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CHINA AND THE WORLD ECONOMY

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Q&A WITH AMBER KELLEHER-ANDREWS, CEO OF KELLEHER INTERNATIONAL

JOSÉ MANUEL BARROSO ON LEAVING A UNITED, OPEN AND STRONGER EUROPE

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Is the eurozone saved?

With Portugal, Ireland and Spain announcing that they no longer need a bailout from the International Monetary Fund or the eurozone's rescue mechanism, the question is whether the euro area's financial problems are history? Institutional investors and hedge funds are not dumping eurozone assets and think the risk of the likes of Ireland or Spain going bust, or the eurozone falling apart is unlikely. So are things OK with the eurozone?

Well not for the almost 12% of eurozone citizens who are unemployed, given that the rate is set to fall only marginally in the coming 18 months (according to the OECD's new forecast) to a still-high 11.4% in 2015. What still appears seriously wrong in the euro area is that meaningful economic growth remains elusive. The OECD forecasts growth of GDP in the eurozone of just 1.2% in the current year - which compares with a forecast of 2.6% for the US and could turn out to be a third of the rate at which the UK economy may grow this year. Even by 2015, the OECD expects the euro area to be growing at just 1.7%, more than two percentage points less than the speed at which it expects the global economy to expand.

Thanks to the European Central Bank's repeated promises to take measures to prevent eurozone Armageddon, there is a good deal more financial stability in the eurozone, but that stability should not be taken for granted.

The immediate risk is of substantial political turmoil. All over the eurozone the sense among citizens that their leaders are not delivering prosperity has seen a dramatic rise in the popularity of eurosceptic parties of left and right. The Front National won the French elections with calls for an immediate restoration of the franc and a referendum on Frexit. The Franco-German axis that has held the project together for 50 years is in danger of breaking down.

Launching the euro before the EMU states were ready for monetary union, and then letting the North-South chasm widen each year, has meant that the eurozone has become an area of low growth and mass unemployment. Current policies mean there is no way out of this.

If the eurozone's electorate becomes even more disenchanted with the region's integrationist elite, it will become much harder for the currency union to adopt reforms widely regarded as necessary to stave off future disaster. There has been plenty of hardship for citizens of those countries where current account and trade deficits became unsupportable and government debts spiralled out of control.

As yet, there has been little of the political integration among member countries to prevent these sorts of dangerous imbalances reoccurring: there is very little direct central control on the spending, taxing and borrowing of eurozone members.

And although new institutions have been created to provide succour to eurozone governments and banks, the resources available to them are limited - largely because the solidarity of deep-pocketed Germans with the rest of the euro area remains minimal. The common funds for rescuing banks are trivial compared to potential long-term needs. And the cost of insuring the deposits of eurozone banks continues to fall on individual governments - which mean that in any future market crash, the finances of a weak government and its weak banks will remain lethally inter-connected.

Goldman Sachs recently published a report and concluded *"Whether the changes that are being implemented will make the euro area's institutional structure sufficiently robust to deal with a future crisis is questionable."* In other words, if the eurozone's leaders don't use the current financial calm to push through a harder and more controversial political overhaul - which would inevitably see power shift from nations to the centre - then we may not have to wait many years to revisit potential euro catastrophe. ■

PHOENIX MULTIMEDIA
NR35 1PU
United Kingdom

www.worldcommercereview.com

Tel: +44 (0)1986 892028

Email: info@worldcommercereview.com

PUBLISHERS
Tom Forster
Roy Williams

MANAGING EDITOR
Tom Forster

EDITORIAL
Tom Page

PRODUCTION
Michael Day

CIRCULATION
Andrew Kilby

SALES DIRECTOR
David Thompson

SALES TEAM
David Warmann
Phil Shaw
David Goldwin

DESIGN AND PRODUCTION
West Riding Media Solutions

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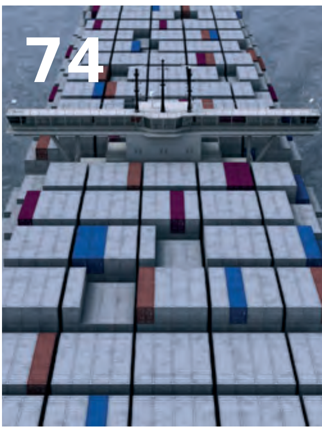

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A united, open and stronger Europe

José Manuel Barroso is President of the European Commission

"When you find yourself in a storm, the only way out is to stay true to your course. The one thing you don't do is change direction."

(Jean Monnet)

Europe has witnessed an unprecedented period of change in the five years since this European Commission took office. The financial crisis evolved into a sovereign debt crisis, an economic crisis and a social crisis, tearing down barriers between European and national politics.

In this time of change, business as usual was no longer an option. If the five years before the start of this Commission were defined by constitutional issues that were formally settled by the introduction of the Lisbon Treaty, then these five years have been shaped by the threat of the financial and sovereign debt crisis. In the face of these challenges, we can all be extremely proud that we have kept Europe united, open and made it stronger for the future.

'United', because we managed to keep Europe together and even enlarge it despite the pressures exerted on our countries; 'open', because we engaged with our international partners through the G20 to define a global response, we kept promoting trade within the European Union and across the world as a means of growth, and we maintained our commitments to developing countries; 'stronger', because the necessary economic reforms are now being implemented across Europe and our economic governance has been reinforced, in particular in the Euro area, to make Europe's economies fitter for globalisation.

In doing so, we have built on what is unique about the European Union. Europe is about values. Values like peace, our founding principle, for which we were awarded the 2012 Nobel Peace Prize. Values like unity and diversity, a source of strength to be treasured. Values like solidarity, with our social market economy and our protection of Europeans less fortunate. These values have guided our work. The EU is more than an economic project. It is a political one. It is a community of culture and of shared values and interests essential to forge a common destiny.

