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Q&A with Christine Clements, Dean of the College of Business and Economics, University of Wisconsin – Whitewater

Suleika Reiners writes on making central banks serve the real economy

Robson Braga de Andrade - Brazil: innovation commitment, the only way

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Five years... anything learned?

It is five years since the collapse of the US investment bank Lehman Brothers. Lehman's brutal demise was the trigger for the worst global recession in over sixty years.

The global financial system was not blown up by sub-prime mortgages, CDOs, greed or fraud alone. The financial crisis was caused by a financial system that had taken advantage of the idea that free financial markets are always good, and that banks would always work in the interest of society.

Five years ago global markets were in turmoil and it was unthinkable that there would be a return to business as usual. Even Alan Greenspan admitted that he had made a mistake.

What has been done in the last five years to prevent another financial crisis and to stop banks holding entire economies to ransom?

There has been a twin-tracked policy reaction to the financial crisis. First is quantitative easing, which has increased debt in the western world. Essentially, the response to too much debt has been to take on even more debt, and this debt has been used to re-capitalise 'broke' banks through the back door, and allowed the banks to avoid write-downs on bad investments and dodge necessary restructuring.

Second, there have been a number of reforms, though there is still a long way to go. So far the thrust of the reform has been to sanitise the financial sector, and not to impose structural change. It seems that the ideology of financial deregulation is back.

Rules and regulations have been amended and made more complicated. On both sides of the Atlantic the big structural changes have been delayed and diluted. Arguably it is even harder to identify the underlying risks being taken by the banks. Regulators are always behind the curve, and the new rules and regulations will reinforce this. We may be more vulnerable to another systemic collapse.

The questions to be asked are:

Can we be confident that there will not be another financial meltdown in the foreseeable future, and that the costs will not be as financially catastrophic?

Why are governments behaving as if the past five years didn't happen? ■

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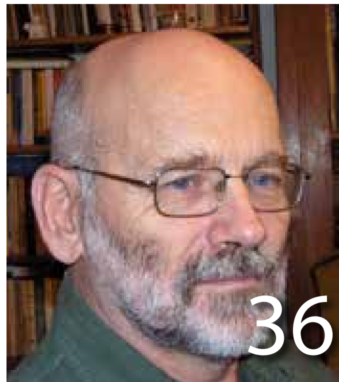

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Online business education

Online business offerings vary widely in quality and methods of delivery. In an interview with World Commerce Review Christine Clements, Dean of the College of Business and Economics at the University of Wisconsin – Whitewater, examines future developments

What is the history of the University of Wisconsin – Whitewater in online business education?

The University of Wisconsin – Whitewater business school has offered online MBA degrees to managers across the globe for almost twenty years. As an early leader in online business education, our college has learned best practices of how to deliver classes in a way that gives students the skills and knowledge they will need to advance their careers and in a way that allows for many interactions with other students and their professors. 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.

What is happening in the marketplace for online MBA courses?

The marketplace for online higher education is exploding worldwide. Online business offerings vary widely in quality and methods of delivery. Some providers are for-profit with very high tuition and employ part-time faculty members hired on an ad-hoc basis. Some online programmes require on-campus visits as part of their course completion. Some are accredited by business-school specific accreditors such as AACSB International or EQUIS; others claim accreditation but do not have the quality standards typical of schools with these premier accreditations. What is clear in all cases is that the demand for online business education exists and persists. Managers want the opportunity to advance their knowledge and their careers through online course offerings that are flexible and adaptable while they still maintain rigour.

What type of student is most suited to online learning?

Online learning is well-suited to mature students who are accustomed to being responsible for directing their own time. Students who are self-motivated and accustomed to rigorous schedules will be ideal learners for this type of experience. Online courses are especially appropriate for executives whose work schedules or travel may prohibit their ability to attend even weekend face-to-face programmes.

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If managers expect to be relocated during the next few years, an online MBA is an excellent option as the work seamlessly follows them to their new locations.

The University of Wisconsin – Whitewater has students who are moving up career ladders in many different industries and countries. Whether a student is managing an oil rig in the Congo River, serving as a physician in Wales, or acting as a plant manager in India, that student can complete a valuable, practical, rigorous degree online.

How are students responding to UW-Whitewater's online business courses?

The number of students in the online MBA at the University of Wisconsin – Whitewater is strong and growing. Our students tell us the reasons that they chose our programme were that:

- They can complete the degree entirely online.
- AACSB International accredited the programme.
- The UW-Whitewater MBA degree is a good value.
- The College of Business and Economics has a reputation for quality.

- The MBA curriculum offers emphases in specific functional areas.

In an exit survey for graduating MBA students in Spring 2013, 98% indicated that they were 'satisfied' or 'very satisfied' with their experiences in the MBA programme at UW-Whitewater.

What are the benefits of partnering with the University of Wisconsin – Whitewater?

Of foremost importance is the quality of the education. A review team of faculty evaluates every online course offered each semester. Their evaluation criteria include student satisfaction, course organization, rigour, feedback on assignments, interaction, and audio visual material. Only faculty whose courses pass review are given the opportunity to teach online.

In an online course marketplace with large numbers of adjunct or part-time faculty, UW-Whitewater's online MBA faculty are all full-time and hold doctoral degrees. They must also have published current research in their fields in order to continue teaching graduate courses.

Continuous review of specific student learning outcomes is also an important part of the UW-Whitewater MBA delivery. Students demonstrate skills related to communication, ethics, and strategic thinking, for example. Where we find limitations, we make changes in our teaching and curriculum.

What developments are in the pipeline?

Beginning this fall, the University of Wisconsin – Whitewater is launching a new MBA curriculum. We made this change based on evolution in the marketplace and on feedback from our students and our advisory boards. The curriculum features a number of new graduate courses based on a set of over-arching needs for successful business leaders. The new MBA emphasizes that graduate business students should be able to think globally, behave ethically, innovate, make strategic decisions, think critically, communicate, negotiate, and persuade, manage projects, and lead. All of these learning outcomes will be addressed across the curriculum and measured in specific courses dedicated to the themes.

What are the practical benefits of the UW-Whitewater approach?

Faculty are the hallmark of the quality of any educational programme. The University of Wisconsin – Whitewater's online MBA faculty are all full-time doctoral faculty who have

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"In an exit survey for graduating MBA students in Spring 2013, 98% indicated that they were 'satisfied' or 'very satisfied' with their experiences in the MBA programme at UW-Whitewater"

published recent research in their specializations. AACSB International accreditation assures that the quality of the MBA and the operation of the entire college are evaluated every five years.

Potential MBA students are always interested in price. UW-Whitewater's MBA programme has a consistent per-credit tuition fee that is available to all students, no matter where they are located. The current tuition is $619 per credit. At a total minimum of 36 credits, an MBA degree's tuition would be a total of $22,284, a superior value when contrasted to tuition and fee rates for for-profit, non-AACSB accredited online MBA offerings.

Graduating MBA students report that they value the emphases offered in the UW-W MBA curriculum. Students may choose from emphases in:

- Finance
- Human Resource Management
- International Business
- IT Management
- Management
- Marketing
- Project Management
- Supply Chain Management

Students may also choose a customized emphasis in conjunction with an advisor.

The UW-Whitewater MBA programme offers students one-on-one academic and career advising services.

The UW-Whitewater MBA is not a cohort programme. Students may take one class per term or five classes per term. They complete at their own rate, with the average completion about three years for part-time students.

UW-Whitewater online MBA students do not need to come to campus at any time during their education; however, some choose to travel to Wisconsin to attend their commencement ceremonies, walking across the stage to the cheers of their families and shaking the hands of the Dean of the College and the Chancellor of the University.

The UW-Whitewater MBA programme offers students one-on-one academic and career advising services

What sorts of business courses do you provide?

Because the College of Business and Economics is a very large college, at about 4,000 total students, we can offer courses in a wide array of disciplines with specialists in every business field. Students with undergraduate degrees in business begin their work by completing a series of courses aimed at preparing them to excel at the designated learning outcomes. Every MBA student completes the following two- or three-credit courses:

- Persuasion and negotiation
- Business valuation using financial statements
- Strategic technology and innovation management
- Fundamentals of project management
- Leadership development
- Quantitative analysis for business
- Marketing strategy
- Business conditions analysis or Managerial economics
- Social responsibility or Ethics in the marketplace
- Business policy and strategy (the capstone course)

In addition to these common courses, MBA students choose an emphasis for concentration and three courses that support that emphasis. Graduate business students have one additional course to complete as an elective of their choice. They have over forty different classes from which to choose.

How does an online class operate? What should an online student expect from an MBA class?

To allay some potential students' concerns, students do not need to have advanced skills with technology to pursue an online degree. Our online MBA uses a web-based platform from which any individual with broad band Internet access can perform the needed tasks.

After the introductory news page, students will move to a content tab where course materials such as a syllabus, readings, and assignments are available for download or reading online. Links to pre-recorded faculty lectures are in this content area as well. A textbook (or textbooks) typically accompany the online delivery of the course.

Another tab will display a discussion area in which students will participate in a faculty-initiated discussion on a topic related to the week's readings and assignments. Usually the discussions span a period of days, and students from different time zones all participate actively.

Students upload their assignments to a drop-box, and they receive feedback from their professors on the web platform. Individual students' grades are displayed in a tab as well.

Although most work will be case-based essay assignments, some assignments may be objective quizzes or exams which students are able to access in another tab of the course web site. This work may be graded electronically, with results available shortly after students finish the exam.

Faculty hold electronic office hours each week so that online students can readily make contact with their professors.

How do students find out more information?

We will be happy to answer students' questions about the University of Wisconsin – Whitewater's online MBA programme. Our advisor can assist students with planning a list of courses designed with their particular emphasis interests included. Students should feel free to contact us through email at: gradbus@uww.edu or to review the complete MBA at www.uww.edu/cobe/onlinemba.

We would enjoy having the opportunity to communicate with the readers of the *World Commerce Review* about UW-Whitewater's award-winning online MBA. Please contact us! ■

Brazil: innovation commitment, the only way

Robson Braga de Andrade is the President of the Brazilian National Confederation of Industry – CNI

The reality of the Brazilian economy has dramatically changed during the last decade. Brazil has not only consolidated its position among the world´s greatest economies, but has also opened up to foreign trade and investment. However, important steps are still needed in order to grow sustainably, recover high growth rates and to achieve a higher level of domestic productivity.

In this sense, Brazil is aware that productivity is one of the key factors to increase the country´s competitiveness. It is also the main variable that most depend on the efforts of private businesses through large scale hands-on, and improved managerial techniques. However, to continuously expand productivity, enterprises should innovate by launching new products or services, adopting more efficient processes, and investing in new methods and business models.

Therefore, the agenda for innovation has lately become a central aspect of industrial policy in almost every country. It is also recognized by business as a mandatory component for companies' strategies as well as for a country´s sustainable growth. This scenario is no different in Brazil, which has the highest innovation level in Latin America, but it is still distant from those of more advanced economies.

The Brazilian National Confederation of Industry – CNI, well aware of this fact, launched in 2009 the *Business Mobilization for Innovation – MEI*. It is an unprecedented collective movement to promote innovation based on two main themes:

(i) stimulate and encourage innovation strategies within Brazilian enterprises;

(ii) increase innovation public policies effectiveness through a constructive agenda and long lasting dialogue between the private sector and the most relevant public entities in this area.

MEI has brought together a great number of important CEO´s from both the largest companies based in Brazil, and those of reduced size but intensive in knowledge and research and development (R&D). As a result they issued a list of recommendations in ten main economic areas to foster indigenous innovation, such as emphasising education and capacity building in engineering, improving the national legal framework for innovation and intellectual property rights, attracting investment in R&D centres, facilitating companies' investment operations abroad, and so on.

The most significant result achieved so far is perhaps in education and the awareness of public and private sector entities of the importance of innovation practices inside corporations.

Innovation is a market imposition to enterprises, and all the actions the Brazilian private sector is taking aims to make companies protagonists of the innovation process. This agenda must be supported by government initiatives, as it has been taken up by other countries.

Some actions by the Brazilian private sector must be given importance, like the work performed by the National Service for Industrial Training – Senai – an education service network managed by CNI to train the work force – which through many decades has developed actions in three distinct areas: expansion and improvement of professional and technological education; extension of services offered through the creation of Senai's Institutes of Technology, and of Senai's Institutes of Innovation, both intended to work on high complexity applied research for small and average size business.

These institutes are important initiatives, especially due to the partnerships created between international universities and R&D centres, focused on the reality of the Brazilian manufacturing and services sectors. The most noteworthy ones are with the Fraunhofer Society, from Germany, and with the Massachusetts Institute of Technology, from the United States, that are world benchmarks for R&D and innovation in the manufacturing sector.

Also, CNI and the MEI movement are working hard to mobilize a greater number of companies to strengthen innovation, structuring the *Net of Innovation Centres* – RNI spread in all five regions of Brazil. MEI has built 25 state innovation centres that are coordinated by industrial federations in partnership with local universities, technological institutes and the Brazilian micro and small enterprises service – Sebrae. More than US$10 million were spent on these initiatives to

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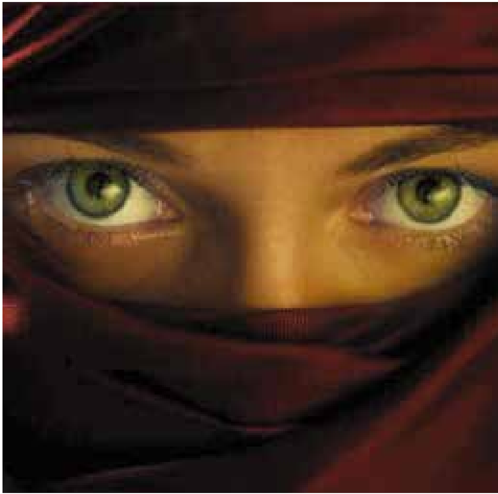

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"The most significant result achieved so far is perhaps in education and the awareness of public and private sector entities of the importance of innovation practices inside corporations"

support companies in projects such as 17 scholarships and tens of projects conducted inside small companies all over the country through RNI.

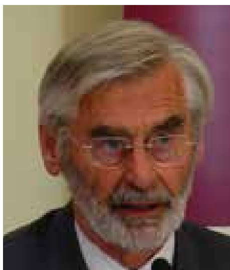
All successful experiences of countries in innovation have been achieved with the involvement of governments through policies taken to adapt and modernize laws and regulations related to the topic. In addition, special attention is given to improve the level of public education as well as enhance government policies in this field.

In past years, this agenda has progressed at a faster pace. Firstly, by defining eight working groups, then by identifying their CEO's leaders and by establishing scope and schedules. The areas targeted were improvement of human resources for innovation, internationalization of Brazilian enterprises, attraction of R&D centres, innovation in finance and legal framework, intellectual property rights, access to biodiversity and specific projects like green economy.

Progress was made in important areas, such as intellectual property and regulations to simplify the analysis process to reduce the period of granting a patent. There is still a lot to be achieved in this area in order to develop a pragmatic regime that aims to extend intellectual property rights compatible with the desire of the country to be a producer and owner of knowledge and technology.

Progress was also made in innovation finance and in the creation of the Brazilian Research and Industrial Innovation Corporation – Embrapii, which is a joint effort between public and private sector aimed at generating innovative products and processes, following the successful model of the Brazilian Agricultural Research Corporation – Embrapa.

Increasing Brazil´s productivity and competitiveness remains the greatest challenge in the hope of improving the country´s growth performance in the next decade and to recover the importance of the manufacturing sector of the economy. This goal will be achieved by continuously working and advancing on the innovation agenda. ■



Improving prospects for the Brazil-EU strategic partnership

Michael Emerson is Associate Senior Research Fellow at the Centre for European Policy Studies (CEPS), Brussels

Over the past year a group of independent Brazilian and European researchers have worked together to assess the scope for enhancing the 'strategic partnership' between Brazil and the EU. The project researched in some depth five topics of undoubted strategic significance: global macroeconomics, trade policy, climate change, norms of foreign and security policy, and continental regionalism. The group's report is about to be published[1].

The strategic partnership is a thoroughly institutionalised diplomatic process, covering a vast landscape of political and economic issues. However many observers consider that it is lacking in truly strategic focus and operational impact.

In its conclusions the report of the group concentrates on two sets of issues of outstanding strategic importance for the Brazil-EU relationship, the nexus macroeconomic and trade policy issues, and issues of international diplomacy at the global level.

The economic relationship

There seem to be winds of change blowing through Brazilian economic policy thinking, to judge by press reports in August 2013 that Brazil was preparing a new trade policy offer to the EU. While details of this are not yet available the broad direction in what has been reported is one we welcome, namely that Brazil would make an offer that would be differentiated from that of its Mercosur partners.

The EU and Mercosur have been trying to make a free trade agreement for years, but these have foundered on a combination of obstinate EU protectionism for some key agricultural products for Mercosur like beef and the reluctance of Mercosur industrial interests to open up. Negotiations started in 1994, were suspended in 2004, and

resumed in 2010, with the end of 2013 now set as target date for a fresh exchange of offers.

However three factors have now become important reasons why Brazil should want to make a change of tack. First, while the Doha Round for WTO-level trade libersalisation is stuck in a deep coma, Brazil with Russia are the only big economies in the world that are not as yet inserting themselves into some major trade block or networks. The Asians are doing it together. The US is doing it with much of Asia and now with the EU. The EU is doing it also with Japan, India and other Asian countries. Brazil for its part does not want to become an increasingly commodity-dependent economy, with uncompetitive industry – as is already the case with Russia. But Brazil has the highest average tariff levels of all major economies, which sustains its uncompetitive industries.

The second related factor is that Brazil's economy has been slowing after the fabulous commodity price boom of recent years, and a new growth impetus is needed – as has been underlined by the manifestations of social unrest in the summer of 2013.

The third factor takes us back to Mercosur. The chances of this grouping being able to make a genuine liberalising offer to the EU are stymied by the highly idiosyncratic and protectionist policies of its second largest economy, Argentina. As if this was not enough, Mercosur has recently admitted Venezuela as a new member, and its economic policy has for years been and still is both disastrous and protectionist. Brazil has long regarded Mercosur as keystone of its diplomatic priority to have stable and positive relations with Argentina. But now the Mercosur blockage factor has now come to be recognised to be a negative of strategic importance for Brazil.

This combination of factors has combined to push thinking for Brazilian policy in new directions, both in academic and official circles. The academic papers in our book suggest a number of possible approaches, given also that the EU for its part does not wish to do anything to harm the prospects for regional cooperation ventures in Latin America. The main argument is for an EU-Mercosur agreement to have a very limited Mercosur content, with some tariff provisions, but leaving the bulk of non-tariff barriers to bilateral agreements, notably with Brazil. The tariff provisions might have a differentiated speed of implementation, for example faster for Brazil and slower for Argentina. This would mean that the already imperfect customs union of Mercosur would become a little more imperfect. But still the Mercosur structure would not be abandoned.

The Mercosur countries have to come to terms with the fact that they, the Atlantic–facing states of South America, are also now falling behind the Pacific-facing states such as Chile, Colombia, Peru, and (facing both ways) Mexico. These Pacific states are both liberal and open in their trade policies and are advancing economically rapidly to the point that they have now achieved informal brand recognition as the 'Pacific Pumas'. If Argentina and Venezuela are going take more time to come to terms with these realities, Brazil for its part cannot afford to be held back by them.

"... the outlook for the Brazil-EU strategic partnership is rather positive or promising. Both parties are keen to explore ways to shape better consensus at the global level on issues of crucial importance"

If Brazil manages to make an attractive offer to the EU, the ball will be back in the court of the EU to work out how far it can go in meeting the requests on Brazil (and Mercosur side in general) for significant liberalisation in agriculture, especially beef. This will not be easy on the EU side, but at least a plausible negotiation process will be launched.

Diplomatic relations on global issues

Here the outlook for the Brazil-EU strategic partnership is rather positive or promising. Both parties are keen to explore ways to shape better consensus at the global level on issues of crucial importance, and at least to try and build bridges between North and South, or between the West and the Rest.

Climate change policy is already a domain of deliberate cooperation over international negotiations at the UN level. Brazil has taken impressive steps to arrest deforestation of Amazonia and the EU has been pioneer in emission control and trading mechanisms. The two parties have worked together at recent UN climate change summits to try and shape convergence and progress at the global level. Of course there is no victory to be declared, but the two parties are doing their best to work together.

Equally difficult, but also interesting at the Brazil-EU level, is the totally different domain of international humanitarian security norms. The EU has been an advocate of the 'responsibility to protect' norm endorsed by the UN. Britain and France invoked this principle to justify the military action intervention in Libya in 2011. However this led to strong objections by China and Russia, and here Brazil tried to conciliate, proposing a Responsibility while Protecting principle to the UN as away maybe to reconstruct global consensus. This has hardly borne fruit as of now, with new military intervention in Syria seeming to be imminent at the time of writing, with even sharper divisions over this among the five permanent members of the UN Security Council. However the point here for Brazil-EU relations is that constructive dialogue over crucial normative aspects of the world order is well worth doing, and the two parties are equally concerned to try and find ways ahead. ■

1. Michael Emerson and Renato Flores, editors, Enhancing the Brazil-EU Strategic Partnership – from the Bilateral to the Regional and Global, published by CEPS, Brussels, in collaboration with the Getulio Vargas Foundation, Rio de Janeiro. This will be available in the course of September 2013 freely on line at www.ceps.eu, as well as purchasable as a printed book. The book incudes chapters on trade and economic policy aspects by Renato Flores, Daniel Gros, Patrick Messerlin, Vera Thorstensen and Alfredo Valladao, but this short article cannot do justice to all their arguments.

Why does Brazil want to lead the WTO?

Susanne Gratius is a senior researcher at the Madrid-based think tank FRIDE

Since 1 September 2013, the Brazilian diplomat Roberto Azevêdo is Director General of the World Trade Organisation (WTO). The insider and former ambassador of the organisation in Geneva won the race among nine candidates, including his principal rival, the former Mexican trade minister Herminio Blanco, who counted on the backing of the United States. This is the second time since the creation of the organisation in 1995 that a representative from a non-traditional power leads the WTO and the first time that a Latin American holds the chair.

The Brazilian leadership coincides with a clear decline of the WTO in the past five years, mainly due to the paralysis of the Doha round on trade liberalisation and the global financial crisis. In this period, multilateralism has been replaced by bilateral and mini-lateral formulae for trade liberalisation and free trade agreements (FTAs). The most prominent examples of this trend are the two 'Ts': negotiations between the European Union (EU) and the United States to conclude a Transatlantic Trade and Investment Partnership (TTIP) and the Transpacific Partnership Agreement (TPP) among 12 countries, including the US.

Brazil is not involved in either the Transatlantic or the Pacific FTA-processes. As a MERCOSUR member state, Brazil cannot sign bilateral trade deals or take part in mini-lateral negotiations without counting on the rest of its partners (Argentina, Paraguay, Uruguay, Venezuela and, in the near future, Bolivia).

For Brazil, rather than a destiny – as former President Fernando Henrique Cardoso once said – MERCOSUR has become a straitjacket for external agreements opposed by Argentina, Bolivia, and Venezuela. In fact, Brazil is becoming increasingly isolated in the global race for trade and investment deals. While Chile has already signed 16 and Mexico 12 free trade agreements with third countries, MERCOSUR has only three: with Egypt, Israel and Palestine – these countries account for less than 1 per cent of the bloc's total trade.

The EU is MERCOSUR's main trade partner and investor, accounting for 20 per cent of the bloc's imports and exports. Nonetheless, EU-MERCOSUR negotiations over an association agreement, which started in 2000, are in a state of permanent deadlock due to Europe's unwillingness to make concessions on agriculture and the EU's demand for less protectionism on industrial products and services on behalf of MERCOSUR member states, including reluctant Argentina and Venezuela.

As a result, Brazil sees itself increasingly excluded from the ongoing global trend towards trade liberalisation. Similar to the United States and other countries with a large domestic market, trade accounts for a relatively small percentage Brazil's GDP: around 23 per cent. Brazil is clearly not a global trader: its share on global exports and imports is less than 2 per cent. Moreover, protectionism of local industries is particularly high. To compensate for a re-valued real, last year the Brazilian government decided to increase the import tariffs of a list of 100 products, including steel, rubber tires, chemicals and potatoes.

But if free trade is not a relevant path for Brazil's global projection, why did the country campaign for WTO leadership? There are at least three major arguments for Brazil's interest in leading the troubled organisation. First, Brasilia's strong traditional commitment to multilateralism, which has always featured prominently in the country's foreign policy. This is also reflected in Brazil's efforts to reform the United Nations and its aspiration to become a permanent member of the UN Security Council, a priority of Brazil's external agenda.

From Brazil's multilateral perspective, the WTO represents a set of global norms and rules against unilateral impositions and unfair asymmetric free trade agreements with the north. An example of this was the WTO's decision in 2009 to prohibit subsidies on US upland cotton, which in this case favoured Brazil.

Second, under the Lula administration, Brazil became a leading global power inter alia through its active engagement at the WTO Doha round. In 2003, at the WTO Ministerial Conference in Cancun (Mexico), Brazil launched the G-20 group of countries with a common trade and agriculture agenda vis-à-vis the industrialised nations. As the largest global food producer, Brazil has a particular interest in lowering non-trade barriers for agricultural products.

Therefore, it is not a coincidence that another Brazilian, José Graziano da Silva, is the head of the United Nations Food and Agriculture Organisation (FAO). Furthermore, Brazil has been one of the six key negotiators – together with Australia,

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"... the main challenge of Mr Azevêdo will be how to inject new dynamism into the stalled Doha round"

the EU, India, Japan and the United States – of the Doha process. Among other obstacles, its demand that agriculture subsidies be eliminated as a common practice in the EU, Japan and the United States has contributed to the paralysis of the Doha round.

Third, Brazil is part of the influential BRICS – Brazil, Russia, India, China and South Africa – group, which supported Roberto Azevêdo's candidacy and could see its influence over the WTO agenda in the post-Lamy- period improved. Brazil has close links with its BRICS partner. China is Brazil's main export market and investor; Russia is an important ally against US impositions; South Africa is its main economic partner in Africa; and trade exchanges with India are increasing rapidly. A common position of these five countries and an alliance with other partners from the old 'South' could make a difference and reactivate the stalled multilateral negotiations on trade liberalisation.

Unlike other international organisations like the UN Security Council or the International Monetary Fund (IMF), the WTO emerged in the post-Cold War order and offers more space for non-traditional Western powers like Brazil, China, India or Russia. Nonetheless, beyond the need to reactivate the Doha round, the heterogeneous BRICS group has little in common.

Roberto Azevêdo is committed to reform and reactivate a WTO which, according to the new Director General, 'is not doing well'. Against the strong opposition of China, Brazil seeks to broaden the agenda of the organisation, including the capacity to solve currency disputes as a source of trade diversion effects. But beyond future plans, the main challenge of Mr Azevêdo will be how to inject new dynamism into the stalled Doha round. In addition to the discouraging financial crisis and creeping growth rates worldwide, even in China and India, Brazil's protectionism and isolation from FTA deals are also an obstacle that needs to be overcome. The ninth WTO Ministerial Conference, scheduled for December 2013 in Bali, will be the first real test-case for the new Brazilian leadership. ■

Ambassador Roberto Azevêdo of Brazil took the helm of the WTO on 1 September 2013 as the sixth Director-General

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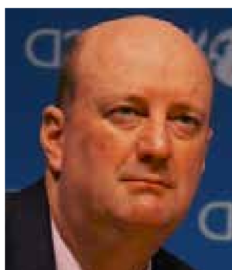

Open trade and growth for all

Phil O'Reilly is Chief Executive Officer of BusinessNZ and Chair of the Business & Industry Advisory Committee to the OECD

Coming from New Zealand, a distant country with a small population, I deeply appreciate the importance of open trade. Being connected with other economies through trade has helped New Zealand's agricultural sector become more competitive and efficient and has supported the growth of other sectors like high-value manufacturing.

