2010 report, *Moving to the Top*, McKinsey reasserts its point, claiming 85% of women and 58% of men believe that there is a connection between gender diverse leadership teams and financial success.[4]

Few women have had the benefit of not having to face a 'glass ceiling'. Martina Haunert, Managing Consultant, Detecon International GmbH and Kellogg-WHU Executive MBA 2009 graduate says, *"So far in my career I have been fortunate to work with companies that value women and our contribution. I am used to being judged by my performance and results, not by gender."* However, she goes on to explain her desire for female managers to be in a position to determine their own career path – and not be at the mercy of male managers who often make decisions regarding to which extent their female colleagues can take on an assignment. *"Instead we need a proper daily child care so that the decision 'mother or business woman' is no more an issue,"* explains Haunert.

The question then becomes – is there a way to support women as they attempt to climb the career ladder? While options such as mentoring and on-site day care are aspects that have long been in discussion, these are also factors that individual organizations are left to consider and implement. However, perhaps there are ways that female managers can impact their climb on their own, relying less on company decisions. One approach may be to consider formally increasing their business know-how and professional network. Both can be accomplished through an Executive MBA.

"The EMBA gave me the confidence needed to move away from my subject expertise and to take on responsibilities in client management and business development. My clients are executives spanning all functions in the telecommunications industry, from strategy to operations. I fully benefit from what I learnt in the MBA and apply it everyday..." claims Haunert.

Still, the decision isn't easy.

"It's important to consider this as an investment in yourself. Women have a tendency to think about everyone else's needs first: family, colleagues and friends often take precedence. Often,

"The participation in an EMBA program results in a greater understanding of management issues across the board and at all levels, increased credibility and a broadened professional network"

the concern of trying to balance all of this is more daunting than for their male counterparts and, rather than diving in, women may be reluctant to attempt this rigorous journey," says Hannelore Forssbohm, Senior Program Manager, Kellogg-WHU Executive MBA Program.

In fact, successfully completing a top-tier Executive MBA Program aids managers in many ways. While an increased financial ROI may be an obvious result, a personal ROI also plays a key role. Female managers are less likely to ask for increased responsibility, a promotion or even higher salary. The participation in an EMBA program results in a greater understanding of management issues across the board and at all levels, increased credibility and a broadened professional network – all of which leads towards a higher degree of confidence.

"The EMBA program enabled me to gain a much greater confidence in interpreting and understanding complex business matters and provided a bridge for me to undertake a General Management Programme role. Had I not undertaken the program I would have been pigeon holed as an HR professional for the rest of my career," states Emma Nicholls, Head of Organisational Development, UK Power Networks and 2009 Kellogg-WHU Graduate.

"I think it also provided a good global alliance of other senior business women and an insight into understanding the issues we may face. I particularly learnt how to be assertive in a male dominated study group and that when you are taken out of the work place – everyone is equal as the usual hierarchy no longer exists so you have a 'safe' territory to try out some different styles and techniques."

Nicholls is also realistic about having to juggle job, potential family obligations and a rigorous EMBA program: "*Carrying out the EMBA programme stretches your boundaries about always being in control and teaches you that sometime s a compromise is necessary and we are all just human!!"*

"It can most certainly be done!" Hanne Forssbohm is quick to point out. *"In our program, there are many examples of successfully balancing everything...Our female graduates have been enriched in every facet of their life having indeed 'done it all'!"*

According to Forssbohm, *"The question moves from 'Should I?' to 'Why shouldn't I?!'"*. ■

1. Catalyst Study 2011, Fortune 500 Companies
2. Harvard Business Review Research Materials; The Sponsor Effect: Breaking Through the Last Glass Ceiling by Sylvia Ann Hewlett, Kerrie Peraino, Laura Sherbin, Karen Sumberg 90 pages. Publication date: Jan 12, 2011. Prod. #: 10428-PDF-ENG
3. Pay & Benefits; Women still playing catch up with men Equal pay by Petra Wilton, date: September 2010
4. Women and the EMBA, EMBA Council Presentation by Prof. Dr. Beatrix Dart, Associate Dean, Executive Degree Programs, Joseph L Rotman School of Management, University of Toronto, Canada