Responding to the economic crisis and preparing the conditions for sustainable growth and jobs

The European Commission has worked tirelessly to avoid a collapse of Europe's economies. The lack of regulation and oversight of the financial markets allowed speculation and credit bubbles to emerge. The subsequent aftershock revealed that many of Europe's member states were living beyond their means and lacked competitiveness. And whilst our economies were deeply interdependent, we lacked the strong governance framework to prevent unsound policies or to handle the crisis when it hit. Over the past 5 years, the Commission has been a driving force behind the initiatives to put this right.

Today, Europe is protecting citizens and taxpayers through necessary stronger regulation that guarantees savings, makes banks more responsible and limits bankers' risk-taking. We brought fairness back into the system. And we have taken the decisive step – unthinkable before the crisis – to create a Banking Union. As a result, the financial sector is now more regulated; and financial regulators are now better equipped to supervise our banks; to deal with difficult economic developments; and to protect your savings.

We have put in place a system of collective economic and budgetary governance at EU level that ensures that all governments put and keep their public finances in order and that the necessary reforms are undertaken to make and keep our economies competitive. We have come together to create a mechanism that provides loans to those countries that are under most pressure from the markets. The euro has come out of this crisis even stronger, gaining rather than losing members. We have used all the means at our disposal to keep people in jobs and help those out of work to get back into the labour market, giving special attention to the acute problem of youth unemployment.

We have agreed a new EU budget which focuses on investments that help member states, regions, companies and people. And to boost growth and create jobs further, we have opened up new markets across our continent by further developing the Single Market and defending its four freedoms, and across the world by pursuing ambitious global trade deals.

Beyond the immediate crisis management, we have developed a long term plan to modernise Europe's economies. Our Europe 2020 strategy sets realistic but ambitious targets to return Europe to smart, sustainable and inclusive growth. The new EU budget seeks to enhance competitiveness through greater

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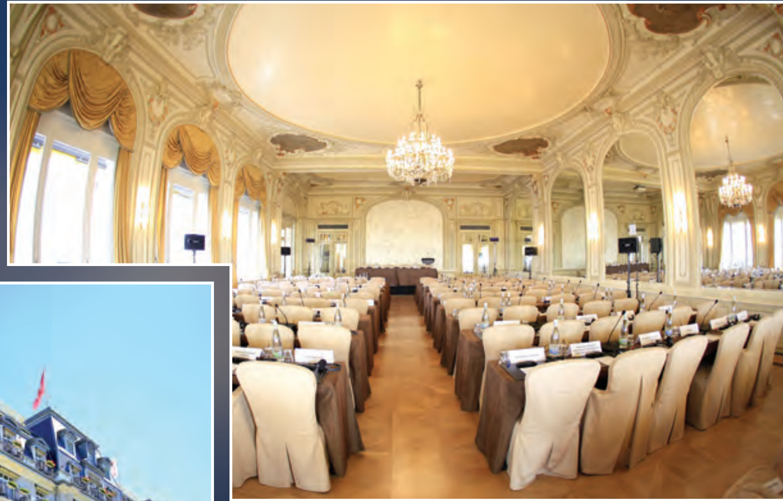

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“The EU is more than an economic project. It is a political one. It is a community of culture and of shared values and interests essential to forge a common destiny”

focus on research, innovation and infrastructure, with special attention given to connect Europe in transport, energy and digital sectors. We have built on the climate and energy goals for 2020 which were agreed under the previous Commission to set out a framework for 2030. Competitiveness, sustainability and security of supply are at the core of our climate and energy policies. On top of that, in our Blueprint, we have set out a clear vision on how to complete the Economic and Monetary Union.

Jean Monnet said: *“I have always thought that Europe would be forged in crisis.”* We have proven him right and the doubters wrong. We have shown what can be achieved when EU Institutions and member states work together.

Working for Europe’s citizens

While the economic and financial crisis has been the main challenge over the last five years, we have not lost sight of the need to address the other concerns of Europe’s citizens.

The Commission has taken a series of initiatives to guarantee free movement of people, goods, services and capital; to ensure choice and fair competition for consumers and companies; and to increase investment in infrastructure. Thanks to the single market, we have been able to bring down roaming charges even further; to bring fairer prices and rights for travellers and consumers; to agree - after over thirty years of negotiation - the European patent, which introduces savings in cost and time for researchers and businesses; and to improve the visibility of job opportunities across the EU to let you find jobs in other member states more easily.

It is now more important than ever that the fundamental values on which the Union is built, such as the rule of law, are respected. The Commission has intervened with a number of member states in recent years to ensure that these fundamental principles are respected and that people’s freedoms and rights are fully upheld. And we will continue to do so in a more systematic and robust way through the Rule of Law initiative we have proposed.

Addressing the real issues that matter to people requires the European institutions to focus on the areas where it can provide most value. European cooperation is crucial in many areas but it is not necessary in every area. This Commission has proposed legislation where intervention was required but has also cut red tape to an unprecedented degree, saving European businesses more than €32 billion a year. We have repealed 6,000 EU laws since 2005. Europe must be big on the big things and small on the smaller things.

Tackling the key issues of concern to Europe’s citizens requires a joined up approach between the different European institutions. The European Commission is the only institution involved in each step of the decision-making process. At the same time, nothing can be achieved without the full engagement of the two sides of the legislative process, because it is the ministers from national governments and the MEPs who you elect, who together decide on legislation. This Commission has fully invested in making that cooperation work. The democratic process has been enhanced. Each institution has played its role in helping Europe emerge stronger from the crisis.