Because trade is critical to our economic well-being, New Zealand has always been involved in regional trade discussions and is a signatory to many bilateral agreements. We also support WTO endeavours because we believe bilateral and multilateral negotiations are both valuable in achieving open trade flows.

Among the many negotiation frameworks that aim to facilitate open trade, the work of the OECD is critical in providing the soundest possible economic analysis. Supported by BIAC's advice and advocacy from the business sectors of all member countries, the OECD is uniquely placed to advance business-led growth. This is the reason for my long-term involvement in the work of BIAC, where I was recently elected Chair.

BIAC has a key role to play in the immediate post-GFC environment. In times of crisis and uncertainty people have a natural tendency to look inwards. We observe this in multinational arenas, in nations and even at the business level. Understanding the immediate and long term benefits of open markets is not always easy, and the task of advocating the benefits of open interaction and trade must be constantly made.

The fact is that no country has ever benefited in the long term from closing its markets. Open and competitive markets are essential for economic growth worldwide. In our globalised world, fluid economic exchanges are too important to be subject to protectionism. Reintroducing barriers to international activities would lead not only to higher costs and lower global trade but also to lower growth, productivity and welfare for the communities in which our businesses operate. It is important to keep communicating the point that growth can only be led by the private sector, and that open markets are not a threat to local businesses.

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"Open and competitive markets are essential for economic growth worldwide. In our globalised world, fluid economic exchanges are too important to be subject to protectionism"

trade and investment. This integration through supply chains strongly supports productivity in both developed and emerging economies, although until recently it has not been possible to show exactly how much value has been added by intermediate goods and services in specific parts of complex supply chains. In the absence of this kind of analysis it has been easy to assume the existence of trade imbalances in favour of countries located at the final link of the chain, and given this misapprehension, it is perhaps not surprising that calls for protectionist measures should arise.

A new method for measuring 'trade in value added' - TIVA - is now helping quantify the value brought at each of the links of the chain. This method, developed by the OECD and WTO, will bring more transparency in accounting for trade flows, and will help to overcome protectionist sentiment. I think that analysis of global value chains using TIVA will be a game changer and we can expect it to bring great benefits in revealing the benefits and efficiencies of open trade.

Our new complex trading environment has also superseded the philosophy that 'exports are good and imports are bad'. Imports, like exports, can drive increases in productivity. They can contribute to the competitiveness of other industries and add to employment. Importing intermediates for domestic production and re-export can contribute to higher productivity and better working conditions and jobs.

For trade to contribute to job creation and rising incomes, the reduction of trade barriers needs to be accompanied by a comprehensive suite of complementary policies:

- Measures leveraging the benefits of open markets: pro-competitive regulatory frameworks, employment policies targeting innovation and adaptability to challenges, sustainable social safety nets, policies for quality education and skills development, technology diffusion, good governance practices and others.

- Measures facilitating market access: foreign companies must be enabled to operate on a level playing field under sound competition rules - these benefit not only foreign investors and importers, but also local businesses in local markets.

Every country is different, and policy prescriptions will differ according to local circumstances, but the fundamental principles of open trade and competition in markets are the best hope for growing the prosperity of all countries. ■

Britain needs to push for EU reform from within

Phillip Souta is Director of Business for New Europe

MPs have come back from their summer breaks to find an awful lot on their plates. Not least of their challenges is Europe. With Germany going to the polls this month and Angela Merkel looking at a third term of office, the UK may be presented with an opportunity to push a case for European reform sooner than many thought. The business community needs Britain to seize that opportunity, because in the current economic climate, every half-knot of speed to be gained from tightening rules, and making Europe more competitive is crucial.

David Cameron put the question of Britain's place in Europe at the top of the agenda when he made his famous speech in January promising a renegotiation, followed by an in/out referendum in 2017. Business leaders are wary of a high-risk strategy of making demands; they know that demands should only ever be made if backed by something, and that something in the European debate is to threaten to leave if we do not get what we want.

The government seems to have realised such a strategy paints the UK into a corner and that demanding a special deal for Britain will be rejected. Rather, we need to push to make the European Union more competitive for all its members – and build the alliances that will make that happen.

We need to focus on being able to trade freely with the rest of Europe. It is a £10 trillion economy that takes half our exports and is home to half a billion consumers. Only the United States and China receive more foreign direct investment, and according to the majority of firms surveyed

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by TheCityUK, access to the common market is a core reason for investing here.

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The Japanese government recently made it clear to our own government: more than 1,300 Japanese companies have invested in the UK, as part of the single market of the EU, and have created 130,000 jobs, more than anywhere else in Europe.

Europe is far from perfect however, and there are reforms that need to be made to make it work better for business. Business for New Europe's manifesto, signed by over 240 business leaders and entrepreneurs, including close to a third of the FTSE 100, contains five major priorities for reform.

First, whilst the single market is probably the EU's greatest achievement – it is estimated to add up to £92 billion per year to UK income – it is incomplete. We need to make further progress in services, which account for over 70 per cent of EU GDP, but just one fifth of trade. Consumers need to be able to buy online from the cheapest source, to be taken to work by train operators fighting to be the best in Europe, and to choose from a much wider range of energy providers. Opening up the single market in services, where Britain has strong companies, is a prize worth staying for. Full completion could boost British GDP by 7 per cent in a decade, equivalent to £10 billion per year, according to the government.

Secondly, we need to focus on free trade. At the moment, talks on the establishment of a trans-Atlantic, EU/USA free trade area are taking place in Washington and Brussels. It has extraordinary potential. The government estimates that it could create two million new jobs in Britain alone, and boost the economy by £8.3 billion per year, while the European Commission estimates that an agreement with Japan would be worth £13.3 billion. The EU is a £10 trillion economy, capable of negotiating with Washington, and for that matter Beijing, Tokyo and Delhi, as an equal. We are kidding ourselves if we think Britain could achieve the same alone, with its 60 million consumers.

Thirdly, the EU offers small and medium sized enterprises many advantages but we need to do better for them – after all they account for over 99 per cent of private sector businesses and close to 60 per cent of turnover. Small businesses suffer most from poorly-targeted or excessive regulation, paying €10 per employee to comply, compared to just €1 for large businesses, according to the Commission. All EU regulation should be subject to an SME test, and the EU should aim to raise venture capital's share of SME finance, currently just 2%, by creating a true pan-European venture capital market.

Fourthly, the City of London is the natural financial capital not just of Britain, but also of Europe; according to the City advocacy group TheCityUK, 40 per cent of global trade in euros is conducted in London, and the shift in power from traditional banks to asset and capital markets should be a prime opportunity for UK financial services. Given the importance of Europe to the City, upholding its position and the single market in financial services from the likes of the Financial Transactions Tax will be much easier within the EU that without.

Finally, the EU must do what it does best and stay clear of areas where it does not add value. This requires an uncompromising commitment to the principle of subsidiarity; if decisions can be made at national (or even local) level, rather than in Brussels, they must be. Money could easily be saved by simplifying regulations, shifting the Common Agricultural Policy away from subsiding agribusiness, and giving the European Parliament a single seat in Brussels.

For these reasons, the UK needs to stay fully engaged in negotiations and not go down the blind alley of making UK-specific demands that will not be met. We know that we can do this effectively, with recent wins on reducing the UK budget, giving powers back to member states on fisheries and securing a double majority system in bank regulation that protects the UK and other euro outs. We clearly have the skill to negotiate good outcomes; we need to stay focused on them. ■

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How to improve security of supply of raw materials in Europe?

CHALLENGES AND ANSWERS

Emma Marcegaglia is the President of BUSINESSEUROPE

Raw materials are the backbone of European industry. Securing the supply of high quality raw materials at competitive prices for EU industry has been a priority for BUSINESSEUROPE. As a strong supporter of the European Commission's Raw Materials Initiative – which aims at fair and sustainable supply of raw materials from both global markets and within the EU, as well as increasing resource efficiency and recycling – BUSINESSEUROPE has identified a number of challenges that need to be more effectively addressed by the European political leadership:

Secure open global markets

On the positive side, the introduction of trade disciplines on export restrictions in EU's bilateral and multilateral negotiations - such as in the EU-Korea FTA and the bilateral EU-Russia Agreement in the framework of the latter's Accession Protocol to the WTO - is welcomed by European industry. These agreements establish a continuous dialogue and common understanding with our trading partners on raw material policies, which provide a legal basis to promote free trade in raw materials. Furthermore, BUSINESEUROPE supports the EU's efforts to reach out to the OECD and other fora in search of international consensus on the removal of trade distortions in raw materials.

Trade disputes with third countries in the context of the WTO, in cases where dialogue has not brought satisfactory results – for instance the removal of trade barriers and restrictions by China – also progress well. Strong signals should be sent to our trading partners pursuing these practices in breach of their WTO commitments that the EU is ready to use all instruments at its disposal to protect the rights of European industry.

In addition, the diversification of EU raw materials sources is absolutely critical to increase the security of supplies for European industry. Closer cooperation between the European Commission and companies operating in or depending on raw materials markets will help identify solutions. This could be done through joint industry-Commission projects to foster cooperation in good governance. BUSINESSEUROPE, through its vast membership from all over Europe, can significantly facilitate dialogue and support the development of international partnerships.

Sustainable supply within the EU

Overall, BUSINESSEUROPE recognises the progress that has been made to the implementation of European legislation at national level. This has contributed to better balancing and improving member states' raw materials strategies. A lot, however, remains to be done in this field. Increased regulatory harmonization would help in aligning best practices among member states further, which will in turn contribute to the creation of a stimulating environment for exploration and exploitation of raw materials within the EU.

BUSINESSEUROPE is ready to support initiatives that will help improve the knowledge base on EU raw materials deposits, assess their value and promote innovative practices in extraction and manufacturing. The issue of providing fiscal incentives to companies operating in the field of raw materials has for many years been a sensitive point in the discussions among stakeholders. In our view, the introduction of fiscal incentives could further increase the exploration of new extraction sites in the EU, improve the competitiveness of EU industry, create new jobs and ensure the supply of indigenous raw materials.

Resource efficiency and recycling

The development of this part of the Raw Materials Initiative has also delivered positive results. However, stricter implementation is needed at national level. For instance, research and innovation should be further promoted by the EU member states and in all stages of raw materials' value-chain, from exploration to extraction, processing, recycling and substitution. This can be achieved by making full use the EU Innovation Partnership on Raw Materials (EIP) and the Knowledge and Innovation Communities (KIC).

Awareness-raising and capacity-building initiatives could also enhance exchange of best practices among the member states. The reduction of administrative burdens – especially as regards access to secondary raw materials markets – could also increase the quantity of recycled materials that could be effectively reused in the raw materials production chain. Finally, the rapid introduction of better control over illicit waste shipments is necessary at EU ports. This not only lowers supplies to recycled raw materials but also sends waste to zones

with low environmental standards with disastrous ecological consequences.

Good governance

Despite progress in the three pillars of its Raw Materials Initiative, the EU has nevertheless failed to develop an effective 'resource diplomacy', that could be used as a leverage for European industry to engage in partnerships with resource-holding countries. Since this would require different angles of the EU policy to come together, complementarities between trade, development and external EU policies should be overall improved and their instruments better integrated.

Projects funded through the European Development Fund (EDF) and the European Investment Bank (EIB) are welcome and should be further reinforced by the launch of partnerships, not only with resource-holding countries but also with the private sector. It is our strong belief that trade and development policies can go hand-in-hand. They not only better leverage private sector's resources in development projects but provide useful tools to reduce poverty by contributing to job creation and improving governance.

BUSINESSEUROPE has been a strong advocate for the establishment of a more structured dialogue with different branches of the European Commission and the External Action Service on policy issues and instruments, including cooperation in raw materials. While some progress has been made, dialogue on raw materials issues, unfortunately, remains a sensitive area for the European Commission. At this point, we see a major contradiction in EU policy. On the one hand a reluctance to engage with large companies in the resource sector to address governance challenges, while on the other there is a propensity to legislate on the same issues. We would like to offer some examples.

- Transparency in the extractive sector is indeed key in order to promote good governance practices, especially when it comes to reducing fraud and corruption. BUSINESSEUROPE's concerns with legislation recently adopted by the EU lie nevertheless with the ramifications that stringent reporting requirements and compliance costs will have for the competitive position of the European industry relative to their competitors that are not obliged to follow similar rules.

"Strong signals should be sent to our trading partners pursuing these practices in breach of their WTO commitments that the EU is ready to use all instruments at its disposal to protect the rights of European industry"

- Discussions on responsible sourcing have also been intensified in recent years, with the private sector taking on more and more initiatives. The European Commission is now exploring the possibility of adopting legislation in this area, more specifically in responsible sourcing from conflict-affected and high-risk areas. As experience from the US Dodd Frank Act section 1502 has shown, rigid legislation not only fails to contribute to the solution of conflict, but it rather creates a series of socio-economic problems in the conflict-affected areas, including trade embargoes, unemployment and social unrest. The EU should therefore avoid any binding legislation and focus its future initiatives to effectively contributing to improvement of the situation on the ground through building strong diplomatic relations with resource-holding countries and supporting voluntary business initiatives.

Final remarks

Although the implementation of the EU Raw Materials Initiative has indeed delivered successful results, especially in the area of guaranteeing access to raw materials markets for EU companies, more efforts should be made in order to achieve a balanced strategy for raw materials in Europe. Furthermore, the establishment of an EU 'resource diplomacy' has become an imperative and it requires the active participation of different policy branches and institutions. In this context, and in times of a fierce economic crisis which Europe is still struggling to overcome, it is not prudent of the EU to pursue policies that increase the burden and costs for European companies, whose competitiveness will help the EU's economic rebalancing and jobs growth. ■

Western Balkans challenges and RCC response

Goran Svilanović is Secretary General of the Regional Cooperation Council

Economic and financial crisis, along with the difficult heritage of 1990s, shows the fragility of transitional democracies in South East Europe, particularly in the Western Balkans. The struggle between going forward and lagging behind is continuously taking turns in our region. Its average GDP is currently at only 38% of the EU's average. It is a scary figure and it shows how drastic is the influence of the economic and financial crisis on this region.

It also means that the gap has been widening, and the region has been unable to catch up with the more developed parts of Europe. It reveals potential for further frustrations, street protests, instability. This is neither in the regions nor in Europe's best interest.

South East Europe is in a sort of upheaval at the moment. It is not the only troubled region in Europe these days, as you well know, but that fact does not make us feel any better. Frustrations with political elites, high unemployment, corruption, have taken people to the streets, to demand demise of the elites and a new social order, new social contract.

Not everything is bleak, of course. Positive examples offer a guideline to the future.

Croatia is the region's major success story: a member of the EU since July this year. In the process, the country has demonstrated the importance of dialogue and cooperation with neighbours. Domestically, civil society, media and ordinary people have become less and less tolerant to issues such as corruption and nepotism, and take much more active role in demanding a societal change and accountability from state institutions.

In the dialogue facilitated by the EU, Belgrade and Pristina have reached very important agreements which are to be implemented in good fate. Consequently, Serbia has been given a date to start accession talks and Kosovo* to start preparation of the Stabilisation and Association Agreement with the EU. Montenegro has recently started EU accession talks. In Albania, we have seen elections which brought a change and have not been contested.

Almost two decades after the end of wars in the Western Balkans, ordinary people want the focus on present challenges; they want immediate actions to be taken by the authorities. The economic and financial crisis has made lives of the poorest impossible and practically destroyed the middle class. The majority is unemployed. Those who do have jobs, work for low salaries with constant fear of unemployment.

The economy, a good standard of living, the ability to afford good education for children, and the ability to get good healthcare is at the heart of every person in our region, as elsewhere in Europe. When that is under threat or inaccessible, people yield to destructive tendencies: they tend to seek solutions outside of institutions, nationalism rises, and corruption flourishes.

We see three ways to counter the mentioned challenges:

- Wise national leaders who look beyond daily politics, who genuinely want to see their countries move forward, who have a vision and courage to take bold decisions.

  This is already happening: bilateral and multilateral meetings on the highest level have intensified across the region recently. These meetings increase trust and confidence, prepare ground for resolving bilateral issues and open up possibilities for practical cooperation. The brave politicians need support both within and outside the region, while they take responsibility for their countries' destiny, and try to seize opportunities for progress.

- EU enlargement as a powerful tool to counter negative tendencies. Yes, the primary responsibility for our region rests with us who are from the region, but the outside incentive is still much needed. And the EU enlargement is the most important such incentive. Events of the recent past have revealed that EU membership does not solve all problems and that accession-related reforms should be coupled with sound economic, fiscal, social and other structural policies that will help our countries reach an equal footing with the rest of the European family. Still, EU accession remains one of the most relevant stability policies for the Western Balkans. The EU's key financial pre-accession support mechanism, the Instrument for Pre-accession Assistance (IPA), can play an important role in this context.

  We want to achieve a maximum level of consideration for the region's interests in designing the IPA II, for the

2014-2020 period. We want the region's voice to be heard. We expect that the RCC will be consulted in the process of making decisions about the use of these funds at the regional level. This is a practical way to maintain EU integration dynamics, enhancing at the same time the region's stability. This also testifies to the EU's permanent support and commitment to the inclusion of the entire Balkans, just like it was decided ten years ago in Thessaloniki.

- Regional cooperation, as an important EU membership precondition, but also as a means to foster dialogue, exchange and stability among the countries.

  The countries of the region are aware of the advantages of regional cooperation and the unavoidable and necessary links between and among them. Regional cooperation and good neighbourly relations are also consisting parts of the Stabilisation and Association Agreement signed by countries aspiring to become EU members. The RCC contributes to preparing European Commission's reports that evaluate progress of the countries in the accession process.

This last point leads me to the Regional Cooperation Council, and what we have been doing, and intend to do, in order to help improve the situation in our region.

Over the last five years of the RCC's existence, we saw important steps forward in connecting the region: joint infrastructure projects, constant increase of the level of cultural exchange, cooperation in the fields of justice, home affairs, security, education, science, healthcare, media. And we all know that the improvement of cooperation, of economic and cultural bonds also leads towards economic growth, which in turn helps eradicate corruption and strengthens stability and the rule of law.

The RCC has played an important role in this process, and will continue to do so. We will continue to work on creating an environment where, with respect to mutual differences,

"We will continue to work on creating an environment where, with respect to mutual differences, we will be able to adjust our own interests to those of our neighbours, and profit from that synergy"

we will be able to adjust our own interests to those of our neighbours, and profit from that synergy. We are proud to have ensured all-inclusiveness in our activities, to show that the region is able to take responsibility for its own future and create conditions for overall progress in the spirit of tolerance and cooperation. We find it important to foster regional stability for the sake of citizens in our region and the quality of their lives. We believe that by advancing European and Euro-Atlantic integration we will reach that goal faster.

By now we have a solid foundation, but we have to look into the future.

For several years now, the RCC has paved the road for the South East Europe (SEE) 2020 growth and development strategy. We have been actively working on it since November last year, when ministers of economy from the region adopted the strategy's main targets. Our basic goal is to improve living conditions in our region and bring back to the region a focus on competitiveness and development of each country and the entire region. In that sense, this document leans on the EU strategy *Europe 2020*.

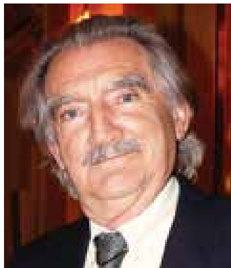
Let me mention the most important goals of the strategy to be reached by 2020: employment growth from 40% to 45%, increase in mutual trade by 230%, the rise of the region's GDP from the current 38% to 46% of the EU average. We also want to see an increase in the foreign direct investment inflows in the region by 120% and an additional 300,000

Participants at the second meeting of the SEE 2020 strategy coordination board, held under the auspices of the RCC in Sarajevo July 18 2013

highly educated people on the job market, with a realistic perspective to get decent jobs. To make this happen, production, trade, investments and education must be improved, and our national governments must be far more efficient than they are nowadays.

We want to create a harmonised framework in the regional cooperation process, where all participants have clear roles and responsibilities in achieving the agreed goals. This is why all relevant regional organisations participate in the strategy development under RCC auspices, such as CEFTA, Energy Community, Health Network, Education Reform Initiative. Of course, national institutions have a key role: ministries of economy, education, employment, healthcare, justice, culture, environment, relevant agencies. International organisations, such as the EU, the OECD, the Council of Europe, and the World Bank will also provide support. The ministers of economy are expected to adopt the SEE 2020 strategy in November 2013. ■

** This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.*



The EU's economic policy architecture after the ratification of the Fiscal Treaty

Jørgen Mortensen is an Associate Senior Research Fellow at the Centre for European Policy Studies (CEPS), Brussels and is a Fellow at CASE - Centre for Social and Economic Research, Warsaw

Despite the resistance by some member states, the EC in 1990 started the process which would lead to the adoption of EMU. A Conference of the Representatives of the Governments of the Member States (the EC term for the inter-governmental conference) convened in Rome on 15 December 1990 to adopt by common accord the amendments to be made to the Treaty establishing the European Economic Community with a view to the achievement of political union and with a view to the final stages of economic and monetary union. The final negotiations took place in Maastricht on 7 February 1992, giving rise to the creation of the European Central Bank and Treaty changes concerning also Justice and Home Affairs and external policy.

With the ultimate limit for passing to Stage 3 (1 January 1999) approaching, some member states became increasingly concerned with the possibility of irresponsible budgetary behaviour by governments once admitted in the EMU club. The need for establishing rules of the game once inside the EMU was recognised by the Madrid European Council in December 1995 and reiterated in Florence six months later. An agreement on the main features was reached in Dublin in December 1996 and final agreement on the text was reached on 7 July 1997 (see annex).

Broadly speaking, the SGP stipulates the need for observing the Maastricht criteria even after EMU membership and provides somewhat specific guidelines for the process of deciding whether an EMU member country runs an excessive deficit. The SGP, however, goes considerably beyond the Maastricht Treaty by giving the Council the competence to impose sanctions if a participating member state fails to take the necessary steps the bring an excessive deficit to an end. Whenever the Council decides to impose sanctions it is 'urged' always to require a non-interest bearing deposit in accordance with Article 104(11). It is again 'urged' to convert a deposit into a fine after two years unless the excessive deficit has, in the view of the Council, been corrected.

However, an institutional crisis in the European Union emerged in 2004 as the result of the ECOFIN Council's failure to 'jump the obstacle' and take sanctions against France and Germany in accordance with the Excessive Deficit Procedure provided for in the Maastricht Treaty's article 104, the associated protocol and the Stability and Growth Pact.

The crisis can be seen as a symptom of a latent and lasting conflict between two equally valid features of the construction of the Union:

> 1. The need to ensure a high degree of consistency, notably in the medium and long run, between monetary and budgetary policy; and
> 2. The principle of 'subsidiarity' which can be taken as the theological argument for assigning the full competence in the field of fiscal affairs and social policy to the national (or regional) governments.

The need to ensure consistency between budgetary and monetary policy can, from the point of view of economic analysis, be based on the argument that in the long run

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"All-in-all, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union does not seem to offer a definitive solution to the problem of finding the appropriate budgetary-monetary policy mix in the EMU"

monetary and budgetary policy cannot be considered to be completely independent policy instruments. There can be little doubt that a prospective building up of public debt in proportion to GDP in the long run will put enormous pressure on monetary policy and make it increasingly costly for the economy to keep inflation under control. The monetary authorities' concern with respect to the long-term sustainability of budget balances of EU member states is therefore legitimate. Clearly this potential conflict was 'forgotten' in the 1990s and the early years of 2000 but came out of hiding with the financial and economic crisis of 2007 and onwards.

Under strong influence of the emerging public debt crisis, the European Council meeting on December 9, 2011 discussed the incorporation of aspects of a reinforced Stability and Growth Pact[1] into the EU Treaties. Only the United Kingdom was openly opposed to the proposal, but this veto effectively blocked the incorporation of the reinforced SGP rules into the EU Treaties, as unanimous support from all member states is required to bring about treaty change[2].

This gave rise to the adoption on 2 March 2012, by 25 member states (in addition to the UK, the Czech Republic opted out) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. As a sufficiently large (12) number of partners had ratified it, the Fiscal Stability Treaty, in fact, came into force in January 2013.

The provisions of the Treat may be summarised as follows:

- The budgetary position of a 'contracting party' must respect a country-specific medium-term objective as defined in the SGP with a lower limit of a 'structural deficit' of 0.5% of GDP but with the time-frame fixed with due account of country-specific sustainability risks.
- The lower limit for the structural deficit may be increased to 1% once the public debt is lower than 60% of GDP.
- The speed of reduction of the deficit is fixed at on twentieth of the gap between the actual deficit and the limit.
- In the case of failure on behalf of a contracting party to comply with the recommendation a procedure may be launched with the Court of Justice which can impose a sanction not exceeding 0.1% of its GDP.

In addition, the Stability Treaty stipulates some more formal rules of governance and also, importantly, in article 16, states that within five years at most of the entry into force, on the basis of an assessment of the experience with its implementation, the necessary steps shall be taken with the aim of incorporating the substance of the Fiscal Treaty into the legal framework of the European Union.

The only really significant innovation due to the Fiscal Treaty is the assignment to the European Court of Justice of the responsibility of deciding to sanction a member state for having an excessive deficit.

In addition, however, the Stability Treaty (in article 8) stipulates that where, on the basis of the Commission's assessments, taking account of observations from the country concerned, the latter has failed to comply with its obligations, the 'matter will be brought to the Court of Justice by one or more Contracting Parties'. And where a Contracting Party, independently of the Commission's report, considers that another Contracting Party has failed to comply with the provisions it may also bring the matter to the Court of Justice. In fact, according to article 8: where, on the basis of its own assessment or that of the European Commission, a Contracting Party considers that another Contracting Party has not taken the necessary measures to comply with the judgment of the Court of Justice, it may bring the case before the Court of Justice and request the imposition of financial sanctions following criteria established by the European Commission in the framework of Article 260 of the Treaty of the Functioning of the European Union.

The inter-governmental nature of the Stability Treaty is also made evident by the fact that the Commission, despite its important role in the preparation of reports and conclusions as regards the existence of an excessive deficit, is not as such entitled to bring a case before the Court of Justice. However, as regards the eurozone countries, article 7 stipulates an 'obligation' for the members to supporting the proposals or recommendations submitted by the European Commission where it considers that a eurozone member states is in breach of the deficit criterion in the excessive deficit procedure. This obligation, however, shall not apply if a qualified majority is opposed to the decision proposed or recommended.

Another issue is, however, to what extent the Stability Treaty, due to its inter-governmental nature, can be expected to entail a modification of the roles of the EU institutional pattern and, notably, the role of the European Parliament. In this respect, Article 13 of the Treaty stipulates that the European Parliament and the national Parliaments of the 'contracting parties' will together determine the organisation and promotion of a conference of representatives of the 'relevant committees of the European Parliament and representatives of the relevant committees of national Parliaments in order to discuss budgetary policies and other issues covered by this Treaty'.

What remains to be seen is, however, also the reality of legal procedures initiated when a Contracting Party actually makes use of the provisions in the Treaty and puts a case before the Court of Justice. At stake here is the interpretation by the Court of the provisions in Article 3 and, notably, how the Court will decide as regards the definition of the annual structural balance of the general government as being the 'cyclically-adjusted balance net of one-off temporary

measures' and even more the definition of 'exceptional circumstances' in paragraph 3, point 'b'.

Under normal circumstances the Court cannot be expected to have the in-house expertise to arrive at an 'independent' estimate of the structural budget balance of the country concerned and must therefore, at least initially, rely on the estimates of this balance prepared by the Commission. However, the country brought before the Court, not least to avoid paying the penalty and the accompanying stigmatism, may argue that the Commission's estimates do not take full account of very 'special circumstances'.