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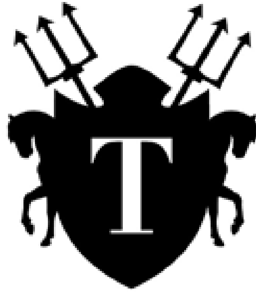

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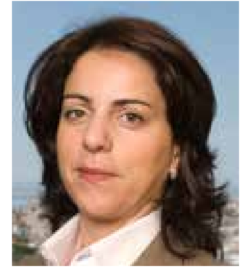
CSR thinking



Sofia Ferreira Enriquez is a Partner at Raposo Bernardo, Lisbon

Undoubtedly, Corporate Social Responsibility (CSR) is emerging as an important concern of boards. We cannot say that social responsibility is something new. Not even the formal concept of CSR can be taken as something 'relatively' new. Many firms, such as our own, have been involved in pro bono work, community activities and environmental initiatives, often for years.

Nevertheless, recently CSR has become more formal. There has been a notable evolution towards CSR's wider approach, envisaged to make social responsibility a structural piece of corporate life. This demands a long-term plan. In fact, one thing is to encourage people to be involved with the community; the other completely different is to be really involved in a coherent and continuous way.

The legal market has followed the general trend imposed by globalization, and larger law firms, which encompass multiple offices and dozens or hundreds of lawyers, started to institutionalize CSR governance.

It is no longer enough to provide clients with a good legal advice. Law firms, as well as almost every business, must now also be able to demonstrate their commitment with social responsibility.

Our law firm is made of real people, who are creative, have strong values and ambitious principles. Also, due to these characteristics, we always tend to be aware of and to be involved in all relevant issues affecting the communities we live and work in.

We may look at this involvement with social responsibility issues in both an 'altruistic' and 'egoistic' perspective. If we consider it in just an egoistic perspective, we may identify several potential risks that may result from ignoring social responsibility: those related to reputation, remaining competitive and retaining talents or recruiting new ones - "*people don't want to be associated with firms that don't share their values*".

Focusing on recruitment, attracting and retaining the best lawyers is increasingly difficult for many law firms, and today's graduates are passionate about CSR issues or, at least, aware of its importance. If the firm they work for is committed with CSR and takes action, then they are more likely to be attracted to the firm, become more involved and, ultimately, more productive.

"It is a matter of long-term trust that must be built between the firm and clients and the firm and its lawyers"

The same happens with clients: clients also expect that the people they are doing business with will have an attitude similar to theirs regarding social responsibility issues. More, they expect that attitude to be crystal clear. For law firms, that means being able to demonstrate their commitment to CSR.

Indeed, good corporate citizenship reflected by an ethical attitude and by environmental and social practices cannot be ignored by firms looking to differentiate themselves in a competitive market.

It is a matter of long-term trust that must be built between the firm and clients and the firm and its lawyers. Businesses that breach that trust can often suffer the consequences.

Some of our clients, depending on the country and jurisdiction, consider that the company's reputation is as important as other aspects, more tangible, such as price, value and customer service. The same happens with lawyers.

Our project involves integrating CSR into the day-to-day operations of our law firm, which will likely only get easier over time. Soon all clients and lawyers will be demanding the same commitment and CSR thinking from their law firms. This is a strong belief at Raposo Bernardo. ■

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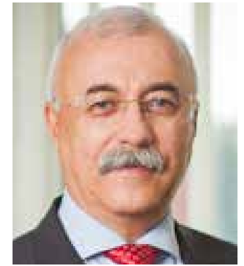
Omissions in the energy strategy disturb the investment climate



Vladimir Penkov is the Managing Partner at Penkov, Markov & Partners

In a previous article[1], I asked the question of whether the state is 'for' or 'against' green energy. The latest amendments to the law of April 10, 2012, as well as subsequent decisions by the State Energy and Water Regulatory Commission (SEWCR) confirmed that the state takes a stand against wind and photovoltaic power generation.