José Manuel Barroso, President of the European Commission, Herman van Rompuy, President of the European Council, and Martin Schulz, President of the European Parliament, participated in the award ceremony of the 2012 Nobel Peace Prize to the EU

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Responding to the global financial crisis at the G8 at Camp David in 2012, round table: Angela Merkel, Herman van Rompuy, José Manuel Barroso, Yoshihiko Noda, Mario Monti, Stephen Harper, François Hollande, Barack Obama, David Cameron, from behind, and Dmitry Medvedev (in a clockwise direction)

Giving Europe a say on the world stage

In an increasingly globalised world, size matters. The economic crisis, global climate change negotiations, concerns over energy security, migration, the Arab Spring and most recently Ukraine have all shown that the EU is only effective if we act together.

The economic crisis has put the spotlight on Europe but it has also demonstrated Europe's ability to exert influence on the international stage. The European Union has set the global standard in many areas, and we have played a leading role in global fora such as the G8/G7, G20, the WTO and the UN. We have also established a stronger global European presence throughout the world, as well as in our own neighbourhood. And from Africa to Asia, from Latin America to the Pacific and Caribbean, we remain the biggest global aid donor – despite the crisis – and have strengthened our political partnerships.

The EU's 2012 Nobel Peace prize should remind us that the EU stands for peace, hope and stability. None of this should be taken for granted. Ongoing events in Ukraine show how the demon of power politics can rear its ugly head at a moment's notice. Images of young Ukrainians holding European flags as symbols of a brighter, freer future are proof of how much we have achieved. The EU will always support freedom and democracy in its neighbourhood and beyond.

Record of achievements

Perhaps our greatest achievement is how we have acted. Let's not forget that some were predicting that a Commission with 27 or 28 members and an enlarged European Union would not be able to work and take decisions properly. We have proven those predictions wrong. Courageous decisions have been made together – united – pointing to a real *communauté de destin* in Europe.

As the shared challenge of globalisation brings us closer together and common values bind us ever more tightly, there is a growing realisation that we need to find stronger solutions agreed by all of us. The last five years have shown that we are up to that challenge: Europe can work well at 28, and our institutions have the necessary capacity and experience to adapt, reform and change for the better.

This 'Record of Achievements' is only a snapshot of the work done by the College of Commissioners during the past term. We have welcomed a new member – Croatia – to the Union and further expanded membership of the euro to Estonia and Latvia. From fighting youth unemployment to fighting human trafficking; from helping 120 million disaster victims every year to helping Europeans to keep their data secure online, we are creating a united, open and stronger Europe. ■

European Commission 2010-14. A Record of Achievements http://ec.europa.eu/commission_2010-2014/president/achievements/files/RoA_EN.pdf

The world in 2020 - making Europe more fexible in a changing world

Jim O'Neill is a Visiting Research Fellow, and Alessio Terzi is a Research Assistant, at Bruegel

In a recently published paper[1], we showed that the world is going through an unprecedented shift of economic growth distribution and trade patterns. We also extrapolate what the world trade situation will look like by 2020 if this continues. The situation is hugely influenced and complicated further by the development of China and its changing economy, which is likely to grow at a slower rate in this decade than in the last. China will find it more difficult to export as much and will import more. Nonetheless the Chinese share of global GDP and trade will rise further. Other countries from the so called emerging world will have a smaller role in this changing landscape but a non-trivial one. All of this surely means the need for a significant shift in world economic governance is becoming pressing.

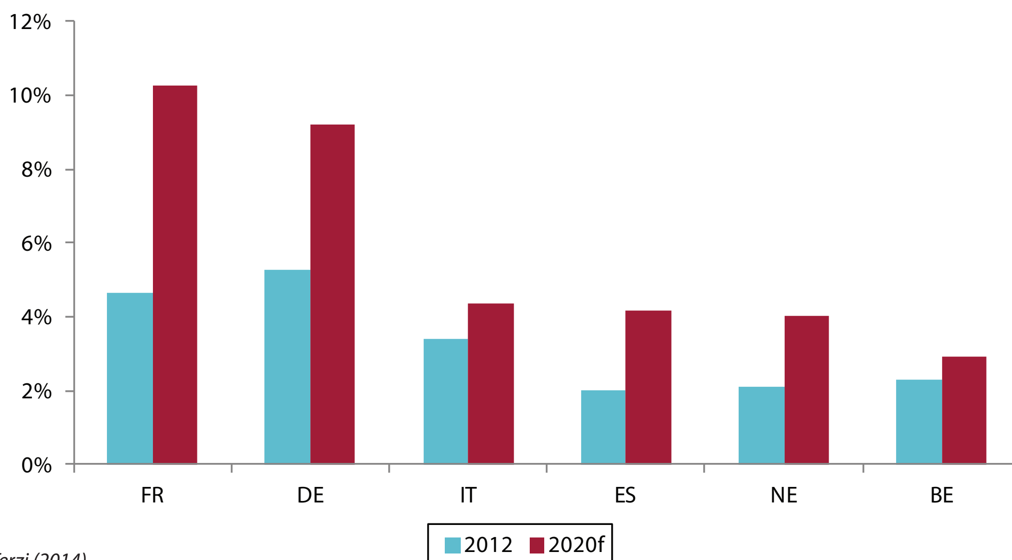
For Europe, and within it, the EU and especially for those inside EMU, the need to change both their policy framework is particularly clear, not least as they hold many of the important keys for better global governance.

In the paper, we show that by 2020, China will probably be Germany's number one export market. China will be close behind Germany as France's next most important export market (a finding that might surprise some people even more than the German export shift). Italy, the euro area's third largest economy, will not see its export share to China rising quite as much, but it will be exporting more to so-called emerging/developing markets than its developed market counterparts. This means that the euro area's 3 largest economies are going to be thinking more and more about their trade relationships with countries outside the euro area.