In order to arrive at a balanced conclusion, the Court and the country concerned may therefore need to call in experts from outside and it cannot be excluded that, in the end, the Court's decision will not support the Commission's views or those of the Contracting Party having brought the case before the Court. To arrive at a purely judicial definition of a 'structural budget balance' and 'special circumstances' might thus create a rather unique precedence for a decision concerning a key economic variable, normally subject of economic cleavages and scientific and political debates but at the end normally left to the validation of economists and policy makers.

The need to ensure a high degree of consistency between budgetary and monetary policy should, however, not be interpreted as an argument in favour of assigning increased discretionary competences to the Council in the field of budgetary policy, at least not in the foreseeable future.

Admittedly views differ with regard to the existence or the gravity of the 'democratic deficit' within the EU's decision-making procedures. Allowing the Council to take binding decisions in fiscal affairs would be against the normal assignment of legislative powers to the elected parliament.

At the level of the EU such competences should therefore only be transferred from the national parliaments to the European Parliament. While such transfers may well take place in a more distant future this is not to be counted upon as a way to ensure consistency between budgetary and monetary policy.

The Maastricht criteria, the protocol, the SGP and the Stability Treaty do not involve any transfer of discretionary competence to the Council and consequently do not run counter to normal democratic functioning of the EU institutions. From the point of view of legal status the provisions contained in these acts are equivalent to rules frequently found in federations putting a cap on allowable budget balances or obliging regional authorities to keep expenditure within the limits of available resources.

The Treaty provisions, the SGP and the Stability Treaty may therefore be considered valid attempts to obtain appropriate trade-off between the need to ensure long-term consistency between budgetary and monetary policy and the respect for the principle of subsidiarity.

The entering into force of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union does not significantly modify the assessments concerning the implications of the Maastricht Treaty and the Stability and Growth Pact. It does provide a slightly modified excessive deficit procedure and in sharp contrast to the Maastricht Treaty and the SGP stipulates a direct involvement of the European Court of Justice, attempting thus to fill the judicial vacuum recognised in the cancellation by the Court of the Council decision to suspend the excessive deficit procedure as regards the French and German deficits in 2003-2004.

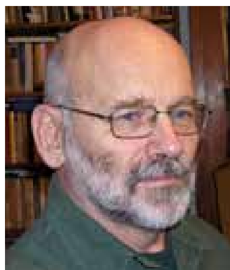
In addition to introducing a slightly more specific constraint on budget balances, the main purpose of this inter-governmental treaty was, in fact, to make an attempt to fill the legal void demonstrated by the excessive-deficit procedure against France and Germany. This procedure having been concluded by the cancellation by the European Court of Justice of the Council's decision to suspend the procedure, the future of the excessive-deficit procedure in fact depended upon the unlikely adoption by the Council of a Commission proposal to sanction a member state in a situation of excessive deficit.

However, the transfer to the Court of Justice of the final decision as to whether or not a Contracting Party is in fact in a situation of excessive deficit and whether it should be sanctioned by a fine leaves serious questions open: on what criteria should the Court take this decision in case there is disagreement as regards the nature of the deficit and the route to be followed towards reduction of this deficit? Given the exceptionally large number of excessive-deficit procedures now under way (twenty), it may be legitimate to apprehend with some doubts the unfolding and outcome of these procedures from 2013 to 2016 and beyond.

All-in-all, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union does not seem to offer a definitive solution to the problem of finding the appropriate budgetary-monetary policy mix in the EMU already well identified in the Delors report in 1989, regularly emphasised ever since and now seriously aggravated due to the Crisis. Furthermore, the implementation of this Treaty may under certain circumstances contribute to an increase in the uncertainties as regards the distribution of the competences between the European Parliament and national parliaments and between the former and the Commission and the Council. ■

1. As presented by the Directorate-General for Economic and Financial Affairs of the European Commission, the Stability and Growth Pact (SGP) is the concrete EU answer to concerns on the continuation of budgetary discipline in Economic and Monetary Union (EMU). Adopted in 1997 as indicated above, the SGP strengthened the Treaty provisions on fiscal discipline in EMU foreseen by articles 99 and 104, and the full provisions took effect when the euro was launched on 1 January 1999.

2. For more see, for example, Broin, Peadar ó: The euro crisis: The fiscal treaty – an initial analysis, Working Paper 5 of the Institute of International and European Affairs (Dublin 2012).



What kind of fiscal union?

Marek Dąbrowski is a CASE Fellow. CASE - Center for Social and Economic Research, is an independent non-profit economic and public policy research institution founded on the idea that evidence-based policy making is vital to the economic welfare of societies

The sovereign debt crisis in Europe brought back a debate on the lacking components of the European integration, particularly on the role of fiscal integration. Both advocates and sceptics of the common currency argue that successful monetary integration must go hand in hand with a fiscal one and the deficit of the latter makes eurozone vulnerable to various shocks.

Is the eurozone really so unique?

Some authors suggest that the Economic and Monetary Union (EMU) represents a unique historical case of common currency area with decentralized fiscal policies[1]. The same argument has been raised by the European Commission in its *Blueprint for a Deep and Genuine EMU*[2].

However, historical analysis of monetary unions does not support such a strong opinion. Apart from historical episodes when monetary unification follows a political one (often involuntary) there are also examples of voluntary monetary unions of sovereign states, when common currency and central bank are not accompanied by meaningful delegation of political sovereignty in other areas (like fiscal policy) to a supranational entity.

For example, the West African Economic and Monetary Union (WAEMU) or Central African Economic and Monetary Community (CEMAC) have virtually no political and fiscal integration but they use a common currency (CFA franc) for almost 70 years. Only recently their member countries started to develop other segments of economic integration, ie, custom unions, common markets and some soft forms of supranational macroeconomic policy coordination and fiscal surveillance but the actual progress to date is rather limited, especially in case of CEMAC. Nevertheless both monetary unions proved sustainable, despite numerous asymmetric shocks, political and violent conflicts both internal and regional, limited trade and financial integration, etc.

If we broaden definition of monetary union by including a permanently fixed exchange rate (against other currency or common metallic standard), we obtain more cases when monetary 'federalism' has not been accompanied by the political and fiscal one. This concerns, in first instance, the period of the international gold standard in the second half of the 19th century and beginning of the 20th century when most of independent (and sometimes politically antagonist) countries shared the same monetary rules and, in fact, remained in a quasi-monetary union.

Arguments in favour and against fiscal integration

Even if monetary union does not necessarily require the existence of fiscal union there may be other arguments in favour of closer fiscal integration within the EU and EMU: pooling resources to carry out common policies and provide supranational public goods as suggested by the theory of fiscal federalism. Thus the discussion on fiscal integration in Europe should start from functional analysis aimed to identify those policy areas and public goods where centralization of competences and resources could either offer increasing returns to scale or help addressing cross-border externalities.

Financial market regulations and supervision, pan-European deposit insurance and bank resolution mechanism (with consequences in terms of greater centralization of public resources) are candidates number one in the sphere of economic policy. However, 'banking union' should not be limited to EMU because its main justification relates to completing the single market of financial services. As long as regulatory and supervisory power and crisis resolution resources remain in national hands the EU financial market will face danger of fragmentation and renationalization, especially in time of financial distress.

Going beyond economic sphere one can find more areas of potential benefits coming from centralization of decision making and pooling fiscal resources, for example, common defence and security policy, protection of external borders, consular services and environmental policy. However, economic rationale of centralization will have to be always confronted with political considerations such as national sovereignty concerns, interests of incumbents on a national level, and limited appetite for cross-border fiscal redistribution. As result, the EU has been historically built around the principle of subsidiarity enshrined in Article 5 of the Treaty on European Union (TEU). According to this principle, the functions of higher levels of government

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"Any substantial increase in the size of the budget in future will require developing direct revenue sources such as pan-European taxes"

should be as limited as possible and should be subsidiary to those of lower levels.

The EU fiscal federalism in place

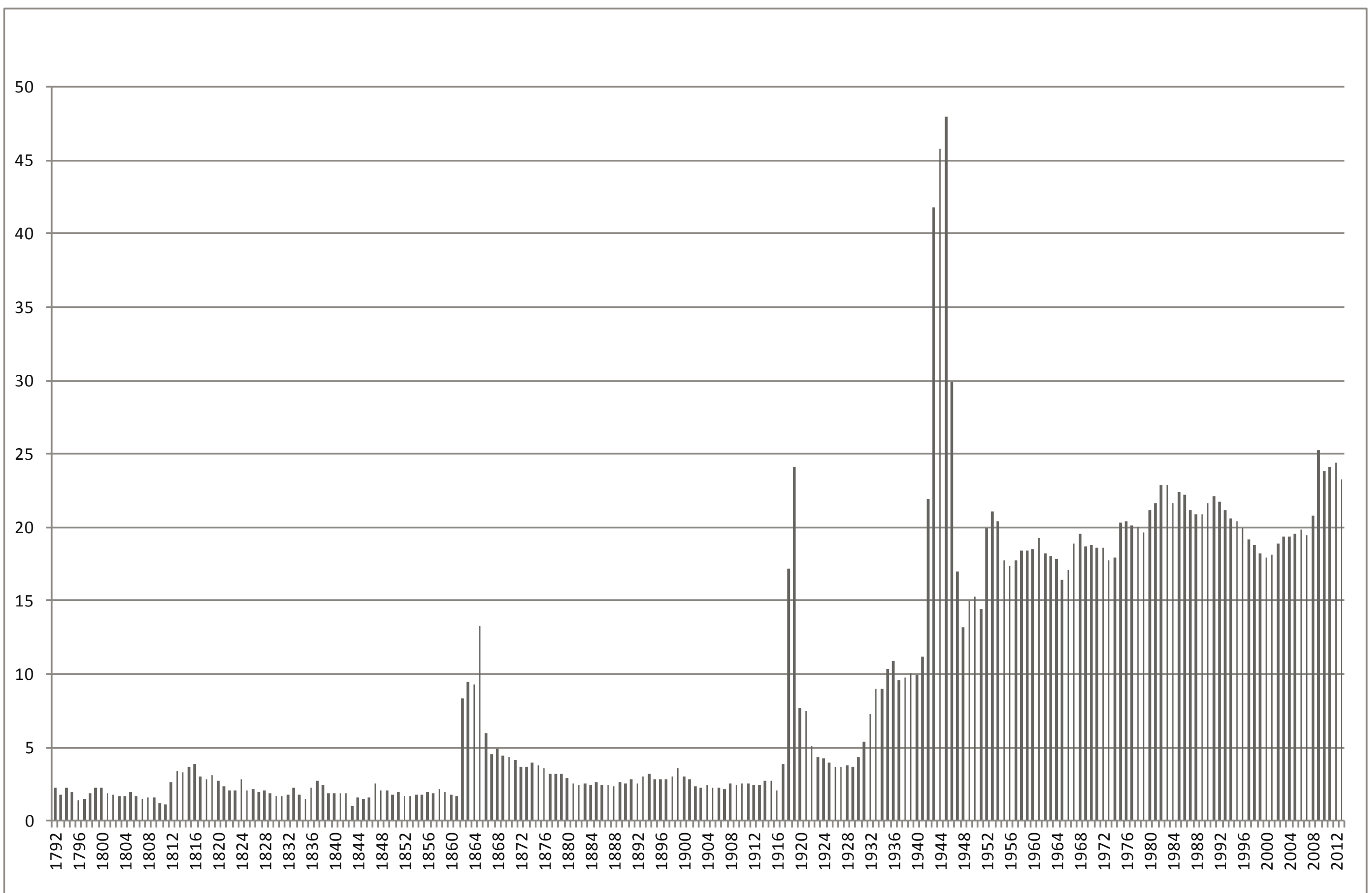
Despite opinions on the total absence of fiscal integration within the EU/EMU there are already several components of genuine fiscal union in place, ie, the EU budget, the newly created off-budget bailout facilities, EU's own revenue sources, fiscal rules and their surveillance. Ironically, quasi-fiscal operations of the ECB since May 2010 also add to the complex picture of fiscal federalism in the eurozone.

The size of EU budget oscillates around 1% of EU's Gross National Income (GNI). Its expenditures must be closely matched by revenues. The EU is neither allowed to borrow nor cumulate budget surpluses (the latter must be returned to member states). However, in the Multiannual Financial Framework (MFF) for 2014-2020 there will be possibility to move unspent money between budget lines to finance other underfunded commitments in a given fiscal year.

The EU budget in its current structure is dominated by cross-country transfer programs such as the Common Agriculture Policy, cohesion and structural funds. Financing European public goods such as research or environmental programs plays a secondary role. This is result of strong path dependence, ie, impact of the past decisions which, in turn, resulted from necessity to reach compromise on some key integration steps. Adoption of the MMF requires unanimous decision of all member states what additionally narrows room for any radical change in the budget size and its expenditure structure.

The above picture has changed with creation of the European Financial Stability Facility (EFSF) in 2010 replaced by the European Stability Mechanism (ESM) in 2012. The ESM's lending capacity is €500 billion, and the combined lending ceiling of EFSF/ESM is set at the level of €700 billion (ESM, 2013), ie, ca. 5 and 7% of the eurozone's annual GDP respectively (it is the accumulated stock while the size of EU budget represents an annual flow).

Figure 1: US total federal spending as % of GDP, 1792-2012



Source: http://www.usgovernmentspending.com/spending_chart_1792_2013USp_13s1li011mcn_F0f_Spending_In_20th_Century

Only the 'traditional own resources', ie. 75% of custom duties on imports from outside the EU and sugar levies can be considered as a sort of EU 'federal' taxation. The two other 'own resources', ie. from value added tax (VAT) and the one based on GNI are calculated according to complicated country-specific formulas. In addition, some net donor member states (the UK, Sweden, Netherlands, Germany, Austria) enjoy individually negotiated rebates.

Any substantial increase in the size of the EU budget in future will require developing direct revenue sources such as pan-European taxes. In turn, this will have to increase the role of the European Parliament, as the direct representation of EU citizens.

If one looks for historical comparison, the US federal budget in peace time amounted to 2-3% of GDP until beginning of the 20th century (Figure 1) and started to grow substantially only after the Great Depression in 1930s. Before adoption of the 16th Constitutional Amendment in 1913 which allowed for introducing federal income taxation, the tax power of the US federal government had been limited to collection of import tariffs and part of excises.

Fiscal discipline vs. fiscal solidarity

Fiscal discipline is critically important within federations and closely integrated economic blocks, due to intensive cross-border spillovers, more opportunity to free ride at the cost of neighbours, and moral hazard problem (expectation of bailout). It may be ensured by market mechanism (danger of sovereign default) and formal fiscal rules, or combination of both as in the case of EU. The former has been built around the 'no bailing out' clause in the Article 125 of the Treaty of the Functioning of the European Union (TFEU) and ban on debt monetization by the ECB and national central banks (the Article 123 of the TFEU). Fiscal rules have been imposed by both the Article 126 of the TFEU, the accompanying Protocol No. 12 and EU's secondary legislation, ie. the Stability and Growth Pact (SGP). They include numeric criteria on the maximum fiscal deficit and debt level backed by administrative and financial sanctions, ie, the Excessive Deficit Procedure (EDP).

Financial markets never seemed to take seriously the 'no bailing out' clause as demonstrated by very low yield spreads prior to the 2008/2009 global financial crisis, in spite of big differences in fiscal positions of individual member states. And they proved right because this clause was de facto suspended with granting balance-of-payment support to Hungary, Latvia and Romania in 2008-2009 and first aid package to Greece in 2010. It has been replaced by policy of conditional bailout, ie, financial assistance in exchange for country's commitment to fiscal adjustment and necessary reforms.

Fiscal rules imposed by the TFEU and SGP have been also frequently breached with no serious sanctions. The situation did not improve after the 2008/2009 global financial crisis, despite their serious reinforcement. The SGP includes now automatic and meaningful sanctions, especially in respect to EMU members. EU legislation also obliges member states to enhance their national fiscal rules and institutions. The new fiscal rules are backed by the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

Difficulties with rules enforcement originate from continuous fiscal imbalances in many EU countries. Most of them continue to be subject of the EDP what makes them reluctant to impose a peer pressure on other 'brothers in trouble'. As result, the Commission's deadlines to bring countries' fiscal positions back under the TFEU and SGP targets are frequently postponed and no financial sanctions have been ever adopted.

Worrisomely, the Commission's *Blueprint for a Deep and Genuine EMU* suggests further weakening of market discipline by creation of the European Redemption Fund. Simultaneously, the Commission would like to strengthen its prerogatives to monitor national budgets, including veto power in respect to national budget decisions. This would make EU fiscal rules increasingly intrusive and rather incompatible with the political and legal architecture of the EU (a sort of limited federation or confederation based on the principle of subsidiarity).

Two radical ideas floated in the public debate - debt mutualization (eurobonds) and lender of last resort for governments, ie, unlimited and unconditional commitment of the ECB to purchase debt instruments of eurozone governments in case of market distress - would mean moving from conditional towards unconditional fiscal and monetary bailouts. Both are presented as the attempt to arrest irrational behaviour of financial markets, avoid cross-country contagion, and help to survive temporary illiquid but fundamentally solvent governments. Unfortunately, intentions staying behind these proposals are naïve, difficult to operationalize in practice (for example, distinguishing illiquidity from insolvency) and largely ignoring a moral hazard problem. If implemented such proposals would lead to deeply dysfunctional fiscal union.

Sadly this part of the debate on the EU/EMU fiscal federalism ignores other countries' lessons. For example, the US federal authorities did not bailout any state since 1840s and this consequent practice remained the strongest incentives for states to adopt their own constitutional guarantees of fiscal discipline. The similar 'no bailing out' practice governs the Canadian federation. On the other hand, those federal countries like Argentina and Brazil which failed to ensure fiscal discipline of their subnational governments and provided them with bailouts suffered serious fiscal and monetary stability problems on a federal level. ■

1. For example, Bordo, MD, Markiewicz, A, Jonung L: A Fiscal Union for the Euro: Some Lessons from History, NBER Working Paper, No. 17380, September 2011
2. Communication from the European Commission, COM(2012) 777, November 28, 2012.

BACK TO BASICS

Parliaments and parties should be more accessible to citizens again

Patrick van Schie is a historian and director of the Teldersstichting, an independent Dutch liberal think tank associated with the VVD political party.

In the western world, common citizens have gradually - over the last century or so - acquired influence on political decision-making. Admittedly, there are prominent thinkers in political philosophy (including Hobbes, Locke, Rousseau, Rawls and Nozick) who founded their theories on the idea of a 'social contract', an imaginary agreement between free individuals who instituted a sovereign to arrange for them certain matters in the public interest, particularly security. However, in historical reality, that has never really been the case. In point of fact, power that had often been gathered to rulers by force had to be curbed through difficult struggle, or sometimes partly taken away from the sovereign by stealth to be more widely distributed.

The rise of citizens; ideal and practice

Parliaments and political parties are the institutions that have come to symbolise and channel the influence of the citizenry. The earliest parliaments arose because the monarch needed money and could not levy taxes all by himself; at the very least, he needed the consent of his most influential subjects for such a levy. Consequently, as early as the late Middle Ages, sovereign and parliament would collaborate on the one hand, in order that taxes for an objective supported by parliament could be levied; on the other hand, parliament explicitly might oppose the monarch, as an autonomous power which could refuse the sovereign's demands.

Basically, the democratization of parliaments which came about particularly in the nineteenth and/or twentieth century - following the extension of the right to vote and the introduction of one (wo)man, one vote - changed nothing in that situation. True, the power was shifted from the sovereign to the ministers, and parliamentarians not only represented the people but were also mandated by them; however, the representation of the people remained an autonomous force that had to cooperate constructively with the national government while at the same time maintaining critical control of it. Although the legitimacy of the people's representation was enhanced, that did not automatically increase the legitimacy of the government. Whether or not this happened depended upon parliament succeeding in sustaining - in a well-balanced way - the prevailing views and interests of the population.

Ideally, general interests were at stake in that context: security, public order and fair justice; the roads; a certain basic level of education and other so-called 'collective facilities', ie. matters that are in everybody's interest but cannot - or not sufficiently - be brought about through private initiative. In reality, as in the past, special interests played a part. Anyone in power or control will - first and foremost - take care of his own interests, and thereby it is useful if such interests can be presented as 'the public interest'.

In the nineteenth century, the ideal - aptly phrased by Edmund Burke, the eighteenth century Irish-British philosopher and politician - that a parliamentarian should be able to form his judgement independently and be able to act upon it freely, prevailed in many countries. He should be free from coercion by the national government and from pressures imposed by his fellow-parliamentarians; neither should he act upon the instructions of pressure groups or the electorate. Since voters with an above-average interest in politics wanted to know what they might expect, political parties emerged which put up candidates and supported them in their campaigns, and also began to formulate manifesto policies. They felt that the candidates supported by them should stand for these policies (principles at first, but later more concrete issues as well). Not all (candidate) parliamentarians took kindly to this approach; subscribing to such manifestoes would affect their independent judgement. Nevertheless, all political parties eventually took to drafting manifestoes, and they expected their parliamentary candidates to support the party manifesto and to secure majorities in parliament for the various policies - unless, at least, coalition required compromise.

According to political scientific literature, an election manifesto is the result of an open and free debate between the active members of a party. Thus, benefit can be derived from a maximum of insights, and admitted partial interests can be weighed as well as possible. Here too, practice often deviated from the aggregation function theoretically allocated to parties; election manifestoes were often 'pre-cooked' or heavily influenced by the party leadership. Nevertheless, such a manifesto is basically the ideal tool to allow citizens - as members of a political party - to exercise their substantive influence.

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"If members of parliamentary parties realise that, eventually, they are not accountable to party leaders but to the party members and the electorate, coercion by the parliamentary party and factions may become less effective"

How parliaments and parties have drifted away from the citizens

In the 21st century, citizens in western democracies are better educated, better informed and (in spite of the economic crisis since 2008) more prosperous than in preceding centuries. Therefore, their ability to exert a well-considered influence on politics should be, theoretically speaking, more substantial than ever before. If ever there was a time when the ideals of the independent judgment and critical function of parliamentarians and political parties could be accessed - as channels through which society's ideas and concerns find their way into political manifestoes, based upon a clear understanding of the public interest - that time is now.

However, over the past decades the democratic systems in most of the western countries have strayed farther away from this ideal picture rather than coming closer to it. Parliaments are considered by fewer citizens to be true representatives of the people. Citizens do not look upon political parties as their 'crow bar' into the system, but rather as part of a system that is alien to them. The importance of political parties may still be supported by citizens in general, but a study - conducted in 32 countries - published two years ago shows that only 10% of citizens feel that parties are interested in their opinions.[1]

Research performed in the Netherlands shows that that the number of citizens who subscribe to the statement 'You become a Member of Parliament through your political friends rather than because of your abilities' rose from 29% to 47% between 1977 and 2010.[2]

Are the citizens to blame for that? Citizens who just do not have a clue and who - with no interest in politics - have an utterly negative view? Now that would be strange; after all, commensurate with the higher level of education and the greater possibilities of obtaining information, citizens' interest in politics and the extent to which they follow political developments have increased all along the line. There has always been an undertow of negativism about what dissatisfied Dutch voters have called, from time immemorial, 'the powers that be in The Hague' (the political hub of the Netherlands), who allegedly take no notice of the common people. The fact that an increasing number of citizens have a negative view seems much more a consequence of the fact that an increased number of people are closely connected to politics and that they do not like what they see.

We should be wary of generalizing, but in quite a few western democracies parliament functions less and less as a critical watchdog. The members of the party or coalition that underpins the government are deemed to provide the political majority that allows the government to proceed. After all, the 'governability' of the country should not be jeopardized. An overly critical attitude by parliamentarians is only bound to ensure 'political instability'. Thus, the control function of parliament is gradually being superseded by the notional function of placing a formal stamp of approval on the most important decisions that have been taken elsewhere, be it by the government, at an international conference or by the European Council. Sometimes, slight marginal changes are possible, but in the case of international affairs there is seldom room for this and a de facto 'yes' is the only viable option; anyway, that is how it is described to parliamentarians, and they feel much the same way themselves.

On these lines, parliaments are sometimes bullied by governments. In addition, fear of giving an impression of internal dissension has tightened the reins on parliamentary parties. In the 1990s, an international study into the 'unanimity score', ie. the extent to which parliamentary factions vote as a block, conducted in fifteen countries, showed that in fourteen of the countries under review, the score fell between close to 95% and an impressive 100%.[3]

Unless members of parliamentary factions happened almost always to see eye to eye, this would indicate a phenomenon that the members are actually no longer free to vote according to their personal views if they deviate from those held by a majority within the party. The country with a 100% score in the survey - Ireland - showed just recently how far parliamentary party discipline may reach. Some parliamentarians who voted against an adjustment to the law on abortion - which is considered in many countries to be an ethical issue par excellence, where voting according to one's conscience is still admissible - were ruthlessly removed from the parliamentary party.

Research in the Netherlands has shown that the number of parliamentarians who feel that their own view should prevail in the case of a disagreement between their own view and that of the majority of the parliamentary party - Burke's independence of judgement - fell from 40% to 5% between 1972 and 2006.[4] What is the problem if parliamentarians themselves are not bothered by it? The problem is that the judgement of associate ministers - and, hence, of the country's government - or of other people in the party leadership becomes binding, rather than the party's own factual balancing of the country's best interests.

Obviously, it is neither conducive nor logical when parliamentary factions continually display dissent at the ballot box. And if a parliamentary faction operates on common principles its members will make a unanimous judgement on many bills. Moreover, the voters need to know to what extent they may rely on a party. However, the situation is not healthy if members of a parliamentary faction are forced into artificially uniform judgements through rigid discipline and disciplinary action.

The fact that parliamentarians themselves consider it logical that, eventually, the bottom line is that they will just have to climb down, reflects the changing role of political parties. Parties do not usually realise their elective function by seeking a diversity of views within their own circle hoping that minds will thus be sharpened. Whoever manifests himself/herself within a party as a critical mind is considered to be a potential 'danger', to be eliminated from the list of candidates. If plans misfire with one of the carefully selected candidates, and if he/she - as a parliamentarian - dares to oppose parliamentary party discipline then the sanction remains that he or she can forget about running in the next round for re-election.

More and more often, such discipline is applied not only to parliamentarians but to party members as well. Rather than encouraging debate with a view to generating new ideas and solutions to political problems, party leaderships only too often labour under the fear that the media will exaggerate any dissent within the party. Consequently, major debates about essential matters involving as many members as possible are often avoided; there is a preference for confining debates to relatively harmless issues that are less sexy from the media's point of view. It would seem that party members are considered, first and foremost, as valuable for their contribution and usefulness during campaigns; but not in terms of their participation and independence of thought. Modern citizens draw the conclusion that membership of a political party is not attractive, and therefore almost all the political parties have been confronted with a decline in membership over the past decades.

A return to control for party members and voters

All things taken together, parliaments and political parties are increasingly closing ranks, thus shutting themselves off from society in a broader sense. By contrast with countries with a majority (district) system, prospective parliamentarians may manage to enter the arena quite well in political environments where proportional representation prevails, without an (appreciable) electoral threshold. All the same, these new parties usually do not reveal themselves as more open to debate; nor do they loosen the reins of parliamentary party discipline. The party apparatus of the two most successful newcomers to the Dutch parliament who have managed to establish themselves during the past two decades is even more rigid than that of the established political parties. Neither the 'old-fashioned socialist' SP party nor Geert Wilders' PVV tolerate any 'dissident' voices within their own realm; to prevent members from becoming a nuisance, Wilders does not even allow members into his party.