Not only the late adoption of a national energy strategy in 2011 after incentives for the green energy sector have been existing for years, but also the fact that the strategy does not provide for a smooth and predictable development of this sector, created huge administrative and organizational problems for both government and investors.

The lack of consistency among preferential prices, time limits for purchase and other terms, as well as the scrapping of the formula for preferential price formation and its replacement with the regulator's subjective discretion, often implemented more than once a year, have caused wind and photovoltaic energy projects, if nothing else, to collapse due to the dramatic decrease of preferential prices.

These chaotic and unpredictable actions are due to the inconsistent and contradictory practice of the National Electricity Company (NEK) of approving large projects, as the government adopts their environmental plans and issues building permits without taking into consideration the capacity of the power transmission grid and without taking the requisite measures for its development and upgrade.

These failures have resulted in the excessive growth of investment in the sector, causing a number of disproportions and difficulties to the government. This process should have been regulated at the stage of initial assessment and approval for connection of new capacities, instead of doing it by placing barriers for the connection of advanced RES projects with signed contracts, which only creates insecurity and undermines the idea of a favourable investment climate. As a matter of fact, there is still no single uniform public register of commissioned projects and pending connection projects, to ensure the much needed transparency. Thus, it is highly unlikely that anybody really knows what the real situation in the sector is.

It is very probable the same issues will soon crop up in relation to hydroelectric and biomass-fuelled power plants, for which the preferential purchase prices remain high.

The dramatic decrease of preferential prices for wind farms and photovoltaic power plants, combined with the fixing of the preferential price at the moment of commissioning and the simultaneous establishment of connection timetables with no deadline attached – it could even be the end of 2019 – will practically stop, under the present conditions, the development of this segment of the RES sector.

At the same time, a very dangerous trend, from a legal point of view, is at hand, whereby projects get their commissioning permits revoked. This constitutes inadmissible government interference in already implemented investments and places investors in a situation in which for them it becomes impossible to maintain the project.

The government should not allow and encourage discussions, or a public debate on changing the conditions for concluded and effective contracts for purchase of renewable energy, if it does not want to undermine the confidence of investors, including those in other sectors of the economy, in the applicability of the principles of rule of law in our country.

"The present stage of development, however, also raises the question of whether the whole sector should continue to develop"

Obviously, dealing with the omissions in the energy strategy, which should anticipate and plan the development of the individual sectors and the investments in the development and update of the electricity transmission network and the whole infrastructure in accordance with the state's interests, is an indispensable priority. Otherwise, as already pointed out, the fate of wind and photovoltaic projects shall also befall water and biomass plants.

The present stage of development, however, also raises the question of whether the whole sector should continue to develop. Wind farms and photovoltaic plants open many long-term jobs in maintenance, security, cleaning, telecommunications and transport services, etc. Even with foreign investment projects, 30% of the project value remains here and creates new products in the country, such as architectural work, the production of building materials, cables and transformers. With Bulgarian investors, the likely share is over 50%.

At the same time, all these investors significantly improve the infrastructure even without a well functioning public-private partnership, which has a very favourable impact on the regions concerned.

Last but not least, all income from interest payable on bank loans remains in the country, and domestic consumption increases.

The boom of wind and solar power plants has led to the growth of new technological consultancies specialized in the development and construction of such power plants, and has turned our country into a regional leader in RES technologies and innovation. This is a very promising development with a potential benefit for the state, considering that the gained experience can be 'exported' to other potential markets.