Our findings suggest that this same pattern will not be repeated for all euro area members, and for some, their own exports to these larger European economies will remain very significant. This is an important finding also as otherwise, one could simply question whether the euro area will still satisfy the most basic of optimal currency area (OCA) criteria. In theory, an optimal currency area has strong economic basis when the OCA member countries are conducting most of their trade with each other. This was the main economic rationale behind EMU's introduction and of course, one of the most bullish arguments of its supporters were that under a single currency, trade between member countries would flourish even more (see *'One Market, One Money'*[2], European Commission). What has happened 14 years on is that, trade has flourished even more outside the euro area.

In addition to these unexpected patterns of trade, of course, most European economies continue to see their share of global GDP decline as many other parts of the world grow faster. Despite these realities, global governance is only shifting in the appropriate direction at a snail's pace. At the discussion surrounding the launch of our paper[3], the IMF pointed out that in 2010, it had been agreed that the respective shares

Figure 1. Exports to China, % of total exports



Source: O'Neill and Terzi (2014)

and voting rights for the IMF should change based on criteria determined by 2005 relative economic and financial positions. These criteria included, among others, the size of GDP and performance in trade. As a result, the share of China would be rising to 3rd if implemented. However, these agreements are yet to be implemented and in fact, the US Congress in January passed on an opportunity to vote in favour of the IMF proposed changes. In any case, these were based on 2005 criteria which is now 8 years away. Today, China is two times the size of Japan following the release of final year GDP data, yet the proposal yet to be ratified suggests a share for China still behind Japan.

China is also now bigger than the GDP of France, Germany and Italy combined, and despite some disappointments with their own economic growth in the past couple of years, the BRIC countries combined GDP is bigger than that of the euro area. For Europe that still will hold a disproportionate share of IMF power even if the 2010 agreements ever get implemented (in which they lose 2 individual IMF seats), what would be the right thing to do?

The current problems surrounding Ukraine in many ways epitomize the slow and byzantine way Europe behaves about many issues. In public, European countries talk frequently about the rights and wrongs of how the Ukraine should be, but in the build up to this problem, they didn't appear capable or willing to decide swiftly on tangible benefits for Ukraine or encourage it to accelerate any possible future as an EU member.

This is symptomatic of the broader issues facing the EU and euro area in particular in their policy development. As it relates to the euro area's external credibility and achieving a better balance of global governance, as we argue in the paper, they can kill two (big) birds with one stone. They should stop representing themselves individually in the G7 (and G8) and encourage more shared representation in terms of IMF seats and voting rights. By doing the latter, they would also put more direct pressure on the US for their own intransigence in adopting change. By doing the former, they would not only allow for a more ideal G7 to become apparent - one in which China was sitting at the table- but it would send a huge message that the euro members were together as 'one' on monetary and fiscal , and broader economic matters for the future.

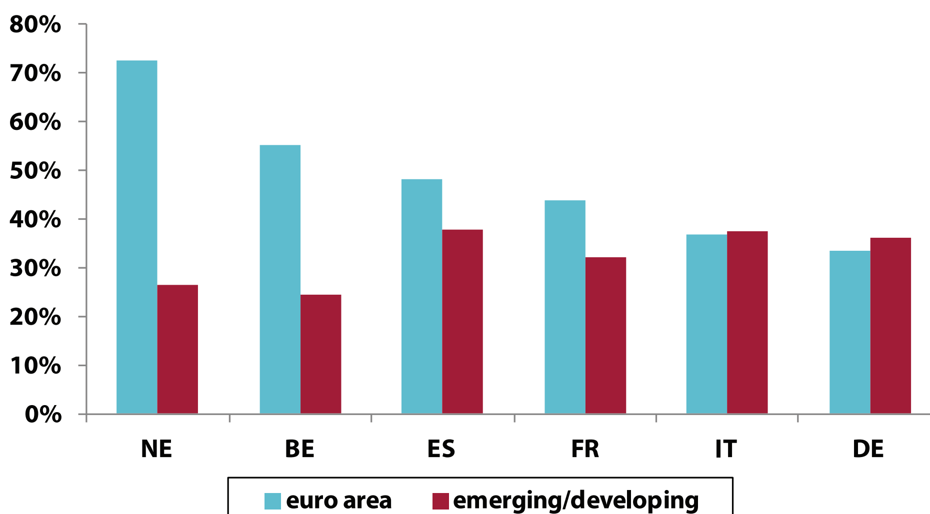
"For the EU and especially for those inside EMU, the need to change both their policy framework is particularly clear, not least as they hold many of the important keys for better global governance"

As necessary as these steps are, they are far from sufficient as they should be accompanied by other changes. There are perhaps three additional specific steps we would recommend for Europe to become more adaptable and less rigid in its approach to this fast changing world.

First, if the euro area is becoming more heterogeneous in terms of trade partners, the likelihood of an asymmetric macroeconomic shock and the risk that different European countries might find themselves at different points of the business cycle will be increasing. This, in turn, will make the conduct of a single monetary policy more challenging. As such, mechanisms which allow to shore up against this risk will be needed. This will need to include some sort of fiscal transfer or macroeconomic stabilization mechanism (see Kennen, 1969), together with a more solid integration and supervision of the financial sector[4].

If this contention is right, it could be claimed that the euro area has been moving steps in the right direction as part of its crisis management strategy, given this included a tighter coordination of fiscal policies from the centre, the establishment of a common lending facility (European Stability Mechanism), and a move toward the creation of a banking union. We would however warn against the strict rule-based approach that is prevailing among European policymakers. While obviously the euro area needs to have appropriate economic discipline, events of recent years have demonstrated that when stresses occur and pressures build, these criteria don't stop countries from breaching them.