Political dissatisfaction among the electorate is increasing not only because politicians simply have to take 'hard' decisions in times of economic hardship but also because parliamentary groups and political parties are no longer seen to be organisations of the voters, or respectively of the members, whereby the latter can exert serious influence. The fact that parliaments and parties have become more closed and compulsorily homogeneous in societies that have become more open and diverse causes friction. And if parliaments and parties fail to adjust, they run the risk of voters either backing out or opting for radical alternatives.

In France and the Netherlands, for example, some parties are experimenting with forms of participation that are open to non-members. It is good that such parties acknowledge the fact that doors need to be opened. However, it remains to be seen if things go too far. If you do not need to be a member of a party to exert influence on it, what does membership offer after all? There is an imminent risk that such a party will only retain members who are interested in a political career and that there will be no more involved, common citizens in the main body of the party. In addition, there is a risk of outsiders 'hijacking' a party. After all, what would inhibit the members of a pressure group or action group - after payment of the symbolic euro that such parties ask for having a say - to press on with their own agenda without further discussion?

Influence may be counterbalanced by obligation: that is a more sustained commitment to a party on which someone wants to exercise influence, as evidenced by paying a serious financial contribution. Conversely, parties will have to recognise that obligations to members should be offset by the possibility of their genuine influence. That influence applies to policy - what will the party be advocating? - but just as much to the people who will be serving the electorate as the people's representatives on behalf of the party. Party members should have a choice when it comes to the selection of parliamentary candidates. And in systems where lists of candidates operate, voters should also have a realistic chance of applying change at their insistence, and, hence, in the composition of factions.[5]

If members of parliamentary parties realise that, eventually, they are not accountable to party leaders but to the party members and the electorate, coercion by the parliamentary party and factions may become less effective. This will increase the likelihood that citizens will have the last word and that those in power cannot rely unquestionably on support for a full parliamentary term. It may bring democracy closer to its essence. After all, the valuable principle that has been acquired over a century of trial and error - that the citizens ultimately determine government - should not now slip out of our hands. ■

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Is there a genuine and feasible Islamic economic agenda?

Javier Albarracín is Director of Socioeconomic Development at the European Institute of the Mediterranean (IEMed)

Islamic lead governments are running out of time to deliver economically

Most of the Arab countries that are going through deep reforms since 2011 have witnessed Islamic political movements capitalizing on the discontent with the previous regime, being elected in most of the elections that have taken place since then, with the surprising exception of Libya in July 2012.

Whether Ennahdha in Tunis in October 2011, the Justice and Development Party in Morocco in November of 2011, or the Freedom and Justice Party and the Islamists salafists political movement of Al-Nur in Egypt in January 2012, fair elections have brought to the political frontline the formerly banned and inexperienced Islamic political movements.

Feelings in both political camps were intense. Expectations of those who voted the Islamic parties were very high in terms of quick changes in the political and economic domains. Those who opposed these movements, either belonging to the previous regimes structures or the secular promoters of the revolts, were frustrated with the outcome of the changes and deeply mistrusted the new authorities from the very beginning.

The challenges faced by these new authorities, whether in coalition governments like in Morocco and Tunis or one-party governments like in Egypt, were enormous in the political, security and socioeconomic fields. Financial resources were scarce and depleting quickly. National and international political constraints were considerable. These new governments had the daunting task of deeply reforming the old unfair structures of the previous regimes while delivering inclusiveness in political and material terms through redistributing wealth and creating fair jobs.

At the beginning these democratically-elected governments had certain international backing from the EU, the USA, Turkey and some Gulf countries, especially Qatar. There were high expectations regarding the potential establishment of a democratic political Islam performing economically, emulating an adapted Arab version of the 'Turkish model'.

Time has shown since then that there is no genuine Islamic economic model to be implemented by these parties except for few specific, although relevant, aspects such as the promotion of Islamic finance in their economies. The lack of huge rents from significant energy resources (gas and oil) in the countries where so far reforms are taking place (except for the case of Libya) does not permit to structure and sustain an economic model supposedly Islamic, like in the Arab Gulf countries or Iran.

Islamic political movements have shown so far that they might have a political, and even social, comprehensive project, but they do lack a coherent and realistic economic vision and project beyond some sharia compliance precepts such as the establishment of the *zakat* (weekly ritual alms) or *waqf* (gift in perpetuity to a charitable or public institutions).

The last few years have shown that none of the Islamic political parties in power have an economic agenda that differs significantly from the Western liberal capitalist one: the private sector is the key engine for growth and the state has to lay a facilitator and complementary role. The slogan 'Islam is good for business', defended by many Islamic economic circles, defines a model were pragmatism is essential and Islam and private ownership reinforce each other as the basis.

To be fair it has to be mentioned that no government, whether Islamic or secular, can be expected to reform significantly in two or three years in an inclusive way a unfair deeply rooted system built during decades, while at the same time fulfil the economic expectations of the heterogeneous constituency that had voted for them.

In fact, these new governments had limited real economic power due to shrinking financial resources; the daily pressure from different stakeholders (the streets, trade unions, the international community...); the international economic and financial crisis (especially in their main trade partners of the EU); and the systematic opposition of the still powerful structures of the previous regime (public administration elites, judiciary system, big business, the financial sector elites...).

This adverse environment, together with the lack of experience in managing complex institutions and the inappropriate skills of many of the Islamic cadres for the

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> ***"Islamic political movements have shown so far that they might have a political, and even social, comprehensive project, but they do lack a coherent and realistic economic vision and project"***

positions they were appointed, made them fail in delivering many of the commitments they had taken during their campaigns.

Many of the Islamic parties have shown their reluctance and difficulties to reach agreements and compromises with other relevant stakeholders during the definition, approval and implementation of their economic policies. These has increasingly isolated their policies from the rest of actors involved in a comprehensive decision making process. This modus operandi has clearly shown its limitations and dangers in the recent demonstrations in Turkey against the way the Government is taking many of its decisions, specifically the Prime Minister Tayep Erdogan.

Some incoherence has also been shown in several relevant economic policies. A significant case was when the Egyptian President, Mohamed Morsi, cancelled a series of tax increases just hours after they were approved on the 10th December 2012. This generated nationally and internationally a sense of improvisation and incompetence, questioning their capabilities and credibility in key economic issues.

Main features of the Islamic economic project

Facts have demonstrated that there is no unique and common understanding of the idea of Islamic economy, and that every party and government decides their priorities according to their national constrains, resources and needs.

The size of the population and its demographic growth; the diversification of the economy and the share of the agriculture; the still unclear relationship between the national main economic actors and their Islamic lead governments; being a coalition or a one-party government; who are the main international economic and trade partners; if the country has suffered a rupture or an evolution or the maturity of the financial sector and the relations with the international financial institutions (IFIs), are all determining factors that define different socioeconomic priorities and strategies of the Islamic parties.

Despite this, there are three issues were most of the mainstream Islamic parties coincide:

- The fact that it has to be the private sector who leads growth and job creation, giving the state a secondary role;
- Their strong commitment to fight corruption, both in the public and private spheres and at all levels; and
- The role the Islamic finance should play in the new economic scenario.

These commonalities in the discourse find very different implementations when it comes to concrete policies, differing by country, government and the political moment.

Private sector as the central engine of the economic development

This is a key issue were all the relevant Islamic parties agree when it comes to defining their project for a national economic model.

The prioritization of private property as a central factor for economic development finds its roots in the fact that many of the cadres of the Islamic parties are small and medium bourgeois composed of middle class professionals, shopkeepers, traders and the like. This socioeconomic background has shaped the importance of private businesses and market rules in the minds of the main economic leaders of these movements. The promotion and protection of economic freedom, entrepreneurship and the rights of the small and medium enterprises is at the core of the economic thinking of the Islamic parties.

Many of these political movements have evolved in parallel to Islamic businessmen associations which have been able to agglutinate most of the entrepreneurs with Islamic sensitivity. Organizations such as ASMECI (*Association Marocaine d'Études et Recherches en* Économie *Islamique*) in Morocco, ASTECIS (*Association Tunisienne de l'Économie Islamique*) in Tunis or EBDA (the Egyptian Business Development Association) in Egypt have been created and expanded in recent years and have inspired the economic thinking of the national Islamic political movements in their countries. These business associations have even provided cadres to manage the economic institutions governed by the Islamic parties.

In this regard, the Islamic parties ruling in Tunis and Egypt defend the central role small and medium enterprises (SMEs) should play in the economic development of their respective economies. This policy derives from the fact that these two counties have gone through revolutions willing to change the previous regimes upside down, thus seeing the big businessmen as beneficiaries and needed accomplices of the previous regimes.

Meanwhile, the PJD of Morocco defends the key role of the big enterprises as needed tractors to promote SMEs, being essential to their promotion. This is not alien to the fact that Morocco is going through a non rupture process of political and economic reform, thus having a symbiosis of the economic interests of the elite with those of the new government.

One of the most conflicting issues in the socioeconomic domain is the mounting tension between the Islamic movements and the trade unions, traditionally leftist and secular. The Islamic movements have been able to increasingly establish themselves as relevant players in the economic field (through associations, a growing bourgeois...) and in the politic one (through Islamic and salafists parties), but they haven't been successful in entering significantly in the workers structures. Trade unions have a long tradition in

the Arab Mediterranean countries as relevant stakeholders, although in some cases have become a sort of transmission belts of the values and policies of the regimes.

But in today's context of urgent need for social dialogue, both bilaterally between the governments and the workers and also with the inclusion of the businessmen representatives, the difficulties and reluctance of the Islamists to deal with trade unions is increasing social tension. A dramatic case was the assassination in Tunis the 6th of February 2013 of Chokri Belaid, a Tunisian politician and worker's activist, by Islamist radicals degenerated in massive and violent demonstrations amid accusations of Ennahdha's silent complicity.

Another issue all Islamic mainstream parties agree on is the need to deeply reform the public administration, seen as one of the main structures that created and perpetuated the crony capitalism prevailing in these countries.

This reform requires, among other issues, the professionalization of the civil service, the establishment of meritocracy as the system to ascend, a public oriented performance of the services provided, and above all a comprehensive and systematic fight against corruption.

A key factor to improve economic performance and social dignity: the fight against corruption

Islamic and secular political forces agree that economic justice should be one of the driving forces of change. This new inclusive socioeconomic scenario will take a long time because it needs comprehensive and resourceful reform policies, which can't be implemented in today's context of political instability and economic and financial scarcity.

But strict policies to fight corruption can go in the right direction and start delivering in terms of generating economic attractiveness, inclusiveness and social dignity. Different regimes should behave differently; and they significantly interact with their society through their public administrations. These are the government's facades and the executors of their policies.

Consequently, in Egypt a 'transparency and integrity' commission was created, and the Central Accounting Agency was reformed to be more transparent. In Tunis a Ministry for Administrative Reform and fight against corruption was created, although it's Minister Mohamed Abbou, from the Congress Party, resigned on the 30th of June 2012 to denounce the scarcity of means given to this Ministry and the lack of political support.

Islamic parties claim that the anti-corruption policies should be applied to both the public and the private sector. In the case of Egypt this meant the retroactive revision of many suspicious public contracts awarded by the previous regime, even internationally. This policy also meant the trial of relevant businessmen as well as former ministers, such as former Minister of Trade and Industry Rasheed Mohamed Rasheed, and their imprisonment, such as the case of the former finance minister Youssef Boutros-Ghali.

However, in these economies corruption is widespread as a complement to the low salaries in the public and private sectors, making it very difficult to combat unless a battery of comprehensive social policies are simultaneously implemented.

Islamic finance as a means to finance governments and SMEs

The other basic of Islamic economy is the promotion of Islamic finance as a way to canalize money from the more pious Muslim believers to the state and to the private sector.

All the countries in the region with Islamic lead governments have adopted or reinforced their legislative and tax framework to promote these kinds of financial instruments and institutions. Tunis introduced in 2012 a new favourable tax system for Islamic finance products. Morocco is finalizing the publication of a new securitization law that will allow the state and companies to issue *sukuk*, the Islamic equivalent of bonds and is expected to launch this 2013 *sukuk* sovereign bond. In February 2012 the Egyptian Financial Supervisory Authority modified the capital market law to facilitate the emission of this kind of Islamic obligations.

By doing so the authorities try to generate tools that could provide loans to the private sectors, specially to the SMEs, due to the fact that this sharia compliance funds are more linked to the 'real' economy, not charging interests but sharing the risks and benefits of the entrepreneurial projects.

They also expect that with the creation of some national charity institutions, such as one centralizing the *zakat*, the governments will have more resources to develop much needed social policies.

Due to the combination of scarcity of available financial resourced in the traditional markets and the philosophy and ideological affinity with the new governments it is expected that international players of the Islamic banking sector will have a bigger role in the financial sector of these economies. The Islamic Development Bank, based in Saudi Arabia, has been recently more active in some of these countries, such as Morocco. Several Islamic financial institutions from the Gulf have also shown greater activism in these economies than before.

Unfulfilled expectations

The non delivery of inclusive socioeconomic results after some years of Islamic lead governments in the region, together with the persistence and aggravation of economic disparities, has quickly banished the illusions that these new regimes brought with them.

Worker's demands haven't been attended to; no permanent and binding social dialogue has been established; no real material gains are felt by the excluded of society or by the middle class; unemployment is increasing and a lack of better perspectives have all increased tensions in the streets and in the parliaments.

The military coup d'état in Egypt the 3rd July 2013 has cast a regional shadow over the Islamic government's democratic experience and their capabilities to cope with the problems of their societies. But the complex and deep rooted socioeconomic challenges of these societies won't be solved in any case by the militaries. ■

The challenge for the next generation

John Manley is President and Chief Executive Officer of the Canadian Council of Chief Executives

There is an old saying that generals are always preparing to fight the last war – but why just pick on them? Economists, politicians and many of the rest of us have a similar habit of focusing on the problems of the past, to the point where we may find ourselves unprepared for the challenges of tomorrow.

We should keep that in mind when pondering the state of the Canadian labour market. In early 2008, 5.9 per cent of our country's labour force was out of work, a 30-year low. The recession drove the unemployment rate up to a cyclical peak of 8.7 per cent in September 2009. It has been drifting down ever since, but remains well above pre-recession levels.

The jobs market is even grimmer for young Canadians. For several years now, unemployment among 15- to 24-year-olds has been close to 14 per cent – double the national rate. Pundits warn of a 'lost generation' of Canadians who, missing the opportunity of a good start in the job market, may never achieve the career stability and living standards enjoyed by their parents. A recent CBC documentary called them 'Generation Jobless,' adding that the shortage of jobs for young men and women is 'a ticking time bomb' that threatens the overall economy.

No doubt about it: youth unemployment is a significant issue. So, too, is the high level of underemployment among university and college graduates. But we have seen this movie before – and it was even more worrisome in previous showings. In the wake of the 1981-82 recession, the jobless rate among 15- to 24-year-olds rose to almost 20 per cent. The situation improved as the economy recovered, but youth unemployment jumped again, to above 17 per cent, after the economic downturn in the early 1990s. Juxtaposed against those previous peaks, today's situation looks considerably less alarming.

What's more, demographic trends seem to be on the side of the current generation of young Canadians. For the past three decades, the share of the national population that fits the traditional definition of working age (15 to 64) has hovered around 68 per cent. But as the baby boomers enter their retirement years, the working age population as a proportion of the overall population is going to shrink.

In 2011, census data showed for the first time that there were more people about to leave the labour force than there were young people preparing to enter it. Statistics Canada expects this gap to widen over the coming decades. The agency's projections also indicate that, between now and 2021, the number of 15- to 24-year-olds in Canada will decline in absolute terms, by an estimated 7.1 per cent.

All of this suggests that the unemployment rate among Canadians is likely to fall significantly over the next decade or two. Sectors that typically employ young people – such as retail, leisure and hospitality – may well find themselves squeezed for staff. And employers across the country are going to have to work harder to fill the positions left vacant by retired baby boomers.

For young people, and their parents, this is encouraging news. But if a lack of employment opportunities is not likely to pose a significant problem for future job seekers, what should they – and we – be worrying about?

"All of this suggests that the unemployment rate among Canadians is likely to fall significantly over the next decade or two"

The real question we need to be asking ourselves is whether the next generation of Canadian workers will be adequately prepared to succeed in the workforce of the future. Finding a job is one thing, but finding meaningful, sustainable employment is another matter altogether. How well is our education system preparing youth for high-quality, satisfying careers? What skills, abilities, aptitudes and interests will they bring to the labour market, and how closely will those qualifications match the needs of employers and the realities of the 21st century Canadian economy?

As 'ticking time bombs' go, the challenge of ensuring that education and training are linked to employment may not stir the emotions as much as the comparatively straightforward issue of youth unemployment. But for employers and young Canadians alike, it is almost certainly a much more serious problem. ■

Better billing: getting smart with eInvoicing and document capture

Mark Kirpalani, managing director at Capital Capture, looks at the role document capture and eInvoicing technologies can play in supporting faster, more efficient processes for finance and accounts payable teams

Each day, accounts payable teams receive a constant stream of invoices, which are often received by various different sites and departments before being sent on. Frequently, they will also appear in different formats.

Invariably, managing unpredictably and high volumes of invoices presents finance teams with a considerable administrative burden, with little or no opportunity to predict when the billing will occur.

Without this transparency, it can be difficult for finance to accurately manage cash flows and gain the insight required for cash forecasting - an important capability in the current static economy.

Here, as many corporates are now discovering, automating document management processes using digital mailroom and document management technologies can play an important role in significantly speeding-up the distribution of incoming documents within the organisation. In turn, this can contribute to improved financial visibility and help realise the significant potential which the EU believes the ongoing shift to paperless invoice processes can offer for organisations and their trading partners.

Faster invoicing, better processes

Whether implementing a new document capture system or improving an existing one, finance and accounts teams can expect to gain significant process improvements. By minimising the reliance on manual invoice entry, the

"... the broader business potential that the ongoing shift to paperless invoice processes offers for organisations and their trading partners has also been recognised by the EU"

technology helps to reduce instances of human error and make finance teams better able to cope with processing peaks – all of which can enable the organisation to reduce debtor days and improve cash management.

As well as improving incoming document management, moving away from paper-dependent manual processes, and replacing them with speedier, tailored electronic systems can have a positive impact for corporates, their customers and supply chain partners.

Whether electronic or paper-based, invoices are subject to automated invoice routing, which sends them directly to either a centralised internal or outsourced production bureau. From here, each invoice is run through capture software and as many fields of data as necessary are extracted into an XML or other data file. This data, along with the individual invoice in PDF format, are returned together ready for automatic import into the accounts payable system.

eInvoicing: faster finance, better interoperability

As well as internal process improvements, the broader business potential that the ongoing shift to paperless invoice processes offers for organisations and their trading partners has also been recognised by the EU. Its endorsement of the process was formalised in the 2001/115/EC Directive, which essentially credits eInvoicing as an important means of promoting more efficient cross-border creation, validation, transmission, acceptance, storage and retrieval of invoices.

In June, the European Commission issued a further draft directive aimed at improving interoperability between different, mainly national, eInvoicing systems, stating: *"eInvoicing… offers the potential for significant economic as well as environmental benefits. The Commission estimates that the adoption of e-invoicing in public procurement across the EU could generate savings of up to €2.3 billion."*

While eInvoicing is not yet mandatory in the UK, the government is encouraging its use among central government transactions and has committed to improving the interoperability of e-invoicing for SMEs.

However, for the true value of eInvoicing to be realised, information must be able to flow smoothly not just within an organisation but also from one organisation to another, regardless of the software being used. For this reason, wider-scale acceptance will be a key factor in determining how quickly eInvoicing becomes the norm for businesses of all sizes.

Supporting compliance

As well as achieving faster, more efficient workflows, for the document-intensive finance department, better document management and capture processes can also be extremely valuable in their capacity to support regulatory controls and guidelines and improve productivity and overall efficiency in records management.

With office space now at a premium, the burden which storing physical documents creates is fast becoming unsustainable for many businesses: in fact, as many as a third of finance companies (33%) surveyed by OnePoll/Capital Capture admitted to keeping far more paper files than they needed to, while over half (56%) agreeing that storing large volumes of paper documents either on or offsite was a waste of money.

Similarly, from a records management perspective, document management and electronic capture technology has proven its worth in enabling organisations to improve compliance. The Data Protection Act 1998 ('the DPA') sets out clear guidance on hosting and storing records, including those relating to employees that have left the organisation.

By helping organisations remain compliant with the requirements of the DPA, an electronic capture solution can offer important cost-saving advantages by contributing to a reduction in storage costs.

Archiving documents electronically also brings the added advantage of ensuring better security than manual storage, with less risk of loss or damage. Using document classification alongside an archiving solution will guarantee that the correct retention and disposal policy can be quickly identified and data cleansing can be carried out on existing records. This important capability ensures compliance whilst further increasing the level of process automation.

End-to-end workflows

In conjunction with eInvoicing, electronic document capture and management systems typically enable finance users to extract relevant data more easily. Using a tailored solution, it's possible to ensure that data is accurate, while the use of document classification enables the measurable data to be quickly identified and instantly passed to the right business stream or workflow.

From an on-going business perspective, the technology offers distinct advantages for the modern finance department and the wider business, not least the opportunity to support compliance, ensure disaster recovery, increase staff productivity and facilitate the cleansing of historical records.

With automated document capture in place, users not only gain more time to spend on more profitable activities but can also benefit from greater certainty surrounding accuracy of transactions and cash flow forecasts. Meanwhile, for accounts payable, the potential to use eInvoicing to support greater financial transparency will no doubt prove its worth in supporting and maintaining future cashflow visibility. ■

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The owners of this little gem are now proposing to sell shares to a small number of families seeking to own their own place for a few weeks a year, without the usual organisational and admin burdens associated with a secondary home abroad.

"When we bought the property in November 2005, this 17th and 18th century domain was in great need of restoration to realise its potential," explains Bob Wileman, who lives with his French wife Josiane in the UK, but fell in love with the Manoir. Led by a local project manager, the restoration work required no less than 17 different trades: *"The challenge was the sheer scope of the work and we wanted it to be completed within 3.5 months. The team rose to the challenge and the work was finished to a high standard, in time for a festive thank-you celebration on 21st April 2006,"* says Mr Wileman.

Tall windows with wide ranging views over the undulating countryside, beamed ceilings, ancient doors and tiled floors, large stone fire places for atmospheric log fires, spacious reception rooms and an imposing stone staircase are some of the features which remind visitors of the historic past of this 17th-18th century Manoir which has been closely associated with over three centuries of local history.

"We enjoy the Manoir on and off for a few months every year, while letting it in the summer to an international clientele who are looking for sunshine and exclusivity away from the crowd. Ideal for family or friends to get together or simply as a retreat from a busy work schedule, life at the Manoir is a good way to rebalance mind and body.

"Our guests appreciate our attention to details and our efforts to help them make the most of their holiday - everything that could be expected from the Manoir's caring team and from a property given a 5 star rating by the French Tourist Board," Josiane Wileman adds.

"In particular, guests love the heated salt-water swimming pool and appreciate the space and privacy of the property. The fruit

trees are a treat for both children and adults and, depending on the season, our guests can help themselves to cherries, apples, pears, figs and walnuts... a bucolic holiday in a 5 star environment".

Rural Quercy Blanc with its scenic wild landscape offers a complete *'dépaysement'*. Its lively cultural traditions, surviving medieval architecture, folkloric events and world famous gastronomy offer opportunities for rich experiences, unique to the region. *"Our guests tell us that they run out of time, long before they run out of things to do!"* says Josiane.

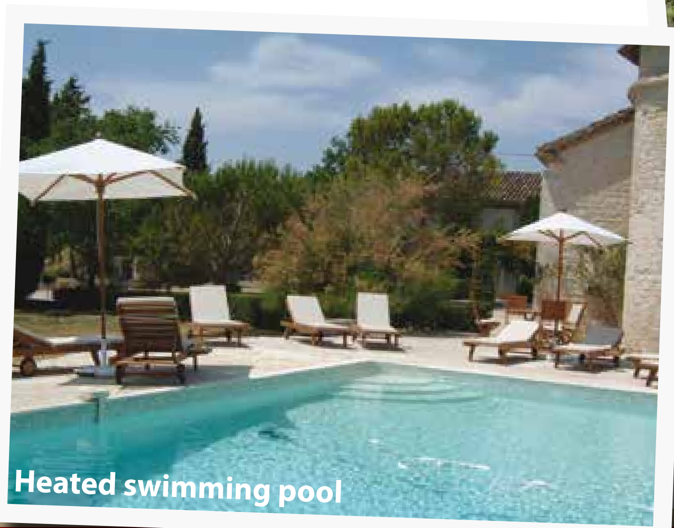
Guests' testimonials can be seen on the Manoir's website: www.ManoirLesGaillardoux.com

If you would like to explore fractional ownership of Manoir Les Gaillardoux with Bob and Josiane Wileman, please get in touch promptly; they will be in residence during October and could meet you at the Manoir. ■

www.ManoirLesGaillardoux.com
enquiries@ManoirLesGaillardoux.com
+44 (0)7860 215202 / +44 (0)1428 654835

Summer colours in the park

Pigeonnier in spring


Heated swimming pool

Luxury in the Lot, SW France – exclusively yours for part of the year...

Place yourself in the centre of the Lot history in the comfort of this little masterpiece of 17th-18th century architecture to explore the area or simply chill out - and let the magic work its charm...

The Lot hides the elected retreat of the Royal Family of Denmark...

This region of south-west France has many secret places and untapped pleasures for those who take time to discover them. Rich in architectural heritage and cultural activities, this delightful corner of France has spectacular cliff-top fortresses, historical remains and stunning scenery. Large river valleys attract water sports lovers with boat hire, fishing and canoeing, while its picturesque medieval villages, with their quintessentially French street markets, are fascinating to explore on foot or by bicycle.

Then, there is the region's strong gastronomic tradition and its many excellent restaurants –the world-famous black truffle (the *'Black Diamond'*) to accompany foie gras and imaginative duck dishes, and of course the Chateau bottled Malbec wines, grown in the region's famous vineyards.

Over the past seven years, Manoir Les Gaillardoux has built a strong tradition of service and a comprehensive 'carnet d'adresses' which help guests immediately feel at home and make the most of their holiday - another asset for fractional owners of the Manoir to enjoy.

Manoir Les Gaillardoux is located 16 km south from Cahors and one hour from Brive and Toulouse international airports via the A20 motorway... and, for private flyers, Lalbenque aerodrome is only 8 km away.

Making central banks serve the real economy

Suleika Reiners is Policy Officer for Future Finance at the World Future Council

"A crisis is a window into the soul of the economy, like Plato's republic was the soul writ large. If non-standard policies saved the economy during the crisis, they surely should play a role in normal times."[1]

Central banks shall supply money for the economy by supplying money for banks. The paradox here is that they lack influence on what banks do with the money. The problem with low key interest rates is that they are not targeted. Quantitative easing measures (QE), such as the purchases of securities by central banks, can help the financial sector in systematic liquidity and solvency problems. QE can also reduce government debt servicing costs by lowering the sky-high interest rates of state bonds. That has, for example, been the case with the European Central Bank's bond-buying programme for struggling member states.

However, the current QE has not been targeted towards stimulating real economic activity. It has failed to spur real economic lending and securities emissions. The monetary transmission mechanism did not work: the central bank money has remained in the financial sector itself. That is why it risks feeding leverage-driven asset bubbles in the financial sector instead of funding real needs.[2] As Dominic Lawson points out[3]:

> *"If the real assets remain unimproved either by investment or by advances in productivity, and all that happens is that their monetary value on the markets increases in nominal local currency terms, this is merely the classic recipe for a financial bubble."*

Hence the challenge is to redirect central bank money into the real economy and to the needs of society. Whereas taxes refer to the re-distribution of money, the task here tackles its pre-distribution.