There is an obvious conclusion to be made, that green energy is not and should not be anathemized – and no such implications should be made before the public – and should instead be carefully and sustainably developed.

The government should strive to do more than just achieve the 16% share for RES energy – it should aim at the potential 23% set by the EU. ■

1. World Commerce Review Volume 6 Issue 4, December 2011 http://www.worldcommercereview.com/publications/article_pdf/508

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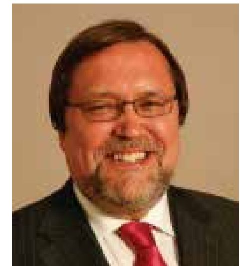
TRANSFER PRICING UPDATE

New discussion draft issued by OECD



Les Secular is a Partner at True Partners Consulting (UK) LLP

The OECD has issued an updated Discussion Draft on *'The Interpretation and Application of Article 5 – Permanent Establishments (PE) – of the OECD Model Tax Convention.'* This latest Draft follows consultations on its previous draft issued in October 2011.

Whether or not a PE exists can have important transfer pricing implications as there would be transactions with the PE that may now be scrutinized and amended for transfer pricing purposes. As such it is important to understand the OECD views on PEs and how they are likely to be interpreted by tax authorities and incorporated into local legislation.

There are a number of suggested changes that could have a potential impact for enterprises. In particular the indication that for the purposes of considering whether an enterprise has a PE because of a construction site or installation project, the appropriate period should include the period in which the building or its facilities/installation are being tested. Under the OECD Model Tax Convention, a construction site or installation project is not a PE if it lasts less than 12 months.

The inclusion of a testing phase can make certain projects last more than 12 months and give rise to issues of attribution of profit under transfer pricing rules. It should also be noted that in some double tax treaties based on the OECD Model, the 12-month period is shortened to only 6 months.

Enterprises should thus keep their overseas construction/installation projects under close scrutiny if they are to ensure that tax and transfer pricing issues do not arise.

Another potential minefield is whether or not an enterprise has a PE through employees overseas being involved in contract negotiation. To date, a PE only exists if the local employee is either involved in concluding contracts or plays a significant part in negotiating important sections of a contract. The new discussion draft indicates that a PE will

exist if local employees take an active part in negotiations – ie. involved in decisions relating to type, quality or quantity of products covered by the contracts. As such, activities will usually constitute an essential part of the business operations of the whole enterprise.

It is acknowledged, though, that the contracts would have to be of significant value to give rise to major concerns. However, as noted above, the OECD Model Tax Convention only expresses the views of the OECD and is not binding; tax authorities can interpret them in different ways and may take a tougher stance. The reduction of the 12-month construction site to only 6 months is one example of a different interpretation and stance by tax authorities.

It should also be noted that it is not only local employees that can create a PE for an enterprise. An agent with authority to conclude contracts in the name of an enterprise can also create a PE unless he is acting in the normal course of his business, for example, a stockbroker. An agent can be held to bind an enterprise even in situations where the contracts are not in the name of the enterprises. In some countries, an enterprise has been held to have a PE in circumstances where a sales contract has been concluded with a third party by an agent who did not formally disclose to the third party that it was acting for the enterprise and the contracts did not disclose the name of the enterprise.

Also, an agent could be considered to have authority to bind an enterprise where he solicited and received orders, which he then sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions. In the past, the issues have tended to arise primarily on sales contracts but the Discussion Draft suggests that the position should not just cover the sale of goods but also leasing contracts or contracts for services.

The Discussion Draft also considers the question of working from home ie. an overseas employee operates from his/her home and there is not a formal office of the enterprise in the foreign jurisdiction. New clauses are proposed for inclusion in the Model Tax Convention whereby the use of the home on a regular or continuous basis for carrying on business activities of the enterprise can create a PE if it is clear that the enterprise has required the employee to use that location.