Figure 2. Exports to euro area and emerging/developing markets in 2020 (forecast), % of total



Source: O'Neill and Terzi (2014)

Moreover, the more-or-less strict consensual basis on which the EU operates, characterized by eternal negotiations, countless summits, and a myriad of veto players does not cater for the fast-paced uncertain world in which we have moved. The original sin of EMU itself was its conception as a rigid structure, allowing for no way to deal swiftly and effectively with unforeseeable external (the Great Recession) or internal (asset bubbles and competitiveness losses) shocks. We would thus favour a stronger centralization of competencies, associated with discretionary powers to cope with a fast-paced changing world, and the necessary democratic legitimization that this new governance will need.

Finally, connected to this last point, we do realize that not all EU countries may be ready to give up crucial parts of their sovereignty, now or in the foreseeable future, and so should do EU policy-makers. A stronger, more flexible, EU might thus need to accept the idea of being permanently characterized by a varying geometry. ■

ABOUT THE AUTHORS

Jim worked for Goldman Sachs (GS) from 1995 until April 2013. He joined Goldman in 1995 as a partner, Chief Currency Economist and co-head of Global Economics Research. From 2001 through 2010, he was Chief Economist and head of Economics, Commodities and Strategy Research (ECS). In September 2010, he became Chairman of Goldman Sachs Asset Management (GSAM).

Alessio was Research Analyst in the EMU governance division of the European Central Bank. He has also worked for the macroeconomic forecasting unit of DG ECFIN (European Commission), the Scottish Parliament's Financial Scrutiny Unit, and Business Monitor International, a country risk and forecasting firm in the City of London, where he was Europe Analyst.

1. *http://www.bruegel.org/publications/publication-detail/publication/817-changing-trade-patterns-unchanging-european-and-global-governance/*
2. *http://ec.europa.eu/economy_finance/publications/publication7454_en.pdf*
3. *http://www.bruegel.org/nc/events/event-detail/event/418-changing-global-trade-patterns-unchanging-european-and-global-governance/*
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Sharing the same vision – the cornerstone of a new industrial policy for Europe

Claire Dhéret is Senior Policy Analyst at the European Policy Centre, Brussels

Introduction

EU leaders have recently missed the opportunity to give industrial policy the weight it desperately requires on the EU agenda. The decision to cancel the February 2014 European Council as well as the low attention that industrial policy received at the March European Council are some examples. They have fuelled a feeling of disenchantment over the European business community, which is convinced that, despite the recent Communication of the European Commission entitled *"For a European Industrial Renaissance"*[1], 'business as usual' remains the prevailing mantra.

However, the results of the European elections, marked by the rise of anti-EU forces and the still very small turn out, have sent, once again, a strong message. The disconnect is profound. There is an urgent need to address, on the one hand, the disillusionment EU citizens feel about the inadequacy of policies to boost economic recovery and to make the European Union (EU) a robust global player, and on the other hand, to respond to large expectations of the business community. These expectations are all the more significant as the EU has sent, over the last years, strong signals indicating its firm intention to become a more active supporter for European industries.

However, the simple act of putting industrial competitiveness on the agenda and reiterating well-known statements are not sufficient. EU heads of state and government have now to provide industry with what it needs most: an unambiguous and well-defined strategic plan for the decades to come. To this end, they have to courageously face the key questions, which can no longer be ignored. These questions include:

- What are the main factors challenging the competitiveness of European industries and what would be the added-value of EU actions in addressing them?
- What should European and national authorities do and, equally importantly, not do as part of a new industrial policy?
- What is the role that manufacturing should play in industrial policy and Europe's recovery?
- Should Europe aim at a precise target for manufacturing production – irrespective of its nature – or should it focus on certain types of industrial activities?
- How to make the best use of EU industrial policy to benefit Europe's economy and support national re-industrialisation strategies?

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"Europe should initiate a thoughtful process of evaluating how an optimal framework could ensure the elimination of tensions between European and national competences"

In this article, I describe current prospects for European manufacturing industries and give an overview of EU actions, past and present, to re-industrialise Europe. Based on this assessment, three possible scenarios with several policy implications are outlined. They represent very different ways in which an EU industrial policy could evolve in the coming years and present strategic options that should be taken seriously by policy-makers. Fostering a frank debate around these three scenarios is urgently needed as it would provide the right framework to answer the key questions mentioned above. Finally, a series of concrete proposals have been suggested, which would, if endorsed by EU heads of state and government, lay the foundations for an EU industrial strategic plan and respond to the most pressing expectations of both EU citizens and the business community.

Part 1: Gloomy prospects for European manufacturing industries

The decline of manufacturing in Europe is nothing new. The sector has been facing serious difficulties for a long time (a situation, which has been aggravated by the economic crisis in some countries), illustrated by the constant reduction of the manufacturing share in almost all indicators. The share of manufacturing in GDP has fallen from 15.8% before the crisis to 15.1% in 2013 and 3.5 million jobs have been lost since 2008[2]. While such trends reflect, to some extent, a structural shift to the service sector and the changing nature of manufacturing, which mirrors the move towards a more knowledge-intensive and green economy, they also reveal a profound weakness in EU manufacturing.

The steady decline over the last decades is the result of two simultaneous developments: ever-mounting external pressure and the growing role of emerging economies at a global scale (1) as well as a profound fragmentation in the way industrial policies are pursued across Europe (2). The combination of those developments and the EU's incapacity to respond to a changing environment with one clear and common vision has significantly weakened its industrial base, making it uneven across the territory and ill-equipped for global challenges.