Central banks should contribute to the funding of real needs

Central bank money should not solely be used to fund private banks; it shall also engage in the financing of public investment expenditures. Renewable energies, public transport, communication infrastructure, public health and climate protection: the world is full of unfulfilled investment needs. Not everything suits the profit-orientated expectations of private investors. Or if you make it to fit them by increasing the profit through higher consumer prices and spreading the risks via excessive securitisation, the price may be social exclusion and financial instability.

For example, research in Alzheimer's disease might take 20 years; and some parts of that research may yield inconclusive results. Yet that is human life, and we need sustainable finance for it. We should not stand and watch the pharmaceutical industry prioritise more lucrative botox research. Central banks should use their ability to create new money and channel it into meaningful investments.

They can also finance the retraining of employees in the fossil fuel industry to enable them to carry out similar work in the renewable energy sector. At the global level, the UN Green Climate Fund was established in 2010 and planned to raise US$100 billion, but is still out of money. Central banks could cooperate with the International Monetary Fund and development banks in order to employ monetary financing to break this funding deadlock.

Among the proponents of a broader mandate for monetary financing are Adair Turner, chairman of the Financial Services Authority in the UK, and Martin Wolf, economic journalist of the Financial Times.[4] Wolf argues that it is impossible to justify the conventional view that monetary financing should operate almost exclusively via today's system of private borrowing and lending.

The benefits of such monetary financing will be substantial:

- Long-term financing will become available at an affordable price. Partnerships between government, financed by new central bank money, and long-run institutional investors like foundations, insurance companies and pension funds are also possible. New government money can, for instance, act as a catalyst during the start-up phase of long-term infrastructure projects. By contrast, private-equity funds aim at above-average returns up to super returns. Thus, it often turns out that they are unsuitable as sponsors for sustainable development. Additionally, their high consultancy fees

and special dividends can even hamper investment.

- The deleveraging process of private banks can be accompanied by new central bank money. Thus a credit crunch can be avoided.
- New central bank money can contribute to overcoming austerity. This will promote social equity too. Poorest people suffer the most from austerity because they can barely afford the better equipped private hospitals and private schools.
- This will also strengthen democracy, as austerity is a means to exert power. New central bank money can end governments and the real economy being held hostage by unreliable financial markets. It can end unreliable conditions of structural adjustments, be it through the International Monetary Fund towards its poorer member states or through the Troika in Europe.
- Finally, instead of waiting any longer, socially and environmentally required investments could be put into practice. Every necessary investment, which is not taken today, goes at the high expense of present and future generations. This ranges from neglected safety standards for public transport to environmental consequences and public education.

Consequently, the widespread taboo of monetary financing should be broken. The key is always where the money goes to and on what terms - in times of stress as well as every day.

... but what about inflation?

Monetary financing of governments is still a taboo, though. This is not without reason as economies have been affected by hyperinflation like in Brazil, Germany and many African countries.

Therefore, some conditions must be met:

First, if new money is issued to expand the productive capacity, there is no reason for inflation. At the same time, there is no necessity to limit central banks' support of governments' financing needs to times of crisis. Rather it can contribute to public finance on a regular basis. Turner, among others, proposes that central banks allow a defined amount of monetary financing as a percentage of the gross domestic product. Matthias Kroll of the World Future Council recommends, depending on economic trends, up to five percent.[5] Since this will be a decision by the central bank, not the Treasury, the independence of central banks can be maintained.

In doing so, central banks should take democratically agreed criteria as the basis, including the degree of the utilisation

“Central banks should use their ability to create new money and channel it into meaningful investments”

of production capacity. Whether central banks adopt the amount of monetary financing before any one budget year, the Treasury can take this into account and balance it with fiscal measures such as taxes and debt. Provided the amount of new central bank money is in pursuit of the gross domestic product level, it can also be spent on dance performances, theatre plays and on the funding of foundations.

Second, although appropriate timing and sequencing is a sensible job, exit strategies are implementable when economic conditions are boosted. For that, central banks have various tools. They can, for instance, increase minimum reserve requirements. Japan in the early 1930s, namely under Finance Minister Takahashi Korekiyo, provides a remarkably good example for the use of new central bank money combined with a well-tailored exit strategy.

In order to escape from the Great Depression spending increases were financed with government bonds which were underwritten by Japan’s central bank, the Bank of Japan. Thereby new central bank money was channelled into government spending. Later, to prevent inflation in a boosting economy, the Bank of Japan sold - part of - these bonds to private financial institutions. This was the appropriate exit strategy to suck off money by transforming it into liabilities. Furthermore, the Japanese government employed its rising tax revenues to keep its debt at a sustainable level.[6]

Third, new central bank money must not replace a sound tax system and the distribution of income and wealth, but complement it. While new central bank money can be used in a certain corridor without being inflationary, taxes are the basis of public finance.

Yet, the remaining task, apart from the financing of real needs, is the prevention of speculative asset price inflation. For this, central banks and regulators should install debt brakes for the financial sector.

Debt brakes for the financial sector

Leverage within the financial sector plays a primary role in creating asset bubbles as well as in making financial institutions too big and too connected to fail. It is nearly impossible to close highly leveraged financial institutions without systemic consequences. Moreover, and most crucially, leverage can be more important to asset prices than interest rates. As leverage cannot be stopped by increasing interest rates, it must be managed directly.[7]

Thus, central banks should focus on leverage cycles and the overstretching of collateral. To a great extent, money creation takes place in the shadows, namely banks interacting with non-banking financial institutions such as investments funds, hedge funds, private equity funds, endowments and insurances.

Policies to be developed as debt brakes for the financial sector:

- An effective policy regarding the overstretching of collateral would be a preventive testing of financial innovations – a finance TÜV[8]. The purpose of some financial innovations – such as collateralised debt obligations and credit default swaps - is to stretch the available collateral further. Securitisation can be useful up to a point; savings banks use it to diversify regional risks. However, re-securitisation is not needed by the real economy and should be prohibited. Other financial innovations should be bound by specific conditions such as position limits for certain derivatives.[9]

- A further form to overstretch collateral is the re-pledging of securities in long credit intermediation chains. This clearly has to be limited. Otherwise, the liquidity illusion is everywhere.

- The value of collateral is also subject to cyclical volatility. Thus, central banks and regulators should focus on the value of that which serves as collateral: in the case of overvalued assets, they should curb the permitted value of these assets as collateral. Regulating leverage based on loan-to-value ratios (asset-based leverage) rather than solely according to debt-equity ratios of banks (investor leverage) will include the whole financial sector. A central bank or regulator should, for instance, say[10]: “You cannot loan at two percent down on houses.”

- Furthermore, leverage from mergers and acquisitions (M&A) should be constrained. Pavan Sukhdev proposes that the capital structure of M&A transactions which exceed a given transaction amount – such as US$10 billion – ought to be reviewed by central banks.[11]

These policies are crucial to avoiding fictitious liquidity and leverage-based asset bubbles. They go beyond the potential leverage ratio in the framework of the Basel Accord for capital requirements which refers only to banks. There will be resistance from the financial sector, as decreasing leverage means a decreasing return on equity. However, the real economy and society need sustainable wealth, not permanent fragility. This real need has to be the priority.

Central banks can conserve the taxpayer’s money

Differently from private companies, central banks cannot default as they can create their own money in their own currency. Their privilege is thus that they need no fiscal backing from the government.[12] Central banks can finance tax cuts in a recession as well as debt cancellation for the benefit of present and future generations. In an historical review, published by the Bank for International Settlements, Charles Goodhart writes[13]:

> *“For over three centuries (1694-1997) a prime function of the Bank of England was to manage the national debt. But as the debt declined, both as a percentage of GDP and in*

relation to the size of the financial market, debt operations became simpler, falling into a routine pattern. Much the same happened in other countries. But now many countries face the prospect of rising debt levels. During the coming epoch of central banking, they should be encouraged to revert to their role of managing the national debt."

As a lender of last resort, it belongs to the job of central banks to buy troubled assets or to accept them as collateral. The purchasing of bonds with long-term maturities – for example in the secondary market - can even lower long-term interest rates.

Independent monetary policy calls for capital account management

The monetary policy of systemically important economies affects capital flows and borrowing costs in the global financial system. The mere announcement that the Federal Reserve Bank might exit its bond-buying programme has led to capital flight and currency crashes in emerging economies like the 'Fragile Five' - Brazil, India, Indonesia, South Africa and Turkey. It made borrowing costs jump up in the euro periphery such as in Greece, Italy and Spain, too.

Hélène Rey aptly describes the transformation of an old macroeconomic trilemma (impossible trinity) into a new dilemma (irreconcilable duo)[14]:

"Whenever capital is freely mobile, the global financial cycle constrains national monetary policies regardless of exchange rate regime. For the past decades, international macroeconomics has postulated the 'trilemma': with free capital mobility, independent monetary policies are feasible if and only if exchange rates are floating. The global financial cycle transforms the trilemma into a 'dilemma' or an 'irreconcilable duo': independent monetary policies are possible if and only if the capital account is managed."

Capital account management enables national central banks to find space for the conduct of their own policies in an interdependent global economy. It includes the management of capital inflows and outflows. Some countries, for instance Israel, Korea and Thailand, have an already active management of capital account.

Additionally, excessive trading which causes systemically risky volatility should be addressed. That is, apart from raising revenues, the purpose of a financial transaction tax. For this reason, the tax rate should be scalable; it would enable the tax to efficiently contribute to preventing price bubbles. A scalable tax rate has already been suggested by economist Paul Bernd Spahn in 2002 in his report commissioned by the German Federal Ministry for Economic Cooperation and Development.[15]

To conclude, coordination between central banks and governments might increase as policies combine monetary, fiscal and regulatory facets. This concerns even the financial transaction tax which involves fiscal and regulatory aspects, along with cyclical trends if the tax rate is scalable. The future role of central banks in these exercises should particularly lie in their insights regarding capital flows and leverage cycles and in their ability to create and withdraw money, depending on economic conditions. ■

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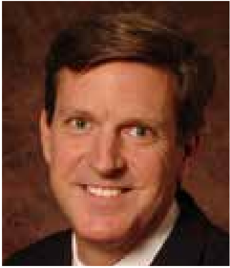

The UN's development agenda: an opportunity to cement private sector-led growth

Adam Greene is vice president for labour and corporate responsibility with the United States Council for International Business (USCIB); Norine Kennedy is USCIB's vice president for strategic international engagement

The United Nations has embarked on an ambitious effort to define forward-looking objectives to succeed the Millennium Development Goals (MDGs), which the UN adopted in 2000 and which set 2015 as a deadline to reach targets toward ending extreme poverty, ensuring universal primary education, curbing the spread of infectious diseases, and attaining a number of other fundamental goals. (See USCIB President and CEO Peter Robinson's column, "The UN's Development Agenda: Business Steps Up," in the Spring 2013 issue of *International Business*.)

Many may roll their eyes and think, *"There they go again – the UN with its hand out, dreaming up ways to waste money."* However, we believe this exercise represents a unique opportunity to catalyze the international community around the importance of private sector-led growth and a more robust, inclusive global economy. The business community needs to be a driving force in this vitally important debate.

It is important to recognize just how far we have moved from the old model of development policy, which relied largely on official development assistance (ODA) by governments. In the four decades following World War II, ODA made up 70 percent of the resources flowing from developed to developing countries, while just 30 percent came from private investment. But the levels of private investment in developing countries surged with the global economic boom of the 1990s, and by the end of the century, that ratio was reversed. Today, over 80 percent of capital flows to developing countries come from private investment, while the share from ODA continues to fall (to say nothing of the additional contribution of in-country investment by indigenous companies, particularly in rapidly developing economies such as China or Brazil).

This shift is well documented and widely acknowledged, yet previous discussions of development in the UN, including the MDGs, has largely focused on ODA, with private investment – and the conditions that facilitate it – getting little if any attention. The MDGs have been criticized as, in effect, a debate over where to target aid rather than how to generate economic growth. To be sure, assistance to the least developed countries is critically important. But in our view, the post-2015 development agenda is a unique opportunity to drive progress for economic and development advancement in all countries.

In addition, the international community and global business now recognize the importance of integrating broader environmental, economic and social elements in the broader concept of sustainable development. This goes far beyond a narrow focus on ODA. The post-2015 development agenda provides a window for us to achieve consensus – individuals, governments, businesses, indeed all stakeholders – around the essential elements of sustainable development in the 21st century.

The UN can help address this imbalance through a new development agenda that recognizes and fosters private investment as the main engine for economic growth and sustainable development. This new development agenda, which would include new Sustainable Development Goals (SDGs) to build on the MDGs, represents an opportunity to shift the focus to how individual countries can create the right conditions for sustained economic growth, environmental stewardship and development – and progress to a state of economic self-sufficiency without aid.

To fully embrace this opportunity, United Nations members will need to take five steps:

1) Ensure national focus and implementation

This approach calls for development goals that promote national policies and institutions that will lead to peace and security, good governance, economic growth, environmental protection and social progress – the mutually reinforcing objectives of sustainable development. Global goals are useful, but we must recognize that all the key drivers for development take place within a national context and must be implemented through national institutions.

2) Address broad framework conditions

The Millennium Development Goals were a good start,

but they left out many important framework issues, such as peace, security and good governance. Good national governance, including the rule of law, accountable government, independent courts, individual liberty, the absence of corruption, clear property rights and functioning national institutions are all prerequisites to sustained growth and sustainable development.

3) Promote private-sector growth

Private investment and economic growth cannot and will not happen in the absence of a conducive environment at the national level, which must include sound macro-economic and fiscal policies, adequate infrastructure, communication and education systems, and efficient business regulations in the areas covered by the World Bank's influential Doing Business reports. Efficient business regulations support entrepreneurship and recue the untaxed informal economy. Moreover, the lack of clear property rights – for both enterprises and households – remains the single biggest impediment to reducing informality.

4) Focus on entrepreneurs and enterprises

Any discussion on employment must focus primarily on enterprises. There is universal agreement on the urgent need for job creation, but far too little focus on who will actually create the jobs. So we must always finish that sentence, emphasizing the urgent need for jobs to be created by enterprises. Increased employment is the outcome of policies that promote entrepreneurship and support enterprise creation, particularly small and medium-sized enterprises, which are the main engines of job growth in every country.

"Only by working together can we ensure that the 21st century is truly the century of broad, sustained development for all the peoples of the world"

5) Harness the business case for development

Put most simply, development is good for business, and business is good for development. The vast majority of potential consumers live in the developing world, and companies recognize that their future growth and competitiveness hinges on the ability address the needs of developing economies. At the same time, economic growth is one of the most powerful drivers of poverty reduction in the world, and business is the most reliable engine powering that growth. Harnessing this virtuous circle is the best path to sustainable growth.

The business community is actively seeking to help shape the SDG and the broad post-2015 agenda. USCIB and its global network – the International Chamber of Commerce, the International Organization of Employers, and the Business and Industry Advisory to the OECD – have engaged with the UN secretariat and member states in an effort to secure truly ambitious and effective targets for private sector-led growth and the achievement of other critical societal goals. Only by working together can we ensure that the 21st century is truly the century of broad, sustained development for all the peoples of the world. ■

IISD SEES WAYS TO INCREASE PRIVATE SECTOR INVESTMENT IN CLIMATE CHANGE MITIGATION THROUGH NAMAs

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IISD climate and energy team

One of the fundamental challenges facing governments looking to develop effective climate change solutions is effectively leveraging private finance. Negotiating bodies such as the United Nations Framework Convention on Climate Change (UNFCCC) have come to the realization that traditional sources of public financing and development aid will not be able to muster the resources needed to prevent the most catastrophic outcomes predicted as a result of global temperature rise.

Through the Copenhagen Accord, developed countries committed to mobilizing upwards of $100 billion annually (by 2020) to finance climate action in developing countries, which would need to come from a variety of private and public sources. Despite notable progress in terms of fast-start financing, the funding available from public sources to help developing countries meet their adaptation and mitigation needs remains significantly below projected requirements. The *Climate Policy Initiative* estimated in 2012 that total direct public financing for climate change accounted for roughly US$16-23 billion[1].

While direct private sector investment already accounted for a large portion of international climate financing flows in 2012 (US$217-243 billion)[2], relatively little is being invested through the UNFCCC in financeable NAMAs (nationally appropriate mitigation actions[3]) that enable developing countries to pursue self-identified low-carbon development.

NAMAs can serve not only as an important instrument for climate change mitigation but also provide significant potential for economic development for developing countries, including those that are most vulnerable.

As a relatively new concept, there are a number of challenges related to implementation of NAMAs, but the core challenge is in accessing the private funding required to undertake NAMA activities.

The International Institute for Sustainable Development is working to assist countries with developing frameworks to encourage investment in climate change mitigation that will not only allow them to proceed on low-carbon development pathways, but also to make these plans attractive to private investors, lessening reliance on public funding.

Reviewing a number of registered NAMAs (understanding that many NAMAs are still under development), it is possible to identify characteristics for attraction of private investment, yielding lessons for NAMAs developers as well as private sector investors looking to seek out productive avenues for investment.

Fundamentally, incentive structures and de-risking instruments have to be in place to ensure that private sector capital will flow to NAMAs, given how many other opportunities there are that are for private investors.

However, in many cases developing countries haven't got the ability to undertake the complex tasks required to create attractive investment options. With this in mind, there are ways international stakeholders can assist countries in developing financeable NAMAs, foster private sector investment, and more broadly align low-carbon development plans with private sector flows.

One action stakeholders can take is to collect and disseminate information on best practices in climate financing involving the private sector. Sharing success can provide NAMA developers with experience to draw upon in overcoming barriers, preventing duplication of effort, and reducing project risk. NAMA developers and project proponents can also draw from other low-carbon development initiatives and financing mechanisms, which may share a lot of characteristics with NAMAs, and have a longer track record than NAMAs.

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"... incentive structures and de-risking instruments have to be in place to ensure that private sector capital will flow to NAMAs"

International organizations and donors can also help by providing NAMA developers with technical assistance and information for identifying and accessing funding streams. International organizations can bridge capacity gaps, help national representatives develop proposals with characteristics that will attract private investment, and identify key sectors that present mitigation opportunities with the biggest impact in reducing emissions and attracting investment.

Finally, it is integral for private sector funders to be proactively engaged in supporting NAMAs. International agencies and donors can foster relationships and facilitate investment opportunities by engaging the private sector in NAMA-related activities, such as conferences, workshops, and study tours. Potential NAMA funders would benefit from face-to-face meetings with NAMA developers to learn about best practices.

The establishment of operational NAMAs is increasingly becoming one of the central tools to help support international low-carbon development. By using public funding to leverage private finance, and addressing risks and barriers to private investments, NAMA developers and the organizations supporting them can increase success in accessing private financing. ■

1. http://climatepolicyinitiative.org/wp-content/uploads/2012/12/The-Landscape-of-Climate-Finance-2012-Executive-Summary.pdf
2. Ibid. The remaining portion of climate finance in 2012 (110-120 billion) was raised and channelled through intermediaries, particularly national development banks and commercial banks.
3. Developing country parties agreed at COP 18 to develop NAMAs supported and enabled by technology, financing and capacity building. The goal of NAMAs is achieve a reduction in GHG emissions relative to BAU, assisting in meeting global GHG reduction targets. Fifty-seven countries have so far communicated proposals for NAMAs through the UNFCCC. More information on NAMAs is available from the UNFCCC: http://unfccc.int/focus/mitigation/items/7172.php

Shariah compliant wealth management:

the rising star within global wealth management

Sohail Jaffer is Deputy CEO at FWU Global Takaful Solutions

It's not arguable anymore that emerging markets are considerably reshaping global economy taking over the driver's seat of global growth and wealth creation. Recent studies show that, emerging markets have outpaced developed markets in terms of AUM growth, 6.4% versus -0.5% and will continue to increase their share of global AUM in the next few years.

Global wealth is estimated to have increased by 8% to US$121.8 trillion in 2010, driven mainly by strong growth rates in emerging economies, high commodity prices, recovery in the real estate markets, and high oil prices. It is projected to grow by approximately 6% annually between 2011 and 2015 to reach US$161.9 trillion. Positive performance of capital markets, strong GDP growth especially in emerging markets and increased savings worldwide post crisis are all factors said to contribute to this remarkable growth.

While North America is expected to remain the largest wealth market, with total wealth growing at an average rate of 6.9% annually to reach US$48.8 trillion in 2015, representing 30.1% of global wealth, Europe is expected to be the second largest wealth market, with total wealth growing at an average rate of 5.7% annually to reach US$45.6 trillion in 2015, accounting for 28.2% of global wealth. And Asia's total wealth (excluding Japan) is projected to grow at the fastest pace, averaging at 18% per annum to reach US$37.3 trillion in 2015 which translates 23% of global wealth in 2015 (2010: 17.8%). Combined wealth of emerging markets of Asia (excluding Japan), MENA and Latin America combined is projected to reach US$49.4 trillion in 2015, representing an average growth rate of 16.6% per annum.

The Middle East is also a significant market that is rising with one of the biggest growths in high net worth individuals

(HNWIs) population which surged by 10.4 per cent to 440,000, with a combined wealth increasing by 12.5 per cent to $1.7 trillion, as per the *World Wealth Report 2011*.Within the GCC countries, Booz & Company estimates that, there are between 1 million and 1.1 million wealthy households in the GCC with total investable assets of $1 trillion to $1.2 trillion. (*GCC private banking report 2010-2011*)

Wealth managers are competing to set footprint in these new emerging markets with promising growth potential, however, having presence in the right market is no longer enough as a strategy. As competition increases from both local and outside players, investors become more sophisticated, and demanding in terms of product offering, transparency and efficient customer service; asset managers, will need to adopt a targeted approach and build a scalable and economically viable business models to succeed in emerging markets.

Value based investment: a global growing trend

In the wake of the financial meltdown, a global trend of ethics/value based investments has been on the rise globally. Renewed attention to social responsibility in economic markets, and advancing the idea of financial social responsibility reached unprecedented momentum. The professional association USSIF: The Forum for Sustainable and Responsible Investment estimates in its *2010 Report on Socially Responsible Investing Trends* that around $3 trillion in assets under management subscribe to one or more of the aforementioned approaches to socially responsible investing.

"Although still a fraction of the global wealth management industry the potential of Islamic wealth management industry is undeniable"

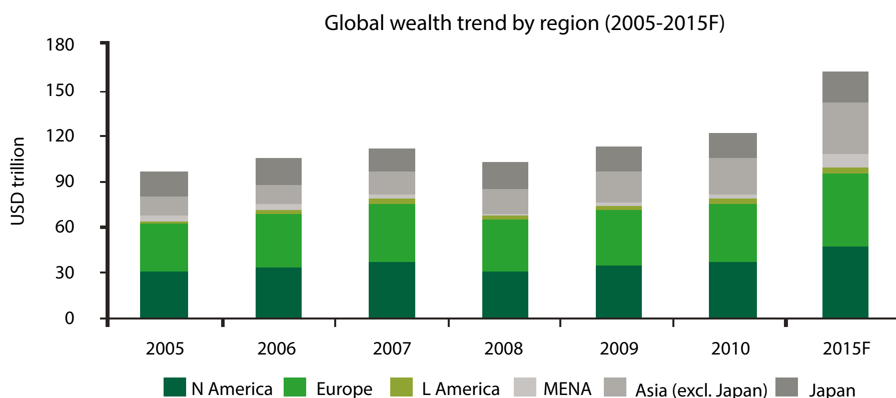
Over 250 mutual funds in the United States alone, utilize a social screening process, with assets of approximately $316 billion. There are hedge and exchange-traded funds (ETFs) that adopt a socially conscious approach to investment, as well.

In Europe as per a study conducted by KPMG (*European Responsible Investment Fund Survey*), 1,236 responsible investment funds were identified with €129.49 billion assets under management.

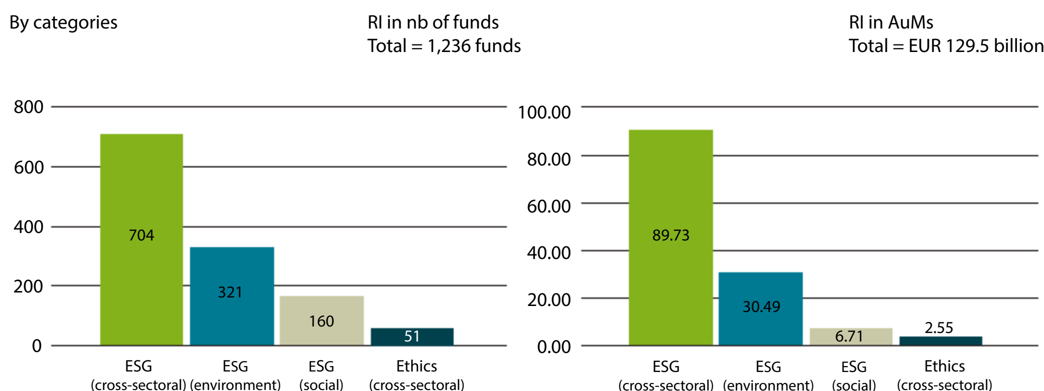
Shariah-compliant investments: a special category of SRI

The growing importance of ethics within the investment industry and its convergence with the principles of shariah-compliant finance is increasing the acceptance of the alternative financial segment in secular markets. Islamic finance has proven its potential and triggered interest globally. With a sizable SRI market segment, the potential to manage assets worth $4,400 billion, growing at 10 per

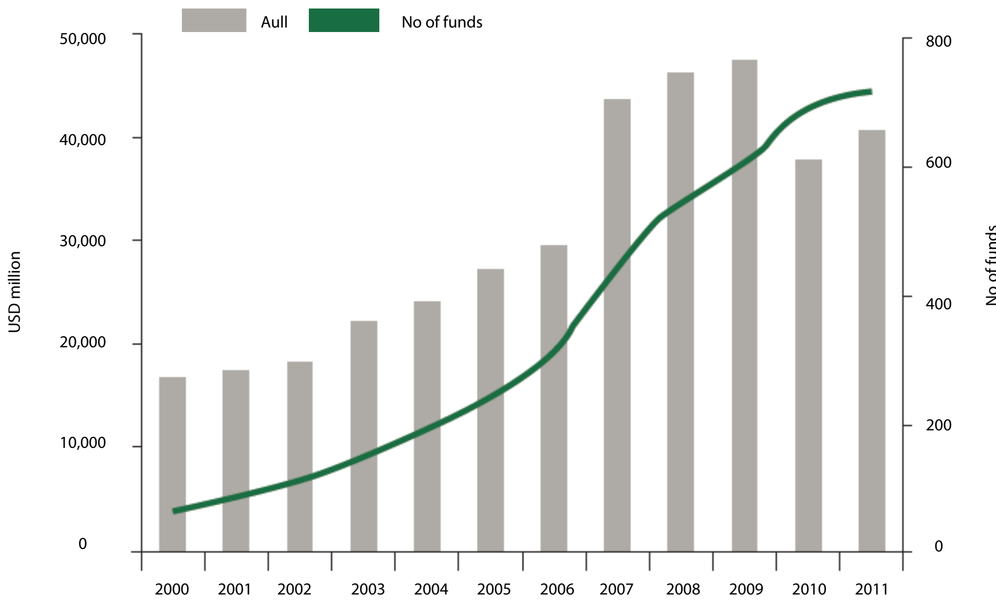
cent per year is significant, especially as the actual size of the industry today is just $1,130 billion worldwide, according to the *Global Islamic Finance Report 2011*.