It is suggested that this would arise where the enterprise does not provide an office for the employee but the nature of the employment clearly requires an office. This issue could arise where, for example, an employee is sent overseas and the enterprise initially intended to rent an office for the employee but was convinced by the employee that it was more efficient for him to work from his home. If this clause is accepted into the Model Tax Convention without change, an enterprise may have to establish a set policy for employees working overseas that prevent issues like this arising.

"… it is important to understand the OECD views on PEs and how they are likely to be interpreted by tax authorities and incorporated into local legislation"

The above are only some of the examples in which suggested changes in the Discussion Draft can have a wide impact. From personal experience over many years, it has been obvious that if tax authorities can prove the existence of a PE, they look at all other aspects of raising tax and transfer pricing is an area in which they are quickly realizing that there may substantial scope for doing so. For those who are unfamiliar with transfer pricing, it involves cross border transactions between connected parties be it the provision of goods, services, financing or the use of intangibles such as intellectual property, brand names etc. Connected parties must be capable of demonstrating that all of their transactions are at arm's length – what an independent third party would have paid or received in similar circumstances – and failure to demonstrate this can lead to tax adjustments and penalties.

Although a PE is not a separate legal entity, for transfer pricing purposes it is considered a 'stand alone' entity. Consequently, the question of attribution of profit made by the enterprise as a whole to the PE arises and transfer pricing methods are applied as if the PE was a separate third party entity. This then enables the local tax authority to raise tax assessments and consider penalties for failure to notify chargeability and/or failure to file correct tax returns.

In the current economic climate where tax authorities are finding their tax take considerably reduced, they are looking at other ways of raising cash and applying transfer pricing rules to a PE situation and levying penalties is a strong possibility. Whereas, ultimately, a tax liability on a PE will not impact an enterprise as relief will either be available through double taxation relief or through the mutual agreement procedure within a double tax treaty (via a corresponding deduction), there is no relief for penalties and they remain a cost to the enterprise.

The Discussion Draft is just that, a draft for discussion, and comments are invited before 31 January 2013 and examined by the Working Party at their meeting in February 2013. ■

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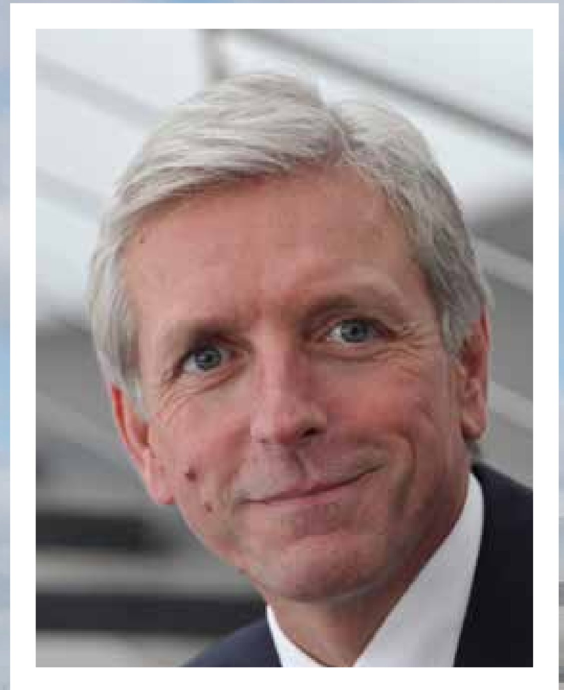
Focused on the future

Brandon O'Reilly is CEO of TAG Farnborough Airport, Europe's leading business aviation airport, located just outside London. World Commerce Review spoke with O'Reilly about business aviation trends, their wider global economic significance and how the airport is prepared to take advantage of future prosperity.



In your view, is business aviation a good barometer of the wider international economy?
Yes, business aviation can be used to gauge how big businesses and national economies are performing in a general sense. Moreover, as many of our customers are investors and entrepreneurs, business aviation patterns can often be ahead of the curve, offering insight into future trends of inward investment and overseas trade. For instance, we have seen a significant increase in movements to and from emerging markets over the past four to five years.