Ever-mounting external pressure

The ever-mounting external pressure has led to the emergence of a new global distribution of manufacturing production and, as a result, to the decreasing importance of manufacturing in Europe's economy, which has intensified over recent times and has been driven by several factors.

First, productivity in Europe is running out of steam and progression is much slower than in other parts of the world (despite a relative strong productivity growth in manufacturing compared to the one in services). Not only do the usual competitors, which are also undertaking a 're-industrialisation strategy', such as the United States, out-perform Europe, but the productivity in emerging industrial giants is catching up at high speed. Innovation and investment in research and development undeniably plays a significant role in explaining this growing productivity gap. However, more importantly, it is the capacity to translate research into the commercialisation of products, which is key. Looking at innovation output instead of input shows that the EU is underperforming with too much focus on basic research.

Second, production costs play a role in determining the location of manufacturing production in different countries as they represent a key competitiveness factor and affect the final price of a product. Among them, energy costs feature as one of the top concerns of European industries due to the increase in energy price differential between Europe and its major competitors.

Labour cost also plays a role in total production costs. Its relation to productivity, in addition to trade liberalisation, has contributed to favour the migration of manufacturing employment outside Europe. Indeed, labour cost differs enormously between EU countries and emerging economies, making it impossible for Europe to compete on this aspect. In this context, dealing with the cost of offshoring and coordinating activities between and within companies has become more profitable for European industries than concentrating all activities in one location. Hence, globalisation has profoundly changed how manufactured goods are produced and delivered to final consumers. Production processes have internationalised, leading to an increased fragmentation of the value chain and the disappearance of certain types of manufacturing employment in Europe.

Third, recent macro-economic forecasts have shown that a large part of economic growth will be located outside Europe in the years to come. Where demand for manufactured goods is stagnating in Europe due to oversaturated markets, the rapid expansion of the middle class in other parts of the world is creating a large cohort of new consumers. This will shape the global distribution of manufacturing production even further, raising both opportunities and challenges for European manufacturing. European industries are therefore likely to continue to migrate their activities outside Europe in order to have direct access to those new consumers and to enable businesses to grow.

The European Union... let's call it European fragmentation!

Despite the creation of the Economic and Monetary Union (EMU), the EU has been characterized by significant divergences in manufacturing performance and there is no doubt that the EMU is far from being homogenous in this regard. Major drivers of competitiveness, be it productivity level[3], capacity to export, or the structure and diversity of the manufacturing base, have evolved in different ways across the territory. Both structural and institutional factors explain huge competitiveness differences among Member States and the long and persistent fragmentation of the European industrial landscape, which has led to the co-existence of exports-oriented (such as Germany) and demand-driven (such as France, Spain, Italy) models in Europe[4].

In addition to structural and institutional factors, the co-existence of such different models is due to the fact that industrial policies are shaped by national interests. Industrial and innovation policies are driven by national concepts and strategic choices do mostly reflect the role played by specific sectors in each country and the nature of the relations between relevant stakeholders. Such differences are difficult to overcome as they both reflect deep-rooted traditions and because

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"Looking at what constitutes industrial policy both at EU and national level suggests that it is difficult to get a clear idea of whether a strategic direction has been taken"

industrial policy has always been seen as a national preserve. A diversified industrial policy across the EU could undeniably benefit Europe's economy, yet it is the predominance of national interests and the absence of coordination between different models, which bear specific risks.

The risky consequences of uncoordinated industrial policies

Pursuing economic integration whilst having very different industrial models has been often considered risky in several respects. From an internal market point of view, both the divergence of manufacturing output as well as the predominance of national interests in the way industrial policy is carried out, represent clear obstacles to the well-functioning of the internal market. Given that innovation and national investments are primarily driven by national traditions, picking out common priorities is difficult. Furthermore, this diversity of non-coordinated investments does not favour cross-cutting trans-border projects or the emergence of pan-European networks, therefore hampering potential growth. In such a context, completing the single market and streamlining investments are condemned to remain marginal. From a monetary perspective, the strong cleavage between the demand-driven and the exports-oriented models represents weak foundations for the currency union.

Part 2: A new motto 're-industrialise Europe' – too little, too late?

Against this dismal background, it is questionable whether Europe is doing enough to create the right framework conditions for boosting the competitiveness of its manufacturing industries. Despite a recognition of the importance of manufacturing for the economy, the weakness of the current policy framework, both regarding the lack of clarity of EU strategic orientations and their questionable impact on national policies, seems unsuited to meet ongoing challenges.

A large recognition in the role of manufacturing industry

'Industrial policy matters!' is the new slogan citizens hear all over Europe. Alongside fierce campaigns to keep the industrial base on the national territory, governmental reports and communications highlighting the key role that manufacturing may play in reviving national economies have proliferated. Even in countries such as the UK where the largely dominating neoliberal economic doctrine has allowed market forces to shape the economy for the last 30 decades and to shift it away from its traditional strengths in manufacturing towards financial services, the rhetoric has now changed[5]. De-industrialisation is no longer perceived as a natural process of economic development and the focus on the services sector has somewhat faded away. In addition, the comparative resilience of some EU countries with a strong industrial base to the economic recession, together with the positive role that the state played in robust and/or emerging economies, encouraged EU member states to recognise both the need for industrial policy and the importance of having a proactive state supporting strategic industries.

The change in rhetoric is also explained by some strong evidence showing that manufacturing is an essential pillar of the economy as *"additional final demand in manufacturing generates around half as much additional final demand elsewhere in the economy"*[6]. Indeed, manufacturing represents the major source of investment in R&D (65.3% between 2008 and 2010)[7], a key source of exports (67% of Europe's exports)[8] and a main driver for employment in other sectors, including services (each additional job in manufacturing creates 0.5-2 jobs in other sectors)[9].