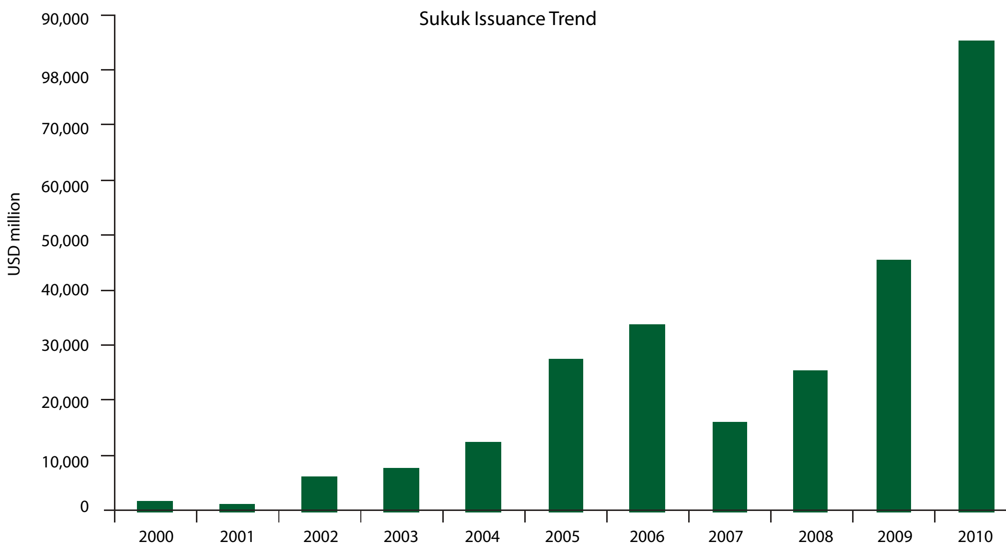
Source: IMF, BCG



Source: KPMG European Responsible Investment Fund Survey



Source: Bloomberg, IFIS, Zawya, KFHR



Source: Bloomberg, IFIS, Zawya, KFHR

It has expanded geographically setting footprint beyond its home markets and is likely to develop significantly in the coming years, with most global financial brands involved in Shariah-compliant finance either with own subsidiaries through strategic tie ups.

The KPMG SRI study has already identified 42 shariah-compliant funds among the 'ethics' category of SRI funds that comprises a total of 51 funds and an AUM of €2.5 billion representing the smallest of all categories of 1.9% of the total assets of SRI.

Shariah-compliant wealth management: on the right track

Although still a fraction of the global wealth management industry the potential of Islamic wealth management industry is undeniable, in light of growing number of rich Muslim populations, continuous growth of Islamic assets, and the increasing demand for shariah-compliant investment options, coupled with the improvement in investor confidence and strong economic growth in emerging countries.

Relatively, the range of shariah-compliant products and services remains limited within few classes and geographies but the depth and breadth of Islamic finance products have increased significantly from basic savings account to more sophisticated instruments on the capital market such as sukuk and Islamic real estate investment trusts.

There also has been significant growth in shariah-compliant structured products such as undertaking collective investments in transferable securities (UCITS) funds. In addition, more flexible structures such as the Specialised Investment Fund (SIF), which allows a wide variety of different investment strategies, can be used for shariah-compliant private equity, property or other alternative investment schemes mainly aimed at institutional or high net worth investors. SIFs used either for shariah compliant funds or for conventional funds, have proven to be highly successful with Middle Eastern investors as per the Association of the Luxembourg Fund Industry. Luxembourg has always been a first European mover in shariah-compliant finance since the 80s, ranks today fifth worldwide by number of shariah-compliant funds. The number of Middle East-based managers launching investment funds in the European country has increased constantly.

There are 41 regulated shariah-compliant investment funds domiciled in Luxembourg and total assets under management in shariah-compliant funds are estimated at US$5.3 billion. Another pioneering initiative in Luxembourg was launched by four Luxembourg-based companies that are joining forces to create a specialised platform that will service shariah-compliant investment funds. Amanie Advisors , ADEPA Asset Management, Theisen Law, and KBL European Private Bankers have launched a service that will

be branded ALIF (Alliance for Luxembourg Islamic Finance), offering fund managers a service to have their custodianship and fund servicing carried out in a shariah-compliant manner. Specifically assets will be held in segregated pools and prohibited from being used for short-selling or as security for interest-based lending, two activities prohibited under shariah.

Sukuk: still at the forefront of the shariah-compliant investment instruments

Sukuk forms a significant component of the Islamic capital markets, second only to equity. Total sukuk issuance by end of 2012 reached $131 billion with 54 percent increase than 2011, where total sukuk issuance in December reached $8 billion with a 61 percent increase compared to last year, as per a recent report from Kuwait Finance House-Research. The report noted that Malaysia and the ringgit continue to dominate the market of sovereign sukuk issuance, where governmental and sovereign issuances were more by 70 percent in December ($5.7billion).

The top countries in sukuk issuance are as follows: Malaysia, Saudi Arabia, UAE, and Indonesia. Notable issuances include the SAR1.9 billion ($506.6 million) sukuk issued by Banque Saudi Fransi and structured using murabahah and mudharabah principles. Recently, FWU Group issued the first sukuk by a German corporate and the largest sukuk from a European corporate, worth $55million.

Governments remained the largest issuer type, representing 70.1 percent during December while there were a number of significant issuances also issued in the financial services sector. Both sectors have represented 61.8 percent an11.4 percent of the primary market respectively in 2012 while the transport sector represents 13.0 percent.

The GCC sukuk market has reached unprecedented growth in terms of new issuance, driven by a fast growing appetite for infrastructure finance as the UAE emerged as the third global growth market for Islamic bonds. Sukuks could provide such companies the longer-term funding they need via a different funding source. This source is becoming more liquid as it reaches across border and becomes more global and grows in scale. The ratings agency analysts observed GCC companies have been crossing the figurative border into Asia for infrastructure finance. Abu Dhabi National Energy Co and Bahrain-based Gulf Investment Corp are the first to issue sukuk in Malaysian ringgit.

"These types of cross-border deals are more than a smart funding solution, in our view. They could also develop the trade relationship between the countries of the GCC and Asia to their mutual benefit" commented an industry expert. *"Such deals might signal the start of more cross-border transactions between the Gulf and Asia, which could help the market become more mature and truly global, and stimulate even more deals and trade between the two regions."*

Conclusion

The global wealth management sector is expected to grow with an annual average up to 6% from 2012-2015 to reach US$162 trillion, despite expected slowdown in global economy. Emerging markets are thought to be leading this growth. With financial assets growing robustly and influencing the global demand for equity products, HNWIs are expected to increase allocations to riskier assets such as equities and real estate, and their appetite for local equity products will grow as they become more willing to put money at risk in order to achieve higher rates of return, in line with improved investment confidence and especially if the global economy continue showing signs of recovery.

Shariah-compliant wealth management is shining with an obvious continuous growth driven mainly by the increasing demand and preference for shariah-compliant financial products, proactive measures taken by governments and jurisdictions worldwide to promote the development of Islamic finance in their respective countries, and the favourable demographics with growing young populations in most majority Muslim countries. Many financial analysts believe that there is likely to be a bigger migration to Islamic financial services in certain markets due to the loss of faith in the conventional system arising from the global economic and financial crisis.

As market conditions continue to improve, shariah-compliant investment options are likely to be more attractive to larger audiences who will be looking for opportunities which are more transparent and ethically structured. The outlook is certainly positive, however, for the industry to thrive, more products need to be developed, more innovation needs to be done to cater to the sophisticated needs of private banking clients. And most importantly it must incorporate the right regulation so these products can be facilitated. ■

A version of this article was originally published in Financial Bridges® Autumn 2012

Revitalizing international business in Bermuda

Most people know Bermuda for its pink-sand beaches and idyllic setting. Most think of it as a great place to vacation – a cultivated hospitality that is perfect for tourism. Whilst that is indeed true, multinational companies have used Bermuda as an offshore location since the 1930s, and Bermuda's largest sector has been international business for many years.

International business is the pillar upon which Bermuda's financing stability rests. A mix of specialty corporate insurance and reinsurance companies, trust services and fund-administration services have flourished on the island, together with a fully electronic trading platform, the Bermuda Stock Exchange. E-business is also expanding.

On December 17th 2012 Bermuda had a change in government which saw the One Bermuda Alliance elected to lead the country. The focus of the new Government is to ensure economic and social equity and stability for every Bermuda resident, stimulate investment, strengthen the economy and create new jobs. Included in the platform was a revitalization of International Business. Since the election the Ministry of Economic Development was formed with a mission to sustain existing business and develop new business opportunities.

Within the first three months in office, the new government brought in work permit reform. The abolition of term limits provided even greater comfort for businesses based in Bermuda. With the term limit policy eliminated, a few new categories of work permits were introduced. The **Global Work Permits** allowing employees already employed with a company to relocate to Bermuda without the requirement to advertise the post. The **New Business Work Permit** allows for a company that is new to Bermuda to automatically receive up to five work permits for senior positions during the first 12 months of the Bermuda office launch.

Living up to its promise of delivering less red tape, more red carpet, the **Bermuda Business Development Corporation (BBDC)**, a public/private partnership established to support and drive the development of international business on the Island, has set up an **International Business Concierge Service** for companies who wish to establish a business in Bermuda.

The Concierge Service is a joint venture between the BBDC and the Ministry of Economic Development. The Concierge arranges, facilitates and coordinates the interaction with the Bermuda Monetary Authority, the Department of Immigration, Ministry of Finance, the Registrar of Companies and other agencies, required for the applications, approvals and documentation, in connection with the formation and launch of the entities establishing or investing in Bermuda. The Concierge will also make the requisite introductions to on-island service providers such as lawyers, accountants, audit and advisory firms, banks, real estate agents, etc.

Why Bermuda?

For over 50 years, Bermuda has been a leading jurisdiction in international commerce. Bermuda is a premier and well-respected financial centre that offers an outstanding environment for international business supported by a world class infrastructure.

- **Tax neutrality**
  Bermuda does not have income, profit, corporate or capital gains taxes. The Minister of Finance has the authority to grant assurance to Bermuda companies that they will not be liable to pay such taxes until at least 2035.

- **Legal system**
  Bermuda's legal system is based on the English common law system with final appeal to the Judicial Committee of the Privy Council of the House of Lords in England. Bermuda's corporate law is flexible and largely based on the corporate law of the United Kingdom. The Companies Act is the principal corporate legislation and is amended regularly to ensure it appropriately reflects modern standards and international corporate developments.

- **Reputation & intellectual capital**
  Bermuda was the first offshore jurisdiction to be placed on the OECD's white list as a result of substantially implementing the internationally agreed tax standard. Bermuda is an extremely well regulated jurisdiction and is internationally acknowledged as a jurisdiction of substance. Most importantly, businesses have benefited from operating in Bermuda because of the concentration of intellectual capital that has amassed over the decades.

  Bermuda boasts a sustainable pool of support services including highly respected lawyers, accountants, auditors, fund managers, administrators and bankers. Its reputation as an innovative insurance and risk management centre is unsurpassed. Bermuda is renowned as the risk capital of the world.

- **Regulation**
  Financial activity is regulated by the Bermuda Monetary Authority. The BMA is internationally recognised for the intelligent balance in its approach to regulation, ensuring high standards of conduct by Bermuda businesses, while allowing ample and appropriate flexibility.

- **Sophisticated ICT services**
  Before Bermuda began playing host to large international companies, it was a tourist destination known as the 'Isles of Rest'. Technology has outdated that description. To satisfy clients who have global operations in business around the clock, Bermuda's ICT professionals and organisations have learned being as good as those overseas is not enough; they have to go one better.

  The need to innovate has been met with a hearty response. Companies considering jurisdictions in which to locate their operations will naturally include ICT development and support high on their list of desired services. In Bermuda, they find a wealth of talent, creativity and tailored solutions to help drive their businesses forward.

- **Digital economy**
  The Government was itself one of the earliest adopters of ICT. Realising that the island's traditional remoteness would be changed by the advent of the internet, the Bermuda Government decided that it must lead, rather than follow, the private sector in this area. Merely keeping up with commercial developments would leave the Government at a huge disadvantage, it was felt. As early as 1999, ICT had its own Ministry in Bermuda and thus a representative in meetings of the Bermuda Government's Cabinet.

  The Electronic Transactions Act (ETA) was published that year. Government itself continues to advance towards the goal of increasing its online services offering to both business and the public. The way in which the population interfaces with its Government in Bermuda has become increasingly electronic, in the payment of taxes, vehicle licensing and registration and in many other ways.

"It is the commitment of the Government of Bermuda to continue to be a jurisdiction of first choice for international business"

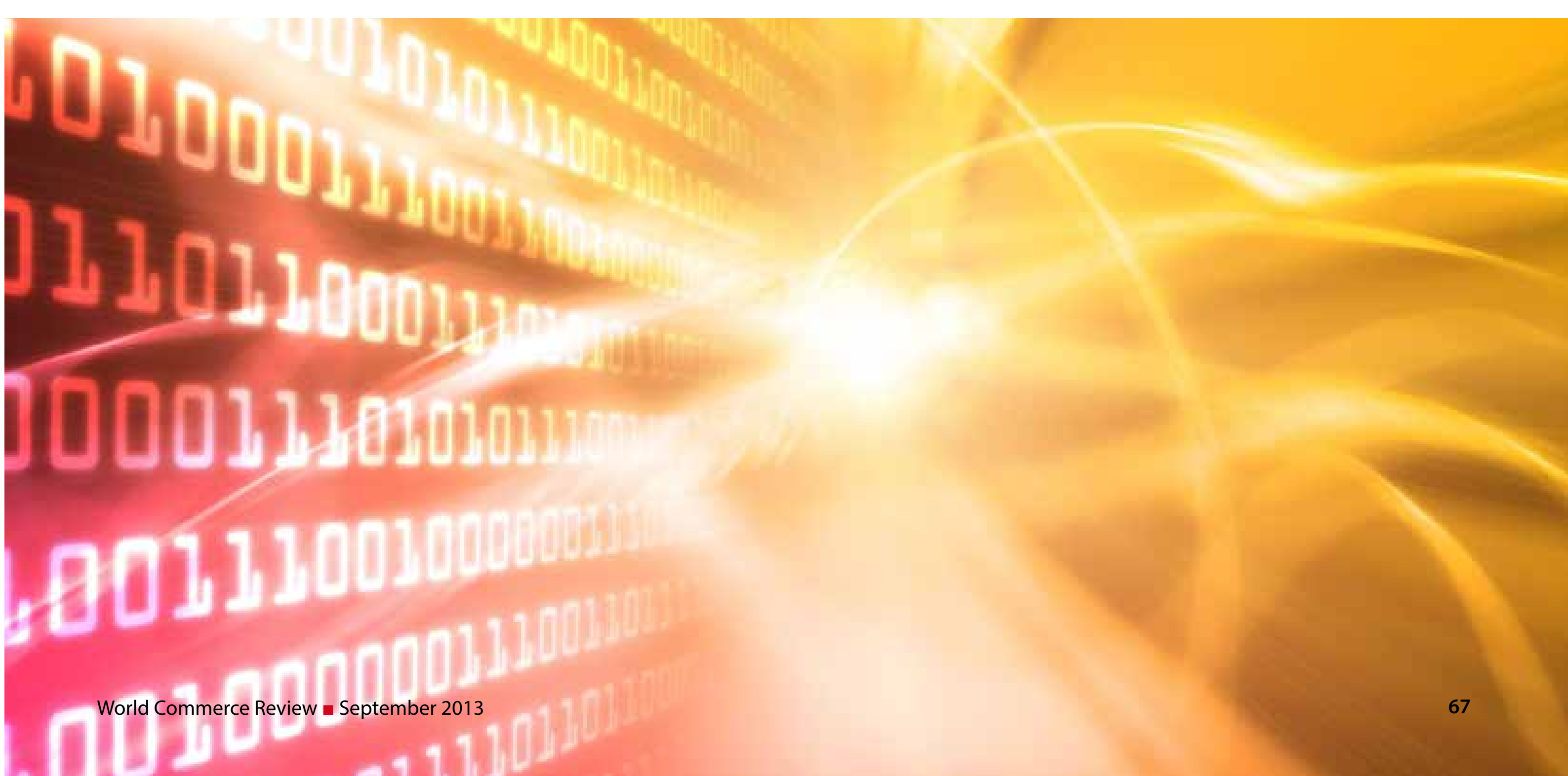
- **Proximity to the US, UK and Canada**
  Bermuda is a two hour flight from New York, most East Coast Gateway Cities and three hours from Miami. There are regularly scheduled direct flights to Toronto and London. US Customs and Border Protection provides pre-clearance of all US bound flights at Bermuda's LF Wade International Airport.

- **Structure & infrastructure**
  Bermuda has a stable government and political structure as well as a secure, modern and world class physical and technological infrastructure, including excellent telecommunications, broadband and the fully electronic Bermuda Stock Exchange.

- **Quality of life**
  Bermuda enjoys a high standard of living, supported by its education and healthcare systems. Bermuda also offers breath-taking beauty and a comfortably mild sub-tropical climate.

Always innovating

Bermuda constantly refines its business legislation to remain competitive. The jurisdiction is extremely protective of its reputation and the integrity of the country's laws and regulations. It is the commitment of the Government of Bermuda to continue to be a jurisdiction of first choice for international business. Bermuda is commercially responsible and offers the best in service and reputation to businesses. ■



Base erosion and profit shifting — what the BEPS does it mean?

Catherine Schultz is Vice-President of Tax Policy at the National Foreign Trade Council

On July 19, 2013, the Organization for Economic Cooperation and Development (OECD) released the Base Erosion and Profit Shifting (BEPS) Action Plan. The BEPS project was born out of a growing concern about how large multinational enterprises handle their tax planning, and that aggressive tax minimization has led to base erosion and double non-taxation of certain corporate income. As governments desperately try to reduce large fiscal deficits against a backdrop of international fiscal turmoil, tax planning by large multinational corporations has been denounced as immoral and unpatriotic. Complex tax issues are often reduced to sound bites and facts are used selectively by politicians to make their case against perceived aggressive tax planning.

The G-20 met in Mexico in June 2012, and instructed the OECD to undertake a study of base erosion and profit splitting. On February 13, 2013, the OECD released the first BEPS report. The report provided a comprehensive analysis of the current tax environment and considers how BEPS may be addressed. The report did not prescribe specific measures to deal with BEPS, but it suggested that changes to established tax principles are required that could have significant implications for international taxation. The report acknowledged that multinationals engage in entirely legal and legitimate tax planning and comply with the tax laws of the countries in which they do business.[1] The report states that current international tax principles and approaches are no longer adequate to ensure a fair tax system in the current era of globalization and e-commerce.

The report suggested that increased globalization requires changes to major international tax principles, including: 1) reconsideration of the balance between source and residence taxation; 2) better alignment of rights to tax with 'real economic activity;' 3) quick changes to existing tax treaty provisions where they present 'difficulties;' 4) calls for cooperation and action at both the OECD and national levels; 5) calls for 'immediate' action by tax administrators to improve 'compliance;' and 6) acknowledges the need for the OECD to hear input of 'all stakeholders' including the BRICS, business and civil society (non-governmental organizations). The key areas of concern pointed out in the report, were elaborated on in the BEPS Action Plan.

The BEPS Action Plan released in July, calls for new international standards 'to ensure the coherence of corporate income taxation at the international level' and new transfer pricing rules that address the use of 'intangibles, risk, capital and other high-risk transactions to shift profits.'[2] The Action Plan sets forth work to be done in 15 areas of law and tax practice. The Action Plan is supposed to be completed by the end of 2015, with the possibility that some of the work will take longer.

The 15 BEPS action areas include: 1) tax challenges of the digital economy; 2) hybrid mismatch arrangements; 3) CFC rules; 4) the deductibility of interest and other financial payments; 5) harmful tax practices of countries; 6) tax treaty abuse; 7) artificial avoidance of permanent establishment (PE) status; 8) transfer pricing for intangibles; 9) transfer pricing for risks and capital; 10) transfer pricing for other high-risk transactions; 11) development of data on BEPS and actions addressing it; 12) additional disclosure of aggressive tax planning arrangements; 13) country-by-country transfer pricing documentation; 14) effectiveness of tax treaty dispute resolution mechanisms; and 15) the development of a multilateral instrument for amending bilateral tax treaties to implement measures developed in the course of the work on BEPS. The G-20 Finance Ministers meeting in Moscow supported the BEPS Action Plan. The G-20 leaders will meet in St Petersburg in early September, and are expected to support the Action Plan as well.

The February BEPS report discussed certain studies focused on BEPS that analyzed the effective tax rates of multinationals in an attempt to demonstrate the existence of BEPS.[3] The report concluded that there are few studies using the same method and it is difficult to show the existence of BEPS on the basis of effective tax rates since a low effective tax rate may be the result of tax incentives voluntarily created by governments to promote investment rather than aggressive tax planning. Some commenters believe that the US international tax system is riddled with loopholes that were not intended to allow base erosion.

Conversely, some believe that because the United States has the highest corporate tax rate among OECD countries and a worldwide system of taxation, that the provisions were added to the tax code intentionally as relief valves so that American multinational corporations could better compete with companies who are in territorial tax systems that have lower effective tax rates. Some believe the rules were designed to be porous. It doesn't matter if BEPS actually

exists, there is a growing perception among governments that they are losing substantial revenue because of BEPS and that the rules must be changed.

The issues surrounding the BEPS project are not new. For the past several years, before the on-set of the BEPS project, the OECD had already been doing a great deal of work in the various working parties on many of the items included in the BEPS Action Plan. Recent OECD reports on aggressive tax planning include: Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure (2011), Corporate Loss Utilisation Through Aggressive Tax Planning (2011), Hybrid Mismatch Arrangements—Tax Policy and Compliance Issues (2012), Aggressive Tax Planning based on After-Tax Hedging (2013), the OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment (October 19 2012-January 2013), and the Discussion Draft on the Revision of the Special Consideration for Intangibles in Chapter VI of the OECD Transfer Pricing Guidelines and Related Provisions (June 6-September 2012).

The OECD spent many years working on electronic commerce, including: OECD, Clarification on the Application of the Permanent Establishment Definition in E-Commerce: Changes to the Commentary on the Model Tax Convention Article 5 (December 2000). The OECD Working Party 6 continues to work on valuing risks, and ownership of intangibles, specifically looking at how you can accurately value risks and intangibles, which are inherently difficult to price and are very mobile. The OECD also has the work underway in Working Party One on the various tax treaty issues, including a 2010 Report on the Attribution of Profits to Permanent Establishment, and the discussion draft on the definition of 'permanent establishment'.[4]

Now that the BEPS Action Plan has been released, where do we go from here? The BEPS Action Plan says that the work will largely be completed in a two-year period, with some actions identified as likely to be delivered over 12 to 18 months and others requiring more than two years. Once the Action Plan is completed, the actions must be accepted by all of the OECD and non-OECD countries especially if there are altered requirements for transfer pricing.

In closed-door meetings, US Treasury officials say they are concerned that no harm is done to long-standing tax rules that work in the majority of situations. For example, the French government requested and strongly pushed for Action Item Number 1, calling for a task force to study the tax challenges of the digital economy. The French issued a report of the topic in January that called for a change to the OECD's permanent establishment rules to create a 'virtual establishment' principle.[5] A virtual PE would enable the OECD countries to tax companies in proportion to the volume of user data they use within those jurisdictions. The U.S. Treasury does not support that proposal, and feels no need to go along with a consensus that is unprincipled, or in its view, fundamentally wrong.

The United States would like to strengthen the controlled foreign corporation (CFC) rules as part of the BEPS project.

"The Obama Administration is very supportive of the BEPS project, but does not have tax reform as a high priority"

The United Kingdom, as part of its recent tax reform efforts, and in a lengthy consultation with the business community, revamped its CFC rules. The BEPS project may look to the UK rules as a model to follow, but if it the governments decide to take a different approach than the British CFC rules, would the British accept the BEPS changes? The British have also recently adopted a patent box as a way to attract more foreign direct investment. How willingly would the United Kingdom surrender these new changes to its tax code? Coming to agreement on BEPS could mean giving up some sovereignty on taxing rights. How likely is it that all of the G-20 governments supporting the BEPS Action plan will be willing to change their underlying tax laws to adopt changes they don't support?

In the United States, the House Ways and Means Committee and the Senate Finance Committee are considering reforming the US tax code. There are many political hurdles to tax reform, and it is unlikely that there will political agreement on tax reform in Congress in the next two years, before the 2014 elections. Chairman Dave Camp of the House Ways and Means Committee will be term limited out of the chairmanship at the end of 2014. Chairman Baucus of the Senate Finance Committee is retiring from the Senate at the end of 2014. There are great political differences between the Republican controlled House and the Democratic controlled Senate that will make the passage of tax reform very difficult. The Republicans would like to enact a revenue-neutral tax package. The Democrats would like to raise revenue to offset the current fiscal deficit. Neither side has shown any willingness to compromise on this revenue issue.

The Obama Administration is very supportive of the BEPS project, but does not have tax reform as a high priority. Without a reform of the US tax system, many of the changes likely to result from the BEPS Action Plan will be difficult to enact in the United States. If changes are proposed through the adoption of an OECD multilateral tax treaty, there is no guarantee that the US Senate will be able to adopt that multilateral. There is an OECD multilateral convention on the exchange of information that is currently languishing in the US Senate, and any other multilateral will be difficult to adopt quickly. If the United States has political problems adopting the recommendations of the BEPS project, will the other OECD countries proceed without them? Many of the concerns of the OECD members involve US multinationals. Without changes in the US tax law, it will be hard to address the individual BEPS action items separately.

Conclusion

The media, governments and international organizations such as the OECD acknowledge that for the most part, multinational corporations are very concerned with respecting and conforming to the tax laws of the

jurisdictions in which they operate. The OECD report on BEPS uses the example of how companies may operate in a jurisdiction without having a taxable presence in it, in order to demonstrate that today's tax laws may not provide for a reasonable or fair allocation of taxing rights. The report reflects the position of several high-tax jurisdictions that some existing and accepted tax principles should be revised. Many countries deliberately create tax incentives in or to become more attractive to foreign investors. Multinational corporations are free to choose the territories in which they wish to establish. A lot of what is at the centre of the debate on corporate tax avoidance therefore comes down to companies responding to the tax incentives that have been introduced into the tax laws in the countries in which they operate.

The BEPS project is in its early stages. Coming to consensus on the items included in the Action Plan could be difficult. It is hard to gauge how willing governments will be to change their tax rules to adopt any final BEPS recommendations if consensus is reached. How can the various governments be brought to a common understanding on tax rules, considering that in most countries, the tax regime in place reflects a policy designed to enhance that nation's economic development? The answer remains elusive. ■

1. OECD, Addressing Base Erosion and Profit Shifting, February 12, 2013
2. OECD, Action Plan on Base Erosion and Profit Shifting (BEPS), July 19, 2013
3. OECD, ibid, February 12, 2013.
4. OECD, Discussion Draft on the Definition of "Permanent Establishment", Article 5 of the Model Tax Convention, October 19, 2012
5. Ministere de L'Economie et des Finances, Mission D'Expertise Sur la Fiscalite de L'Economie Numberique, (Expertise Mission on Taxation of the Digital Economy) January 18, 2013.

The OECD report on Base Erosion and Profit Shifting (BEPS) concerning the perceived abuse of commissionaire structures

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

Introduction

On July 19, 2013, the OECD released a comprehensive report, detailing a two year program for its member states (and other countries if they want to), to combat aggressive tax planning structures, revise some transfer pricing rules and introduce other ways to combat the erosion of these countries' tax bases and profit shifting. The report is already widely known as the BEPS report.

In the coming issues of *World Commerce Review* I should like to discuss some of the plans which the OECD has unfolded in its BEPS report, to see how effective the new approach might be. It is to be kept in mind in this regard that the OECD is not in a position to actually create new tax laws or change tax treaties. All it can do, and has done over the years in this respect, is to report findings of situations where multinational enterprises (MNE's) do not seem to report their 'fair share' of taxable income in the countries of their operations and to suggest ways on how this situation can be mended. The report has a very short timeframe: most measures should have been adopted before the end of 2014.