Since the economic downturn in 2008, what regional economic trends have been evident at TAG Farnborough?
As has been widely reported in the media, this has been a challenging time for Europe and North America, which to some extent has been reflected at the airport with flat growth from these regions. However, this has been counter-balanced over recent years by strong growth in markets such as the Middle East, Far East (particularly China) and Latin America.

Looking ahead, there are nascent signs of an upturn in the US market, but there is little indication of change in Europe. Importantly for TAG Farnborough Airport, we are ready to take advantage of extra demand as recovery and growth return.

How has TAG Farnborough airport responded in these uncertain economic times?
We have been focused on offering industry-leading products and services to ensure that we are the first choice for business aviation customers travelling to and from London.

In line with our customers' expectations, it is imperative that we offer a bespoke service and cutting-edge facilities. We have invested more than £100 million over the past 10 years to develop our state-of-the-art infrastructure, which has helped us set a new global standard for business aviation airports.

The airport now features an award-winning terminal, control tower and more than 240,000 sq ft of hangarage space and office accommodation. We are also able to offer a wide range of amenities including concierge service, direct ramp access for customers wanting to drive up to waiting jets, a crew room with 'snooze' facilities, The Aviator hotel (also part of the TAG Group) located on-site as well as aircraft maintenance and servicing from TAG Farnborough Engineering.

In 2011, we were also granted approval to increase the number of permitted aircraft movements at the airport by the UK Government. This allows us to phase in an increase from 28,000 to 50,000 movements per year through to 2019.

With added capacity and the ability to tailor our service to each customer, we are well-positioned to attract business from across the globe.

Earlier this year you hosted the Farnborough International Airshow. What does this mean for the airport?
Every two years it is a great privilege to host the world's leading airshow; a seven-day showcase of the latest developments in aerospace, defence, space and security.

As a key event in the global aerospace calendar, it attracts international media attention and puts Farnborough on the map.

According to Farnborough International, the event organisers, this year was a great success with orders and commitments announced at the airshow totalling US$72 billion. 1,506 exhibitors from 39 countries took part and over 109,000 trade visitors and 100,000 members of the public were in attendance over the course of the week.

We also had the pleasure of officially opening our second 120,000 sq ft, three-bay hangar following the second day of the show. Olympic gold medallist Sally Gunnell joined us for a ribbon-cutting ceremony, which marked the completion of 10 years' infrastructure development.

What do you think sets TAG Farnborough Airport apart?

We are the only airport in Britain that has been specifically developed with business aviation in mind. Every other airport in the country is a hybrid, either a commercial airport with business aviation as a part of its operation, or a small aerodrome with light aircraft and flying lessons taking place.

At TAG Farnborough, we have listened to our customers and created an environment which is purpose-built for their unique requirements.

The airport has been designed to ensure privacy, ease of access and a seamless travel experience. You can only enter the site if you are arriving or departing from the facility, as opposed to a commercial airport where you can enter the terminal building and wander around without flying. This way, we are able to offer our clients complete privacy.

Additionally, the airport has been designed to maximise ease of access – with no check in or baggage carousels. In fact, 65 percent of people flying to or from the airport never enter the terminal building. The 35 percent who do, however, can take advantage of the state-of-the-art business and meeting facilities on-site.

Farnborough also has a unique history. It is the birthplace of British aviation and is the home of the UK's first powered flight in 1908.

Before we had responsibility for the site, it was owned by the Ministry of Defence and housed the Royal Aircraft Establishment, a centre of groundbreaking research and development which was responsible for innovations such as Concorde that have left their mark on aviation worldwide. We have a number of Grade I listed buildings on-site and have recently invested £1 million to restore a Grade IIA listed building known as the G29 hangar - which was formerly the Royal Flying Corps' main hangar - back into working use. We are committed to preserving the airport's extraordinary history for generations to come. ■

"With added capacity and the ability to tailor our service to each customer, we are well-positioned to attract business from across the globe"

The most beautiful diamonds ever made

As a 2nd generation family business, DAYEKH has seen it all. The adventure began in West-Africa where the founder Hassan Dayekh began his career mining river beds for a solid 20 years. It wasn't before 1975 that he decided to take the next step and open his rough diamond office in Antwerp.