In light of this, while manufacturing and services have been considered by some as two incompatible choices of economic strategies in the past, there is now no doubt that the two of them are depending on each other. Services have indeed entered the world of manufacturing in all sequential stages of a product and the service content in manufacturing final output has significantly increased over the last decades.

But despite the recognition in the importance of a large and strong industrial base, some basic questions pertaining to the nature of Europe's re-industrialisation strategy are left in the air. Answering these basic questions are, however, a pre-condition for the design of a robust and coherent EU industrial strategy capable of meeting present and future challenges and of providing European industries with a long-term vision.

The EU strategy – go back to basics!

Looking at what constitutes industrial policy both at EU and national level suggests that it is difficult to get a clear idea of whether a strategic direction has been taken. First of all and from a theoretical viewpoint, it is hard to grasp what is understood by 'industrial policy' as the term is not always used with the same meaning. Where some strategic documents emphasise the need to boost manufacturing production, others have a larger scope and also include the services embedded in it. Hence, defining first what industrial policy is and is not, should provide the starting point of any solid plan.

Secondly, from a more pragmatic viewpoint there is no indication of what the key objectives are that should be pursued by an EU industrial strategy. While EU Industry Commissioner Antonio Tajani announced the Commission's aspiration to raise the contribution of industry to GDP to as much as 20% by 2020[10], the European Commission does not provide any indication of how to reach this target and leaves the following questions open: what kind of production activities should this 20% be composed of?

Is the intention to shift European manufacturing only towards high added-value activities or to re-locate most of the production chain in Europe in order to protect jobs, including those that are low-skilled and low-waged? What is Europe's approach vis-à-vis the increased fragmentation of production processes, which is undeniably leading to job migration but might also augment European industries' competitiveness by allowing them to reduce production costs and to gain new market shares?

Adding to the ambiguity, it is questionable that actions aiming to achieve the 20% will support other EU objectives, in particular relating to climate change and energy. Recent EU communications in those fields have been strongly denounced by the industry as creating additional costs and accelerating Europe's de-industrialisation. This signals a great deal of confusion and a perceived lack of coherence between different EU policies, which in turn, might reduce the attractiveness of Europe for private and foreign investment.

The EU industrial policy: a myth?

As indicated above, it is undeniable that the EU is trying to become more active with regards to industrial policy and to mainstream industrial competitiveness into other policy fields through various ways. For instance, recent developments in the Union's new economic governance have shown that the European Commission is becoming more vocal – in particular through the country-specific recommendations published in the framework of the European Semester – on issues deemed as key drivers of competitiveness such as taxation on labour and wage setting system, the commercialisation of research, the diversification of the industry, energy policy, and the export capacity of firms.

In light of this, EU competences on industrial policy are, however, still limited, and the Union does not have a clear mandate to act in this field. The main reference to industrial policy in the Treaty, Art. 173[11], underlines the EU's role in creating the conditions necessary for the industry's competitiveness but restricts it to measures in support of national actions. As a result, measures aiming to drive industrial change are either relying on instruments from other policies, mainly internal market provisions, competition policy and trade policy, or on soft tools allowing consultation and coordination between member states. Whether this division of competences is optimal is a debate on its own, and goes beyond the scope of this article. However, recent exchanges on state aid surveillance illustrate how aspects of such a framework can create tensions between the European and national level, and indicate how European and national powers can constrain each other.

In addition to constraining aspects of the framework, one may also wonder whether there is sufficient coordination between investment priorities across Europe. In its 2012 communication[12] the Commission decided to complement its horizontal approach with a more vertical one, giving emphasis on specific technologies. Hence, it announced intentions to focus investment and innovation on six priority action lines: advanced manufacturing technologies, key enabling technologies, bio-based products, sustainable industrial and construction policy and raw materials, clean vehicles, and smart grids.

The success of turning such action lines into investment with a critical mass will obviously depend on whether similar priorities will be captured by other governance levels, such as the national and regional ones. But looking at the industrial plans of Member States having a firm commitment to re-industrialisation, one can observe that national investment priorities do not always correspond to the ones set at EU level[13].

Part 3: Hard but necessary choices for the future of industrial policy in Europe

The two first parts of this article have shown that despite an urgent need to address current challenges, EU industrial policy is trying to be everything for everyone. Bringing more consistency and coherence in the way industrial policy is pursued will certainly require hard but necessary choices, providing the industry with more clarity and better predictability and increasing therefore the attractiveness of Europe for investment.

Ambitious declarations and snappy slogans, including 'manufacturing revolution' and 'industrial renaissance', now need to be turned into tangible deeds. To this end, Europe needs a more in-depth reflection on the adequacy of current framework aspects supported by a sound and evidence-based understanding of the comparative advantage each framework could generate. In other words, Europe should initiate a thoughtful process of evaluating how an optimal framework could ensure the elimination of tensions between European and national competences, offer smooth coordination between EU and national policies and maximise the benefits of EU interventions.

In order to kick-start the reflection process, the following presents three possible framework scenarios – called *Towards the Europeanisation of the Value Chain* (1); *The EU as Facilitator of a Level-Playing Field* (2); and *The Predominance of the Free Market Approach and National Forces* (3) – with very different strategic options for the future of industrial policy in Europe. Where assessing the competitive advantage of each of those scenarios goes beyond the scope of this article and is also a clear matter of political choices, this article focuses mainly on drawing the scenarios' contours and setting the scene for further discussions.