One of the action points that has been announced, is to bring so-called commissionaire structures under the working of the permanent establishment article of tax treaties. This will be my focus for this *WCR* issue.

An explanation of the commissionaire concept

Large MNE's obviously derive most of their revenue from large markets. These markets are almost always in high tax countries. But revenue streams are not the predominant criterion for the payment of corporate income tax: this tax is payable on the taxable profits of the subsidiaries of these MNE's in their countries of operation.

So there has, logically, always been a demand for tax planning whereby high turnover in a given jurisdiction, even if this would give rise to high profits, can still be construed in such a manner that taxable profit remains low.

In the mid-nineties of the previous century, just around the time that transfer pricing rules were introduced to avoid that MNE's would, by using artificial prices for intra group transfers of goods and services, be able to realize their profits in countries with a relatively low tax burden, the commissionaire concept was discovered by the major firms occupying themselves with international tax planning (including the big four accounting firms which all have a significant international tax division). As is often the case with tax planning, legal instruments that have local significance only, appear to have the ability for much wider use and can be seen as a 'tax discovery'. One example that I will not further elaborate on here, are the Dutch Cooperative

Associations. Even ten years ago these legal entities were hardly used in the Netherlands outside economic sectors like fishing and farming, but nobody can stop other businesses to use a similar set-up if this would be beneficial.

So today, the Netherlands knows many hundreds of 'cooperatives', because these entities were, at least till early 2013, not subject to dividend withholding tax. So by interposing a 'coop' between a foreign entity and a Dutch intermediate holding company or operating company, one could avoid the then 25% (now 15%) Dutch dividend w/h tax in cases where the treaty rate was higher than 0% or in case there was no tax treaty with the Netherlands at all.

Commissionaires were also hardly used by MNE's till someone, 20 years ago, spotted the fact that the newly emerging transfer pricing rules would allow MNE's, if they would set up their sales subsidiaries in the countries of their major operations as such, to reduce taxable income in these countries despite high turnover and high profitability of the products or services sold.

A commissionaire, in the countries where this notion exists as part of a country's legal system, is an entity that sells goods and/or services in its own name but for the risk and account of an undisclosed principal. Because it operates it its own name, it is not, legally, an agent of its principal: in agency contracts the agent sells goods and/or services for a disclosed principal. The customer, when dealing with an agent of, say, ABC Inc in the USA, knows he is buying from ABC Inc. But if ABC Inc sets up a subsidiary in, say, France, with the name ABC SarL, the customer is not informed of the fact that ABC SarL might operate for the risk and account of ABC Inc.

However, from an international tax viewpoint, an agent and a commissionaire are treated quite differently, at least in situations where the agent is 'dependent' on his principal. A dependent agent creates a so-called permanent establishment for the principal in his country of operations, whilst a commissionaire (arguably) does not. A commissionaire is perhaps economically an agent of his principal but legally he is not.

The difference between both structures is that a dependent agent (an agent that only has one principal) leads to a tax liability for ABC Inc in the country of the agent and ABC Inc will have to allocate part of its sales profits to such agent, which will become taxable in the agency country (confirmed by the tax treaty, if any exists, between the USA and the country of the agent). A commissionaire will only have to report a type of service income: it's activity is to renders services to its principal in a rather riskless manner (the risks are for the principal) which under prevailing transfer pricing principles leads to a much lower taxable income than an agency structure whereby part of the sales profits of ABC Inc become taxable in the country of the dependent agent as well.

So commissionaire structures looked like a promising concept and if they would be accepted by the tax courts, the MNE's would have achieved the first step of their long

"One of the action points that has been announced, is to bring so-called commissionaire structures under the working of the permanent establishment article of tax treaties"

list of goals: profit shifting from high tax jurisdictions to a low tax jurisdiction. Ireland, in many cases, was the place of choice, firstly because of its low tax rate (12.5% compared to an average 30+% in the larger European jurisdictions and regions) and secondly for language reasons, I assume. After all, the first commissionaire structures were set up by US based MNE's.

As we all know, the profits did not stay in Ireland too long: a further tax reduction was achieved by substantial intercompany charges from within the MNE to the Irish entity for the technology embedded in the products and/or services, sold by the Irish entity through its commissionaires. Everyone, by now, will have heard about the 'Double Irish/ Bermuda' structures many US based MNE's are using to reduce taxation on their foreign profits to very low percentages indeed.

One of the BEPS action points is to revise the 'dependent agent' meaning in tax treaties, by adding commissionaires to the definition of a dependent agent, because the commissionaire, if he is economically dependent on his principal, represents his principal in an economical sense. This magazine is not the forum to discuss whether such an extension of the definition of a dependent agent can be introduced for existing treaties or should be reserved for new tax treaties only, but everybody will understand that this will become a big issue. Tax treaties are revised once in 25 years on average so the OECD will have to find a solution here if the BEPS program should be operating by the end of 2014...

The question for the MNE's that operate commissionaire structures is, if they should anticipate the OECD action plan concerning commissionaire structures and if so, find out if there is a workable alternative. I believe there is.

Limited risk distributors

The decision by the large multinational tax consultancy firms to give off a 'should' or even stronger opinion on commissionaire structures in the mid-nineties of the last century, was of course not taken lightly and the result of a long lasting debate amongst the member firms in the various countries. Some advisers clearly believed that a commissionaire would not work in their country if it had only one principal. This would make the relationship 'dependent' and in a 'substance over form' approach, the economical dependency might well override the legal independency resulting from the fact that the customers would not be aware

of the fact that the products or services they purchased were purchased for the risk and account of another legal person than the one they did business with.

But there were more hurdles: many countries did not acknowledge the concept of a commissionaire in their legal system and relying on a foreign law concept is dangerous: tax authorities and tax judges do not normally want to engage in interpretation of foreign law and will look at the arrangements in their own laws that most closely resemble the foreign contract or structure. The outcome of an analysis of commissionaire structure in countries unfamiliar with the commissionaire concept would also in these cases put additional risk on the possibility that a tax judge would let the economical aspects ('dependent agent') prevail over the legal aspects (acting in one's own name).

The essence of a commissionaire structure is profit shifting: by reducing the various business risks of a sales entity in a high tax jurisdiction, the taxable profits of the distributor should go down under the basic transfer pricing principles that each entity in a MNE group should be properly rewarded for:

a) Its functions;

b) Its risks;

c) Its assets in use (including intangible assets)

Clearly, if distributor X in country X operates as a commissionaire for principal Y in country Y, this leads to risks shifting. Under proper structuring of the commissionaire agreement, the following main risks can almost automatically in part or in whole be shifted from the distributor to the foreign principal:

1) Bad debt risk;

2) Currency risk

3) Inventory risk

What results, in a typical transfer pricing analysis, is a sales entity or distributor that gets rewarded for its functionality on the basis of the so-called 'resale minus' method: the entity gets a percentage of the sales price for each product or service sold. This leads to substantially lower pre-tax margins than the ones one will find if a sales or service entity assumes all of the basic economical risks itself. For the MNE as a whole, it really does not make much difference which group company bears a given risk: all will end up at the bottom line of the group's parent, in the end.

On further analysis, before the large international tax adviser attached their OK, in the form of a positive tax opinion, to commissionaire structures, they already invented the 'limited risk distributor' as an alternative for a commissionaire: stripping business risks out of a sales entity in the group could also be done by contractual arrangements between members of an MNE, other than concluding a commissionaire agreement: the production entity or group parent company could also outside a commissionaire environment reduce a number of business risks for its sales entities by contractually assuming these risks itself.

Currency risks can obviously be avoided by the group selling its products and/or services to the distributing entity in the currency of sale rather than in the currency of production. And inventory could either be delivered to the distributor on a consignment basis (so the distributor only becomes the owner of the item once he has found a customer for it) or by giving the sales entity the contractual right to ship unsold and obsolete product back to the producing group entity for its historical acquisition price. For dealing with bad debts, similar contractual arrangements could be made.

In this way, the distributor operates not only in its own name, but also for its own account, albeit that it does not assume certain risks or has contractually arranged that those are born by the production entities in the group. Such a 'limited risk' sales entity, in no way, acts as an agent for a principal elsewhere in the group, so the risk of being seen as a dependent agent in the sense of the OECD comments to its Model Tax Treaty, applicable to genuine bilateral tax treaties is much more remote than via commissionaire structures.

In the last several years, commissionaire structures have been tested before the supreme tax courts of a fair number of countries and in the cases I have seen, the tax judges have taken the (expected) legal approach: a commissionaire is not a dependent agent of his principal, even though, economically, he operates to a large extent for the risk and account of his principal.

Conclusions

If the OECD now sees a benefit in rewriting the ''dependent agent'' rules in its comments to its Model Tax Treaty, it may become the victim of an optical illusion: even if this could be done on short notice and even if it could be made to work also in existing situations, ie. the new interpretation could be launched as a refined interpretation of an existing phenomenon and not as a new interpretation, which is a big question all by itself, then all the OECD will likely find is that MNE's will have changed their intercompany relationships between the producing entities of the group and the distributors, from commissionaires into limited risk distributors.

MNE's should, of course, take a close look at any existing commissionaire agreements in place today, to determine how those should be cancelled and replaced by the agreements that fit a limited risk distributor relationship, without additional tax cost. One important element here will be timing: contracts if they are to be 'at arm's length' cannot normally be cancelled and replaced by something else on very short notice. Independent parties would normally include penalty clauses for early termination of distribution agreements. So it might be better not to wait to see how the OECD plans to live up to (this aspect) of its anti-BEPS report and to start the contractual investigations now, to make sure that one is ready if needed. ■

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Malta: a cool climate that's hot on the quality-of-life index

It's official - Malta has the best climate on earth

Malta was one of two countries that were tied for first place with the title of Best Climate, according to the Quality of Life Index issued by the *International Living* magazine last year. Sharing top honours was Zimbabwe.

Yet a Mediterranean climate (over 5 hours of sunshine a day) isn't all that Malta has to offer. Malta's many other virtues in the 9 categories of the IL index combined to earn it 3rd place overall in the Index, pipped to the post by the US and New Zealand. That ranking speaks volumes for the size of Malta's quality offering relative to the island's land mass of just 122 square miles.

How about a stable government, economy and a modern health service? These factors carry a lot of pull for wealthy English and Europeans looking to get away from their frosty climes. In fact, frost and snow are unknown in Malta with shirt sleeve order and temperatures of 70 degrees Fahrenheit (21 degrees C) in November. Flights to many European capitals are just 3 hours away. Crime is low, education levels high, the locals hospitable and English-speaking with 48 English language schools. As a result, homes and apartments here have now attracted the international set. So has the historic harbours, 5-star hotels, restaurants and summer nightlife.

Night shot of Tas Sellum property with lights in the distance

The value of Portomaso property has risen by 300%. Might this reflect property expectations by overseas buyers for Tas Sellum and Ta' Monita residences, too?

Day shot of Portomaso

True recognition by the international property market. A whole clutch of awards for Best Marina Development was won by Portomaso in 1999, 2000, 2001 and Gold in 2005

But overseas domestic buyers aren't the only ones to recognise the reputation of the island's property potential. Malta's success in attracting City hedge fund managers to re-domicile to the island as a result of a well regulated and cost-competitive jurisdiction has spurred more demand for high quality homes in the sun.

Back in 2000, it wasn't like this. Sure, the island had a loyal following of repeat overseas visitors but nothing that one could call gold standard. Despite its geographic location and abundance of sun and sea, Malta's lifestyle as an up-market destination had little relevance for the aspiring overseas home buyer. That was until Portomaso was built.

George Fenech, the Tumas Group's Chairman, pioneered the lifestyle concept in Malta. He had a multi million Euro dream. He wanted to enhance the quality of life for those buyers who could make the right investment decision. His vision of the Portomaso marina would bring Malta to the attention of the international property market with an Oscar of the property world - Gold Award in the Best Marina Development Category in the 2005 International Property Awards. As a result, Portomaso was acclaimed the most exclusive address in Malta and became home to the well-heeled, international celebrities and footballers. Those that bought in 2000 have seen the value of their property rise by over 300%. Rental income has also risen, in many cases giving a return of up to 06%.

Out of the Portomaso mould have been cast two more luxury developments in the north and south of the island, both a stone's throw from the Med. They are already reaching completion, thanks to Tumas Developments, the Group's property arm. As both properties websites rather prosaically state, these two new residencies 'offer lifestyle choices of the highest standards'. More to the point, poured into these two moulds are all the expectations of luxury, safety, tranquility and, you've guessed it, lifestyle. Tas Sellum and Ta' Monita have been designed to suit most pockets. Tas-Sellum offers a one-bedroom apartment of 97 square meters starting at €199,000 going up to a million plus for larger apartments whilst Ta' Monita offers apartments starting at €98,000 going up to a million plus. Both residences are termed Specially Designated Area*, allowing the buyer to purchase more than one property in Malta and Gozo for private use or for business. ■

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** Special Designated Areas allow non-Maltese purchasers to buy property with the same rights as Maltese citizens. That means that one does not require a permit from the Maltese Government; one may purchase more than one property in the name of an individual/s, a Company or a Trust ; and one is permitted to rent out the property legally*

Ta Monita residence

City fund managers and international footballers also recognise the value of good property standards in Malta

The evolving business doctorate and how it can help businesses

Elliot Davis is a research associate with AACSB International's Research and Knowledge Services Group

Higher education has seen tumultuous changes over the past few years, particularly with the rise in prevalence of online learning and Massive Open Online Course offerings (MOOC), as well as the increasing globalization occurring at many institutions. Doctoral education, often the most steady of the degree programs, has not been unaffected by the many changes that are rampant in the industry. In fact, doctoral business education has reached a period of time where the future carries a great deal of both uncertainty and promise. This uncertain future may begin impacting businesses sooner than you might think, as the gap between industry and academia may be shrinking.

Research done at AACSB International (AACSB), the premiere accrediting body of business schools worldwide, is guided in part by the Committee on Issues in Management Education (CIME)—a committee of the AACSB Board who identifies and studies emerging issues and challenges in management education on a global basis. In response to the rapidly changing environment, CIME organized a task force to thoroughly research the current state of business doctoral education and to forecast what its future may hold. In their report, *The Promise of Business Doctoral Education: Setting the pace for innovation, sustainability, relevance, and quality* (released in September 2013), the task force outlined a series of challenges and recommendations, both for business schools and AACSB itself.

The task force has challenged business schools to experiment and innovate within their doctoral programs. This charge may lead to a closer connection between the business school and industry, through areas such as collaborative research, more applied curricular offerings in business doctoral degree programs, and the cultivation of industry partnerships, among others.

Joseph DiAngelo, 2012–2013 chair of AACSB's Board of Directors and dean of the Erivan K Haub School of Business at Saint Joseph's University (Philadelphia, PA, USA), writes in the report's foreword that the findings are intended to serve as a *"spark to ignite new energy focused on preserving the strengths of business doctoral education while enhancing its ability to serve management education and practice."*

Business schools and industry have a great deal to gain through collaboration, and these opportunities are emphasized in the report. There are many ways for doctoral programs to collaborate with industry, including joint research projects, partnership programs where PhD candidates provide consultancy services, opportunities for corporate members to be involved with the funding of doctoral students, or for corporate executives to be members in an institution's board or general governance. Some of the benefits therein may include access to the research that is applicable to certain gaps a business aims to fill, or even access to potential hires that have developed skills such as problem framing, research, and data analysis that are often sought after in industry circles in today's knowledge-driven society.

Business schools are also adapting to better serve the needs of industry. While many business schools remain traditional in their approach to doctoral education, with a large component of the program being constituted by full-time research conducted by the PhD candidate that is intended to contribute to the knowledge of business and management, some schools have emerged with alternative structures.

The growth in doctoral programs has led to an increasing amount of variety in the kinds of scholars it produces. But, it is still the creation and delivery of an original, substantive research contribution that remains the defining characteristic of most doctoral programs, according to the report. Yet, the way that this substantive research contribution is met by the PhD candidates has certainly seen changes, and part of that has to do with the research focus becoming more in tune with industry. This has been noted in the increasing amount of applied or translational research focuses, in contrast to the more dominant research focus that has a theoretical or experimental foundation, with an aim of acquiring new knowledge without any particular application or use in view.

Another development that has seen doctoral programs align themselves more closely with industry, which is quickly increasing in popularity, is the proliferation of the professionally-oriented doctorate. Generally, a professionally-oriented doctorate is pursued by business practitioners with significant work experience who will study

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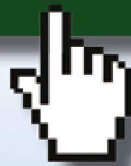

"Business schools and industry have a great deal to gain through collaboration, and these opportunities are emphasized in the report"

and work simultaneously while in the program. These programs often expect students' research to be relevant and applicable to the student's industry or workplace. Such programs represent one way that business doctorate programs may be better linked with the needs of industry, and where doctorate research may result in a direct impact on the student's business or industry.

The degree title of a professionally-oriented program may vary from program to program, region to region; however, most commonly result in a Doctor or Business Administration (DBA). Currently, the report notes the lack of consensus on which components of doctoral programs are necessary to the preparation of individuals for a career in academia versus a career in business.

The need for different kinds of doctorate programs varies widely, dependent upon the region. For instance, in Europe there is a growing need for professionally-oriented doctorate programs. However, even within this region, distinctions are handled differently dependent upon where in Europe the program is held.

The task force observed that for many business doctoral programs in some German-speaking countries, there is no distinction between schools that are either professionally oriented or academically oriented. Conversely, in the United Kingdom, individuals whose career intentions focus on the industry/professional side of the spectrum will pursue professional doctorates (DBA), which as mentioned above, are distinctive from traditional, academically-oriented doctorate programs, whereby the candidate continues to be employed with their company while completing the degree.

Additionally, there are also slight variations on the professional doctorate in the form of the industrial doctorate. The industrial doctorate is characterized by a close interaction with both the candidate, a company, and the university. This interaction is typically closer than for example a typical DBA program, wherein the candidate's continued employment may only imply collaboration between academy and industry.

Notably, Copenhagen Business School offers one of the oldest, most established Industrial PhD Programs in Denmark. Copenhagen's Industrial PhD program has *"achieved higher completion rates than a formerly offered, and now closed, professional doctorate program, and is growing in popularity."* The task force's findings show that there are still additional variants to achieving a doctorate degree in business, even at Copenhagen, as the Industrial PhD is but one of four unique routes to a PhD that a candidate can take– the remaining three are a research fellow, an independent PhD student, and a visiting PhD student.

Through the offering of flexible degree variants, such as professional and industrial doctorates, business doctorates will be better equipped to pursue a wide array of career paths. Further, the growth in applied research may also serve to assist industry in positive ways. This research, combined with collaborative research between companies and business schools, should provide positive returns for industry.

These many variants in doctoral degree programs serve a multitude of purposes, not the least of which is meeting the changing demands of businesses. Business doctoral programs and companies have many opportunities available for cooperation, and as business schools continue to evolve to better suit the needs of businesses, the uncertainty of the future may just become a little less daunting. ■

For more information, or to download a copy of The Promise of Business Doctoral Education report, please visit www.aacsb.edu/doctoraleducation

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MANAGING COMPLEXITY

AN IDEA WHOSE TIME HAS COME

Richard Straub explains why we now need to tackle the complexity of business

"Our world is increasingly subject to failures that require systems-level and cross-systems-level thinking and approaches. The consequences of any decision can ripple with unprecedented speed across business ecosystems the way the crisis has impacted nearly every market. For CEOs and their organisations, avoiding complexity is not an option – the choice comes in how they respond to it."

IBM CEO Study

"Capitalizing on Complexity"

We may have different visions about the future. Few, however, would doubt that the world has become more complex in recent decades and that it continues this journey at an accelerating and - for many of us - unsettling pace. With digitisation, the interconnectivity between people and things (software "talking" to software) has exploded. Dense, global networks now define the technical, social and economic landscape. This interconnectedness and interdependency brings about entirely new risks, as well as opportunities, at every level.

A scholarly interest in complexity, as a subject unto itself, began in earnest some 30 years ago. This was when, for example, researchers at the University of St Gallen in Switzerland developed a management model based on Systems Thinking. Popular literature propagated 'complexity theory' - in particular, the notion of the 'butterfly effect' by which a small event in a remote part of the world (such as the flap of a butterfly's wings) could trigger a chain of events that would add up to a huge disturbance in the larger system (such as a hurricane many thousands of miles away).

With this, managers' eyes were opened to the reality that organisations are not just complicated; they are complex. To be more precise, organisations are complex, adaptive systems because they are made up of humans with brains and, as such, possess learning capabilities.

Peter Senge's landmark 1990 book, *The Fifth Discipline: The Art & Practice of The Learning Organization*, showed the potential for organisations to enhance their learning capacity at a system level and to increase their nimbleness and competitiveness. Senge's bestseller resonated strongly around the world and unleashed a flurry of literature on what was described as a new kind of 'learning organisation'.

But, in reality, little changed.

This wave of interest in complexity thinking led to few actual new practices being adopted among corporations. Why?

There are, I think, five major reasons for the failure to affect management. At the same time, a deeper look at these impediments also suggests why this long-overdue shift may finally be poised to take place.

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[1] QS Global 200 Business Schools Report 2012
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"A complexity approach demands that competing values and priorities remain in view — and not just for the good of shareholders but for customers, employees and society at large"

It is hard for managers to think multi-dimensionally

Where complexity exists, managers have always created models and mechanisms that wish it away. It is much easier to make decisions with fewer variables and a seemingly straightforward understanding of cause-and-effect.

The notion of 'maximising shareholder value,' which determines so much corporate behaviour these days, is the perfect example. This school of thought provides clear-cut and 'simple' guidance to decision makers and relieves them of considering difficult trade-offs. We know, of course, that constantly dialling down investments to boost short-term profits or divesting assets to show a better return on assets (ROA) number often damages the long-term health of a company. Still, all too many executives play this game.

By contrast, a complexity approach demands that competing values and priorities remain in view - and not just for the good of shareholders but for customers, employees and society at large.

The good news is that the shareholder-is-all paradigm is showing increasing signs of strain. A growing chorus of thought leaders (including Roger Martin and Stephen Denning) and organisations (such as the Aspen Institute and Conscious Capitalism) are pushing back against the 'maximise shareholder value' school. And a growing number of companies - Unilever, Starbucks, Costco and Amazon come quickly to mind - are explicitly embracing a more complex orientation.

Until recently, technology was not powerful enough to capture much complexity

When systems thinkers and theorists turned their attention to the implications for organisations in the 1980s and 1990s, the tools simply did not exist to model their workings at a level that would yield practical insight.

Now, the exponential increase in computing power and the progress in mathematics and statistical analysis have propelled us into a new era. With the ability to draw on 'Big Data' and map networks at scales that were unthinkable only a decade or so ago, we can begin to understand communication flows through large organisations, as well as the impact of disturbances and managerial interventions on these flows.

What is more, the increasing ability of individuals and teams to connect through enterprise social media may lead, at last, to the widespread flowering of the learning organisation. By leveraging instant messaging, blogs, wikis and other platforms, more and more companies are creating living networks where knowledge is generated and then flows across organisational silos in unprecedented ways and at unprecedented speeds.

Too often in the past we have ignored the human element

Although it has taken time for the technology to emerge that is allowing us to better cope with complexity, many managers have been leery to even try because of a nagging concern: Might we reach a tipping point when human brainpower becomes obsolete? Might robots or computers, as Ray Kurzweil suggests, supplant the knowledge worker?

For many of us, this is a disturbing thought because we have seen so many of the models designed to predict the future state of complex systems (from economies to climates) fall far short of accuracy.

The eager futurists talking about machines taking over evaluation of situations and decision making have set back their own cause, as others see them ignoring an essential fact: sense-making is always informed by values. The idea that we might look for value judgments from algorithms is badly flawed if not downright dangerous.

Fortunately, there is a growing recognition that, while computers can provide our brains with enormous extensions of its storage and processing capacity, machines must remain only inputs to human reasoning.

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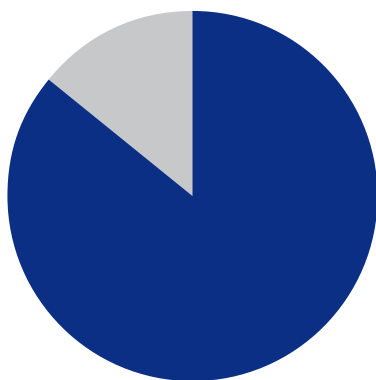
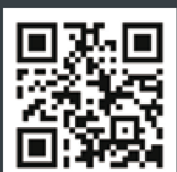


86% of Companies made back *at least* their investment in coaching.

Of the 86%, 28% saw an ROI of 10 to 49 times the investment and 19% saw an ROI of 50 times their investment.

Source: *2009 ICF Global Coaching Client Study*



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"The move from linear thinking to complexity is indeed a paradigm shift. It may be comparable with the move from Newton's physics to Einstein's"

It is in our minds - often in communication with other minds - where the ultimate evaluation and deliberation must continue to take place. The brain is the very best 'complexity processor' and itself our most complex organ.

For managers, new skills are becoming essential to manage all of this Big Data: to determine what the analytics should be solving, to decide what information is truly relevant to the enterprise and what simply constitutes 'noise,' and to make critical value judgments about privacy and security.

In the end, we are slowly recognising that technology alone cannot solve the knottiest problems in complex organisations. The machine must be in service to human beings - not the other way around.

We have confused the truly 'complex' with the merely 'complicated'

It is crucial that decision makers understand the difference between a complicated problem and a complex one because the two require different strategies and tools.

Sometimes a problem will morph from one state to the other - either from complicated to complex or vice versa - and so managers need to be ready to adapt their approaches accordingly. They are largely not interchangeable.

How are these concepts different?

In their 2011 *Harvard Business Review* article 'Learning to Live with Complexity,' Gokce Sargut and Rita Gunther McGrath offer this fundamental distinction: *"The main difference between complicated and complex systems is that with the former, one can usually predict outcomes by knowing the starting conditions. In a complex system, the same starting conditions can produce different outcomes, depending on interactions of the elements in the system".*

The move from linear thinking to complexity is indeed a paradigm shift. It may be comparable with the move from Newton's physics to Einstein's. Newton's laws did not disappear with Einstein's revolutionary discoveries but Einstein opened the door to an entirely new world - unseen before.

In this sense, complexity must become our worldview - a basic mindset guiding us in our assessments of situations and decisions. It should make us more humble and more alert. It should open our minds. It should spur an awareness that too often our linear interventions do not achieve what we want, and may even result in unintended consequences.

We have much more work to do to understand the difference between the complicated and the complex. But we are at least beginning to create a common language around these ideas.

Many managers have not found 'the innovation fulcrum'

In their quest for double-digit growth in single- digit markets, many companies are finding themselves in an almost unmanageable state of complexity - one that they often do not realise is of their own making.

This 'Complexity Crisis,' as John Marotti calls it in his book of the same name, is caused by a runaway proliferation of products, customers, markets, suppliers, services and locations. All of these add costs, which go untracked by even the best of modern accounting systems. Complexity also tends to fragment management focus. The Complexity Crisis thus becomes a hidden profit drain for many companies today and it remains under the radar screen of those who cause it.

As bad as this situation is for business, it might be even worse for government. In a number of European countries, including Austria, Belgium and France, the government's share of GDP now exceeds 50%. And this does not include the hidden costs to the private sector that are imposed by any bloated public administration, with its flawed regulations and convoluted tax systems.

In their 2005 *Harvard Business Review* article 'Innovation Versus Complexity: What Is Too Much of a Good Thing?' Mark Gottfredson and Keith Aspinall explain that organisations must decide how much innovation is appropriate before it leads to needless, or even damaging, complexity. The goal is for managers to find 'the innovation fulcrum' — the pivot point where innovation suddenly tips over into complexity.