A few years later he became world famous for having polished one of the world's greatest diamonds, *"The Challenger"*. Weighing a massive 295ct, it gave birth to four diamonds of exceptional quality.

The HRD diamond lab stated that *"The Challenger is the largest diamond we ever graded up to May, 1983."*

However the urge to go downstream and explore new adventures wouldn't go away, DAYEKH began crafting and creating jewellery as well. With first an office/showroom set-up in Beirut (Lebanon), a retail space quickly followed suit in Antwerp.

It opened as a small 50m^2 retail space and ten years it has grown into a 200m^2 diamond jewellery flagship boutique in the heart of Antwerp's diamond district. Having polished many diamonds in all shapes, sizes and colours that nature provides, it became clear that to build a proper brand one had to have a unique selling point.

This gave DAYEKH the motivation to work with the greatest polishers of Antwerp to develop a new shape, with the challenge that it had to have in a scientific measurable way, a better light performance than the traditional round brilliant.

These efforts gave rise to the "D" Brilliant Cut which got a perfect score in the light performance tests done by third party equipment known as Firetrace. This is truly a historical achievement and a true masterpiece in its own right. Shaped on the pattern of a lotus flower of 105 facets, it is the diamond from the age of enlightenment.

The "D" Brilliant Cut has made DAYEKH the jewellers of choice of Rolls Royce EC, as they regard this perfect diamond on par with the perfection of a Rolls Royce automobile.

Being active in the Antwerp diamond trade since 1975, our trading partners and connections are vast and numerous allowing us to have access to a large selection of diamonds be they rough or polished.

Through our website customers can place an order for any type of diamond and should DAYEKH not have that particular diamond in stock, it can quickly be found on the world market through their extensive network of traders and large scale manufacturers.

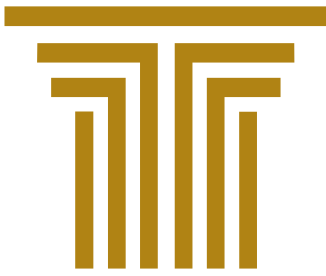
Since the financial crisis of 2008, gold has become an attractive safe haven and will still be attractive for years to come. However diamonds have become as well an attractive investment due to a plethora of factors, such as: the scarcity of new mines being found and the dwindling supply of existing mines, combined with an increased demand from the booming Asian economy.

This has created a strong undercurrent for a long term rise in prices thus making diamonds a safe bet as a medium to long term investment vehicle. Our service as consultants is to tailor a "portfolio" to the wishes of the client. Some wish to invest in large or rare diamonds whereas others may have different preferences. Once decisions are made, DAYEKH's network steps in to fulfil the demand and will provide similar services when liquidity is required.

As creative jewellers, from the start, DAYEKH had an interest in making one-off unique pieces. This is due to the fact that instead of creating a certain design to which stones are found and set, DAYEKH finds a unique stone and builds the design around that stone.

This makes its eventual wearer the only person in the whole world owning that particular design. Everything we do is handcrafted and there is no mass production on our end.

Customers know that each unique masterpiece they wear from us has been professionally handcrafted through many hours of passionate and thoughtful care for perfection. ■



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- International tax consultancy
- Corporate tax
- VAT
- Tax risk management
- Customs duty
- Expatriate tax
- PAYE & NIC advisory
- European tax management

We also provide health checks at no cost which review your business and determines where there are gaps to be filled or opportunities to be explored that can reduce your group's effective rate of tax.

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