The authors put it as follows: *"The pursuit of innovation can be taken too far. As a company increases the pace of innovation, its profitability often begins to stagnate or even erode. The reason can be summed up in one word: complexity. The continual launch of new products and line extensions adds complexity throughout a company's operations, and, as the costs of managing that complexity multiply, margins shrink".*

Peter Drucker recognised the same phenomenon. In his classic 1963 *Harvard Business Review* article 'Managing for Business Effectiveness,' he asserted that clarity of focus is critical in allocating resources, which is the essential job of management. The hard part of innovation is sorting out which ideas should make the cut - and which should be abandoned.

Not everyone, thankfully, is failing in this exercise. Stripping out unnecessary complexity from products and services - and targeting them to specific customer needs (including affordability) - has become a major movement in emerging markets. So-called 'frugal innovation' has led to stunning results in fields such as mobile devices and medical equipment.

Some of these products, having proven themselves, are now being shipped to more developed markets. This "reverse innovation" may well show us the way to a better future.

The awareness of the complexity challenge among managers has increased significantly during the past 10 years. Tools and techniques to better understand and help navigate complex systems have reached a state of operational readiness. Good thinking about ways to navigate or even embrace complexity is now available.

Yet most management practices are still anchored in the pre-complexity world. The pioneers who not only preach but also apply new complexity- tested management methods and tools such as Fredmund Malik, a pioneer of Cybernetics-based management and the Scrum Alliance in the field of complex projects are the exception rather than the rule.

For years, Gary Hamel has been the most vocal proponent of a new management paradigm. In his *Harvard Business Review* article 'Moon Shots for Management,' he and a group of prominent thinkers and business leaders (including the late CK Prahalad, Julian Birkinshaw, Tim Brown, Yves Doz, Henry Mintzberg, Vineet Nayar and Peter Senge) jointly define a set of grand challenges to move management out of its bureaucratic and hierarchical ghetto.

Were Drucker still alive, I assume he would have added his voice as well, for his foundational ideas and ideals are in line with most of the specific solutions posited in the piece: offering more autonomy to knowledge workers, seeing leaders play more of an enabling role, fostering trust throughout the organisation, achieving clarity of focus and direction of the organisation, providing a diversity of views, unleashing the human imagination and cultivating systems-thinking skills.

"Stripping out unnecessary complexity from products and services has become a major movement in emerging markets – so-called 'frugal innovation' has led to stunning results in fields such as mobile devices and medical equipment"

With the implementation of these principles, organisations can finally evolve from complicated entities, marked by clearly defined functional borderlines, towards adaptive complex learning systems.

But achieving such a 'managerial moon shot' will not be easy; as far as we've come, it still requires a huge earthly effort from all of us. ■

The 5th Global Drucker Forum 2013 will be held on Thursday 14 and Friday 15 November 2013. The theme for this year's Drucker Forum is 'Managing Complexity'. For more information visit http://www.druckerforum.org/

ABOUT THE AUTHOR

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50%

"In a number of European countries, including Austria, Belgium and France, the government's share of GDP now exceeds 50%, and this does not include the hidden costs to the private sector that are imposed by any bloated public administration, with its flawed regulations and convoluted tax systems"

How an executive MBA education can foster responsible leadership

Daniel Weninger, Theologian and Entrepreneur, is an MBA-Alumnus of WHU – Otto Beisheim School of Management. He is responsible for the leadership development and personal growth activities at WHU's different MBA programs.

In recent years, managers have been heavily criticized. Disasters such as the Enron scandal in 2001, the financial and economic crisis in 2008 or the BP Deep Water Horizon catastrophe in 2010 led to the public perception of selfish, greedy and irresponsible managers.

Business schools have been blamed for being part of the problem. Sumantra Ghoshal (1948–2004), Management Professor at London Business School, stated: *"Many of the worst excesses of recent management practices have their roots in a set of ideas that have emerged from business school academics over the last 30 years."* (Ghoshal, 2005)

The good news is: a couple of things changed. In academia, a new discussion about 'Responsible Leadership' arose. Schools started to rethink their curricula and put more emphasis on ethics and values. For example, Harvard Business School conducted a large-scale research project in order to redesign its MBA program. The results have been published in the book *Rethinking the MBA*. The insights sound easy: apart from the 'knowing' part, the 'doing' and 'being' part needs to be emphasized in future management education. B-Schools are by nature academic institutions and tend to be more focused on delivering business know-how. But how can a school train students to develop true implementation and leadership skills (the doing)? How can students internalize principles of responsible leadership and have a clear set of morally accepted values (the being)? The answers to those questions will shape future business education. And those answers are increasingly important to graduate students.

Interestingly, potential MBA-students stress the importance of personal growth and leadership development. No longer do they only want to gain business know-how. They have also high expectations to be shaped with regards to their 'doing' and 'being'. In an increasingly complex world senior executives sense that being a good executive needs much more than business administration know-how. He needs integrity. He needs character. He needs a clear sense for his own purpose in life. He needs a clear set of guiding principles. To be a responsible leader means to be a successful leader with regards to knowing, doing, and being.

Of course, an executive does not necessarily need an MBA to be a responsible leader.

An executive MBA program can be very helpful, though. Many executives get caught in their company culture, meetings with clients, customer calls – the urgent things of daily operations. There is only little room for inspirational talk, fresh insights or academic exposure. Without a structured framework, many executives simply won't have the time to think about the deep stuff and their personal leadership development. A structured executive MBA program can provide such a framework and 'force' somebody to escape for a limited amount of time from the corporate machinery and daily routine.

At the Kellogg-WHU Executive MBA Program, we are very proud to be one of the leading Executive MBA Programs in the world. Hence, it is not surprising that we deliver first-class business know-how by our excellent, internationally recognized faculty which is acknowledged in the different top rankings. But what are we offering with regards to the 'doing' and 'being' part?

First, we give students the space to reflect. During the EMBA introduction week on campus, the students get many classes and 'knowing' inputs. But they are also invited to reflect. This invitation contains a set of guiding question regarding their learning goals, practical tools such as a special notebook, a personality profile with follow up coaching – and a calm environment. Executives love to come to Vallendar, which is located in a rural area one hour from Frankfurt Airport. Students find there a framework, which allows them to focus on personal leadership development.

Second, we give students substantial challenges. In teams comprised of peers from very diverse and international backgrounds, EMBA students will need to develop emotional intelligence in order to utilize their team resources and be able to accomplish a given task within a limited time. *"This strong emphasis on breakout session, group assignments and team activities proved to be extremely powerful to develop students' doing skills"*, says Prof. Juergen Weigand, Academic Director of the two year Executive MBA Program.

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"It is one of our core convictions that successful leaders are self-reflective leaders"

Individual coaching as part of the curriculum: scrutinizing oneself from inside out supports executives during a formal personal development process

To be a responsible leader means to be a successful leader with regards to knowing, doing, and being

The teams do not only have to tackle business challenges. During an outdoor event with a former army general, groups have to build bridges and complete other tasks, which allow them to apply their 'doing' skills. Time is very limited during an executive MBA-Program. But with selected activities high impact in the 'doing' can be achieved.

Third, we ensure students get feedback from as many angles as possible. Part of the process is a formal 360 degree session , including feedback from team members andexternal peers. Executive coaches help to synthesize the different feedback perspectives, to better understand own personality traits and motives and to extract the next steps for the personal and professional development journey. The being part is the hardest part, students need to be willing to open up, which is sometimes more challenging than solving a business case.

But do all these components really help to develop more responsible leaders? The answer is, as often in business: it depends. Harvard Professor Clayton Christensen ones said: *"I worry that someone on the outside can't retrofit people with a different heart"*. A school can only provide the framework and the content, but cannot force somebody to internalize certain principles. A school can only deliver ideas and bring people together, but can't simply change ones doing or being. However, it is worth a try. In the long run, education has a lasting impact. And looking at our graduates we can definitely say: the results look promising. ■

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IN THE WORLD FOR THE PAST FOUR YEARS

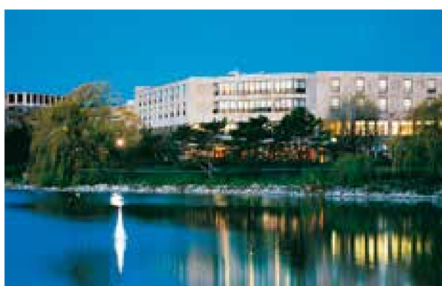
Source: 2009-2012 EMBA Survey by Financial Times

The Kellogg-HKUST EMBA program stands in a class of its own — the World Class. We create a unique and truly exceptional environment, in which top-notch professors from the world's leading business schools share their insights with an elite group of executive participants. The outcome is inevitably a fusion of energy, brilliance, and determination that can carry today's top business executives to new levels of leadership and influence. Each year, our six strategic global locations become home to students who have already proven themselves in their chosen fields of business endeavour. Typically, these participants are looking to be challenged further, and to interact with like-minded individuals from around the globe who share their business ambitions and their appetite for success. Since first being placed amongst the world's top EMBA programs by the *Financial Times* in 2003, the Kellogg-HKUST EMBA program has been ranked the world's No. 1 EMBA program five times in six years. Are you already standing on the heights of business achievement in your field? Then, consider taking the ultimate step to the peak… by joining the World Class.

"The outstanding faculty and seasoned participants back up the Kellogg-HKUST EMBA program's reputation. The program's structure with two consecutive weekends a month allowed me to concentrate on my work in Helsinki while pursuing the degree in Hong Kong. I have done my research and find no other program has such diverse, senior and seasoned executives! If you take an EMBA, take the best one as you take only one EMBA in your life time!"

Tomi Erkkilä (Class of 2009-2010)

Pinnacle of Power - The Kellogg-HKUST EMBA program brings together leaders in a truly remarkable intellectual quest that is designed to make a difference, and to leave a mark. Our dynamic interaction of faculty and class members has inspired generations of brilliant business minds, men and women who have gone on to shape the business landscape of whole industries and entire countries around the globe. Teaching is intellectually rigorous and deeply tuned to the political and economic realities of today, designed to open up previously unexplored routes to success. But the program goes far beyond the accumulation of knowledge. We create an environment that demands deep thinking, but also one which fosters empowerment and networking at both personal and industry levels. World-embracing and personally enriching, the Kellogg-HKUST EMBA program brings together the elite from five continents and gives them all they need to shape unique futures for themselves and the world they influence. ■



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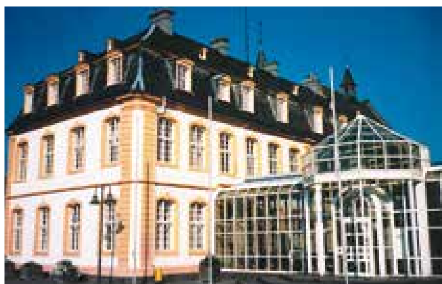

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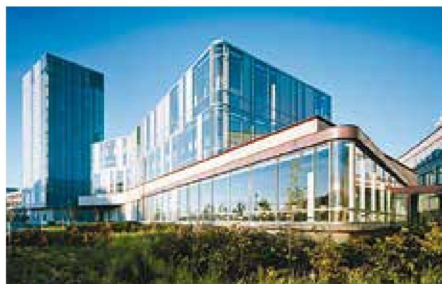

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Developing human capital through coaching

When asked to identify their top concern for the year 2013, the 729 CEOs, presidents and chairmen from around the world who responded to *The Conference Board's 2013 CEO Challenge Survey* put human capital at the top of their list. In today's dynamic business environment, talent management is no longer just about hiring and firing: success is contingent upon attracting top leaders to your organization, cultivating engagement and loyalty, and providing the training necessary to develop talent and promote from within. For a growing number of organizations, coaching is the linchpin of fruitful talent-development plans.

The International Coach Federation (ICF) defines coaching as partnering with clients in a thought-provoking and creative process that inspires them to maximize their personal and professional potential. According to the *2009 ICF Global Coaching Client Study*, the top two motivations for clients seeking coaching services were self-esteem/self-confidence (cited by 79 percent of clients as very or somewhat important) and work/life balance (76 percent). Other examples of reasons to pursue coaching include:

- Something urgent, compelling or exciting is at stake (a challenge, stretch goal or opportunity).
- A gap exists in knowledge, skills, confidence or resources.
- The client has a desire to accelerate results.
- There is a lack of clarity regarding choices to be made.
- Success has started to become problematic.
- Core strengths need to be identified, along with how best to leverage them.

ICF industry research has shown that organizations are successfully adopting coaching to achieve their human capital goals and respond to challenges. In July 2013, the ICF released findings from the *2013 ICF Organizational Coaching Study*, which was undertaken to provide businesses, coaches, stakeholders and the general public with new information and insights about the status, value, effectiveness and impact of professional coaching. The study reinforced what prior ICF research has shown: for organizations of all sizes and in all sectors, coaching works.

Engaging your talent

Coaching is an investment in your organization's talent and, as such, it can be a powerful tool in recruiting and retaining staff. In an era of low worker engagement - consider recent findings from the polling firm Gallup revealing that 70 percent of US workers are disengaged, and Aon Hewitt's *2013 Trends in Global Employee Engagement* report, which indicates that 40 percent of workers worldwide are passive or actively disengaged - coaching is also a powerful tool to promote engagement.

Roche Turkey, a subsidiary of Roche Group, a multi-national pharmaceutical company, has experienced firsthand the positive impact of coaching on employee engagement. In 2009, a human resources audit revealed 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 professional coaching at a time when it was still considered a relatively new tool for corporate development.

Roche Turkey coached high-potential leaders to become internal coaches, and then offered another 45 high-potential employees 12 coaching sessions with an internal or an external coach. *"What makes our coaching initiative unique is twofold: the coaching process in Roche Turkey involves the total life of the coachee - it is for both personal and professional development. The process is completely driven by coachees and*

Coaching at Roche Turkey led to an 11 percent increase in employee engagement

their development needs," says Berrin Yılmaz, head of human resources at Roche Turkey.

The organization dramatically increased employee engagement from 55 percent to 66 percent; expanded its talent pool by 22 percent; developed its leadership talent and enhanced internal promotions and international assignments. Roche Turkey employees report using coaching skills in daily business dealings, and the HR consulting firm initially charged with evaluating the organization has found employees to be more open and trusting since the coaching initiative went into effect. Employee turnover has also decreased.

As a result of the coaching initiative, Roche Turkey has been rated as a 'high-performing' company rather than being in the 'indifferent' zone in terms of engagement, and other companies in Turkey have inquired about how they too can create a coaching culture. In 2012, the organization was awarded an International Prism Award by the International Coach Federation, an honour bestowed upon organizations that have achieved a standard of excellence in the implementation of coaching programs for culture change, leadership development, performance improvement and productivity.

Coaching also boosts many of the indicators associated with employee engagement. According to the 2009 *ICF Global Coaching Client Study*, 70 percent of clients reported a positive improvement in work performance. The same study showed that coaching improved clients' ability to achieve work-life balance by 67 percent.

Improving a company's overall culture can help positively impact employee engagement, and coaching plays a role here too: In the *ICF Global Coaching Client Study*, 72 percent of clients who identified a change in corporate culture as one of their goals for the coaching interaction experienced positive change, while 20 percent of respondents identified culture change as an unanticipated but positive side benefit.

Boosting productivity

In addition to increasing engagement, coaching can contribute to improved productivity, more-effective team interactions and increased creativity within your organization. These were just a few of the changes that came to fruition at the United Nations Secretariat, another 2012 Prism Award winner, when coaching was woven into the organization's longstanding talent-development program.

Training and leadership development have long been institutional priorities for the UN Secretariat, with managers enrolling in the organization's Management Development Program (MDP). In 2009, the UN Secretariat initiated a review and revision of the MDP, contracting the consulting firm EnCompass LLC to oversee implementation. According to Maria Hutchinson, Chief of the Learning, Leadership and Organizational Development Section, Office of Human Resources Management, for the UN Secretariat, *"As we reviewed feedback from previous MDP participants, several people indicated that they felt coaching would assist them in applying the new management approaches we were teaching [in the classroom]."* As a result, EnCompass positioned coaching at the centre of the reconceived MDP.

"In addition to increasing engagement, coaching can contribute to improved productivity, more-effective team interactions and increased creativity within your organization"

When a manager enrols in the MDP, he or she participates in a 360-degree feedback assessment and uses the results to develop a personalized list of goals, as well as an action plan for achieving them. Bookending the MDP are two intensive, residential workshops totalling six days in length. During the months between the two workshops, MDP participants commit to a four-hour engagement with a professional coach. According to Jeri Darling, president, Darling Global, LLC, and former vice president of leadership and organizational effectiveness for EnCompass, coaching has increased the training program's efficacy by providing participants the opportunity to put classroom learning into practice and to set and pursue professional and personal development goals in a structured setting.

Since the MDP's re-launch, more than 1,300 UN Secretariat employees have received coaching. The organization reports an 87.6 percent return on its investment in coaching - a $1.88 return for every dollar spent.

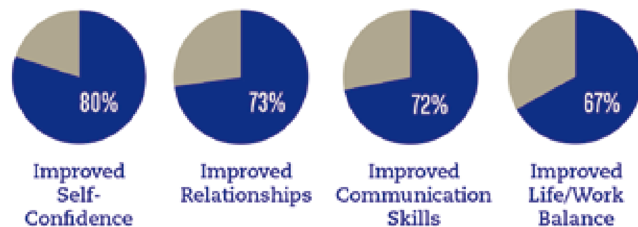
Feedback from MDP participants and coaches shows that the 360-degree assessment process, classroom training sessions and coaching are impacting individual and organizational performance at the UN Secretariat. Hutchinson says the MDP has made employees more aware of their own capacity for productivity. MDP participants have also experienced improved self-confidence, interpersonal skills, communication skills, team effectiveness and time

The United Nations Secretariat has reported an 87.6 percent return on its investment in coaching

Increased Productivity*

According to the *2009 ICF Global Coaching Client Study*, coaching clients see improvements in a number of indicators that contribute to productivity

Positive People*



ICF research shows that coaching can yield a more positive and empowered work force for your organization

management. These improvements are consistent with ICF findings on the benefits of coaching. In the *ICF Global Coaching Client Study*, 80 percent of coaching clients reported improved self-confidence. In the same study, clients reported improved interpersonal relationships (73 percent), communication skills (72 percent), team effectiveness (51 percent) and time management (57 percent).

The UN Secretariat has not been immune to the consequences of the global economic crisis. However, so far the organization has been able to safeguard its commitment to management development and coaching. In fact, coaching has spread within the organization. Hutchinson has turned over leadership of the MDP to Staff Development Officer Carina Stern, and she now directly oversees only the Leadership Development Program for top officials within the organization.

LDP participants are asked to commit to five hours of coaching in the midst of their training. Coaching skills have also been integrated into a supervisor-skills training program within the organization. What's more, leaders at all levels of the organization take what they learn from coaching back to their teams, helping to develop visionary leaders well-equipped to achieve personal and organizational goals.

Reaping the rewards

Coaching clients provide overwhelmingly positive feedback of the experience. A whopping 99 percent of respondents to the *ICF Global Coaching Client Study* reported being 'somewhat' or 'very satisfied' with the coaching experience, and 96 percent indicated that they would repeat the process given the same circumstances that first prompted them to seek coaching.

What's more, coaching is a worthwhile investment in an organization's future. Eighty-six percent of companies participating in the *ICF Global Coaching Client Study* say they at least made their investment in coaching back, while 19 percent reported an ROI of 50 times their investment and 28 percent reported an ROI of 10 to 49 times their investment.

Finding a coach

Hiring a coach is a significant investment of both time and money, so an important first step is to determine whether your organization is ready to commit to coaching at this time. Educate yourself and your colleagues about coaching. The ICF Research Portal (Coachfederation.org/portal) hosts industry research, case studies and peer-reviewed scholarly articles, and is an excellent starting point for your research process. In addition to providing a clearer picture of what coaching entails, your research should help you clarify your objectives for the coaching engagement.

Interview three coaches before you decide on one, asking for at least two references from each. Because the coach-client relationship is so important, use the interview to assess the connection you feel with each candidate. The value of good chemistry between coach and client can't be overstated.

The ICF also recommends asking the following questions of a prospective coach:

- What is your coaching experience (number of individuals coached, years of experience, types of coaching situations, etc.)?
- What is your coach-specific training (an ICF-approved training program, other coach-specific training, etc.)?
- What is your coaching specialty or areas in which you

most often work?

- What types of businesses do you work with most often? At what levels (executives, upper management, middle management, etc.)?
- What is your coaching philosophy?
- What types of assessments are you certified to deliver?
- What are some of your coaching success stories (ie, specific examples of individuals or organizations who have succeeded as a result of coaching)?
- Are you an ICF member? Do you hold an ICF Credential?

The ICF's membership eligibility requirements empower coaching consumers to make an informed purchasing decision. All ICF members are required to commit to coach-specific training, and they must pledge to uphold ICF's code of ethics. As a result, consumers can have confidence that ICF member coaches are well-trained and well-prepared to offer their services.

Possession of an ICF Credential further signals a coach's dedication to education and continuous professional development. More than 10,000 individuals hold an ICF Credential, distinguishing them as consummate professionals who have fulfilled stringent education and experience requirements, including completing coach-specific training, logging a set number of experience hours, and partnering with a mentor coach.

According to the *2010 ICF Global Consumer Awareness Study*, clients who partner with ICF-Credentialed coaches are more likely to be satisfied with their coaching experience and more likely to recommend coaching to others. You can begin the search for an ICF-Credentialed coach with the ICF Coach Referral Service (Coachfederation.org/crs), a free, searchable online directory of all ICF Credential-holders. ■

Cayman's role in the aircraft industry as a significant international financial services centre

Sherice Arman, an attorney in Maples and Calder's Cayman Islands office, is writing on behalf of the Civil Aviation Authority of the Cayman Islands (CAACI)

In today's world, where the time value of money is critical, many more companies and individuals are opting to acquire private aircraft. The choice of a jurisdiction for registration of such aircraft becomes crucial to the process and is influenced by many factors. Each owner, operator and financier has different requirements and driving forces.

Some of the key factors which influence owners, operators and lenders when choosing a jurisdiction for registration of aircraft are tax efficiency, confidentiality, security, internationally recognized standards of regulation, commitment to superior service levels by regulatory staff, international reputation of the register, neutrality and/or anonymity of the registration prefix, professionals within the industry with expertise in the aviation industry, stable legal, political and economic environment and certainty with respect to regime for enforcement of mortgages.

The Cayman Islands is an English speaking overseas territory of the United Kingdom. As an overseas territory of the UK, the Cayman Islands benefits from a high level of political, social, economic and judicial stability, whilst at the same time, exercising a high degree of autonomy, having been a stable parliamentary democracy since 1831. The Cayman Islands' legal system is based on English common law, with the Privy Council in England being the jurisdiction's final court of appeal. This provides an added degree of comfort to international lenders, owners and operators of aircraft.

The Cayman Islands is well known in the industry as a tax neutral jurisdiction and, as such, the purchase, sale or lease of an aircraft in the Cayman Islands or of aircraft registered in the Cayman Islands does not give rise to tax consequences in this jurisdiction. This means that there is no income tax, sales tax, capital gains tax, profit tax, use tax or tax on lease payments are imposed by or in the Cayman Islands. In addition, its internationally well respected financial services industry also provides owners, operators and lenders with access to a full range of services, including banking facilities and legal expertise, to set up and administer sophisticated structures for ownership and leasing purposes.

The Cayman Islands follows international regulatory and safety standards for air transportation. The regulatory obligations for effective safety oversight exercised by CAACI is based on the Convention on Aviation signed in Chicago in 1944 by member states (the UK is the signatory) of the International Civil Aviation Organization, an agency of the United Nations. The Convention puts in place a commitment

"At a time when so many jurisdictions are competing for business, Cayman continues to set itself apart by concentrating on quality service and attention to owners, operators and lenders"

to foster the growth and safety of international air transportation through compliance with common Standards and Recommended Practices.

Although the Cayman Islands typically accepts only aircraft operated in the 'private category', it is entirely possible to register any type of parked aircraft on the Cayman Islands Register of Aircraft (eg. during the period of fit out) thereby allowing a financier the benefit of registration of a Cayman Islands registered mortgage, after which the aircraft may be registered on another register when it is ready for commercial operation.

In order to complete registration, an aircraft must first be inspected for airworthiness, however, this can be done wherever the aircraft is located and a certificate of airworthiness is then issued once the aircraft satisfies the necessary requirements. The aircraft is given a registration number which is prefixed by 'VP-C' and followed by two additional unique identification letters. The VP-C registration is generally accepted internationally as being politically neutral and therefore offers owners some additional level of anonymity.

The CAACI has regulatory oversight of the Register and it has developed a reputation amongst many owners, operators and lenders for providing a safe, stable and well respected flag for registration of an aircraft. Although it demands the highest standards from its owners and operators, the CAACI also holds itself to these same standards by offering responsive and efficient service to the industry. This has enabled it to enjoy a place of recognition within the aviation industry internationally. The CAACI is known for quality and not necessarily quantity, especially given its selective process with respect to acceptance of aircraft on the Register.

As further evidence of its commitment to efficient customer service, the CAACI has introduced a new online electronic data management functionality called VP-C Online which allows it to further improve its already outstanding service levels. With the new system the CAACI can manage documentation online through a secure portal. This means that it can accept registration applications and issue certificates and authorisations online, even outside of office hours. The new online capability offers owners and operators real-time access to registration documentation, certificates and survey information online.

Cayman Islands mortgage registration

The Cayman Islands Mortgage Register for aircraft offers a secure mortgage register to financiers with a system of enforcement based on the English legal system. The CAACI, maintains a Mortgages Register pursuant to the Mortgaging of Aircraft Regulations 1979. Registration of a mortgage in the Mortgages Register offers a system for obtaining priority for a security interest in an aircraft and protection from deregistration of an aircraft without the registered mortgagee's consent. Under Cayman Islands law, a mortgage over an aircraft includes the aircraft itself and the store of any spare parts.

Registration of the mortgage over an aircraft, can't take effect until the aircraft is registered, but a mortgagee may secure its interest prior to registration of the aircraft by registering a priority notice prior to the registration of the aircraft. The effect of registration of a priority notice is that it prevents any other security interests over the aircraft being registered in advance of registration of the mortgage, which is protected by the priority notice during the effective period of the priority notice.

Where such a notice has been entered in the Mortgages Register and the contemplated mortgage is then made and registered within 14 days after entry of the priority notice, the mortgage will be deemed to have priority from the date that the priority notice was registered.

There is no specified form of mortgage over a registered aircraft and, although not a requirement, the mortgage may be registered. As with registered mortgages, priority arises from date of registration. The registration of a priority notice gives the lender or prospective lender priority from the date of registration of the notice. A lender's rights under any registered mortgage will not be affected by the aircraft's removal from the Mortgages Register.

At a time when so many jurisdictions are competing for business, the Cayman Islands continues to set itself apart by concentrating on quality service and attention to owners, operators and lenders, rather than simply on growing numbers of aircraft on its Register. It does so by identifying and solving issues of its owners, operators and lenders. It remains committed to ensuring that the Cayman Islands experience is in keeping with the standards that the industry has come to expect from this jurisdiction. ■

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ABOUT THE AUTHOR

Sherice Arman is Of Counsel at Maples and Calder and has over 14 years of experience in the area of corporate and commercial law. Her practice areas include banking and asset finance and corporate finance. She is recognised as an industry leader in the field of ship and aircraft finance in the Cayman Islands and is often called upon by the Cayman Islands Shipping Registry and the Civil Aviation Authority of the Cayman Islands for collaboration and guidance.

Sherice is ranked in a number of legal directories, including PLC Which Lawyer?, Legal 500, IFLR 1000 and Chambers and Partners.

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