Scenario 1: towards the Europeanisation of the value chain

Moving towards the 'Europeanisation of the Value Chain' implies a deeper integration of EU manufacturing with a high degree of intra-community specialisations based on national comparative advantages, more cooperative industrial relations among member states, and the integration of many policies such as the ones related to research, labour market, innovation, and energy. European investment is streamlined in a coordinated way to ensure higher return and trans-European network projects as well as clusters form a key pillar of scenario 1. Europe is put at the centre of the production process and of the value chain without, however, neglecting the outside world. Such a scenario implies significant transfers of competences to the EU level and key changes in the way member states approach industrial policy. National discourse promoting 'Made in... [national country]' would be replaced by a 'Made in Europe' giving a solid recognition to European champions. A robust EU governance model is a pre-condition to follow this path and should not necessarily involve all member states as such a qualitative leap may only become possible with industrial models sharing a certain degree of similarity.

Scenario 2: the EU as facilitator of a level-playing field

Concentrating on the facilitating role the EU could play in establishing a level-playing field for industry in the EU and beyond its borders is the scenario closest to reality as it implies striking a delicate balance between European and national competencies. Several steps, laying the foundations for such a scenario like the single market - have already been launched for decades. However, the EU's role in creating a level-playing field is far from being optimal. Important steps, some of them still under construction, will have to be pursued so as to turn the current architecture into a coherent bloc in which EU and national policies complement each other in a mutually reinforcing way.

Completing and deepening the Single Market in order to boost intra-EU trade forms the most important pillar of such a scenario and some coordination and convergence mechanisms in areas like innovation, connectivity and cross-border infrastructure are fully activated in order to grasp the full benefits of the single market. In addition, instruments to strengthen the external dimension of EU industrial policy and engage in economic diplomacy will be further developed. This scenario combines an internal pragmatic approach, where member states remain the main agents in the design of the strategic direction of future industrial developments, with a robust external strategy.

Scenario 3: the predominance of the free market approach and national forces

Going back to the mere predominance of national forces in the design and implementation of industrial policy requires not only abandoning moves towards a deeper European integration but also dismantling some achievements of the past. The third scenario does not mean the disintegration of the single market but places it at the centre of its strategy, leaving aside convergence mechanisms. The free market approach is at the core of scenario 3.

The predominance of national forces and interests lead to the promotion of a culture of competition among EU member states, regions and industries. Each member state has its own way to deal with the globalisation process and its possible consequences on domestic industries and specialisation. The co-existence of very different industrial models in Europe is reinforced and industries are likely to be more concentrated in certain parts of the EU territory. In addition, the pursuit of the free market approach is likely to lead to the disappearance of weak industries and to reinforce the position of the most competitive ones. Under such circumstances, divergences between EU member states are likely to grow, putting tremendous pressure on the common currency.

The scenarios described above represent three different strategic options for the future of industrial policy. Although scenarios often bear the risk of over-simplification, they also offer the advantage of putting the cards on the table and clarifying what is at stake. Fostering a debate around them and their policy implications, ranging from institutional aspects, division of competences, policy reforms to budget considerations and EU fiscal capacity, will put EU member states in front of essential questions, forcing them to confront the future strategic direction of EU industrial policy.

Developing a shared vision around one of these scenarios will obviously not occur overnight. It takes a long process requiring the involvement of all relevant stakeholders, including the industry, and the full commitment of our policy-makers.

In order to achieve such an objective, three concrete and ambitious steps listed below should be seriously implemented and undertaken by the EU heads of state and government:

- First, there is no doubt that clear-cut choices in EU industrial policy will not be achieved without a high-level political commitment. A coalition of EU countries needs to take the lead in order to form governmental alliances and to work on the design of an EU industrial compact, which would complement the Compact for Growth and Jobs. The already existing group of EU countries called 'Friends of Industry'[14] could serve as a forerunner for such a group but it will need to be endowed with clear objectives and a real action plan.

- Second, this coalition of EU countries should establish a reflection group of high-level experts with a clear mandate to carry out analysis on cross-cutting and cross-sectoral issues, which are at the core of any industrial strategic plan. The starting point of this analysis should address the questions raised in the introduction of this article.

  In addition, the group of high-level experts should reflect upon the policy implications of the three scenarios mentioned above in the view to identify the opportunities and challenges each of them would raise. Such an exercise and the clear mandate given by a coalition of member states would provide a right balance between experts' analysis and political choices. Indeed, the objective would be to feed the analysis findings into the choices made by the coalition.

- Third, the coalition of EU countries would need to agree on some concrete proposals addressing the main obstacles, which are currently threatening industrial competitiveness in Europe. The priority should be given to three main issues perceived as top concerns by European industries: the financial fragmentation and the difficulty to access finance in some parts of Europe; energy prices and the high price differential with Europe's competitors; and the absence of a level-playing field with other regions of the world. This should be addressed by the revision of the EU's state aid framework and the opening of foreign markets to EU industries through for instance, a stronger focus of trade negotiations on EU industries' access to foreign public procurement markets.

These three concrete steps are undeniably ambitious. But they could offer a real action plan with concrete long-term solutions to the more pressing issues together with a clear vision on the future of the EU industrial policy. ■

1. See European Commission (2014), For a European industrial renaissance, COM (2014) 14/2, p.22.
2. See European Competitiveness Report 2013 (2013), Towards knowledge-driven reindustrialisation, Commission Staff Working Documents SWD (2013) 347 final.
3. While countries like Denmark, Ireland and Luxembourg had a productivity level of above €50 per hour worked in 2012, the level of a large number of Eastern and Central European countries as well as some Southern countries was below €25. See Eurostat data.
4. For more details on the different industrial models, see the long version of this article: http://www.epc.eu/documents/uploads/pub_4279_sharing_the_same_vision.pdf
5. See a recent speech of Vince Cable, UK Secretary of State for Business, Innovation and Skills: www.gov.uk/government/speeches/industrial-strategy-conference-2013
6. See Competitiveness Report 2013 Memo : http://europa.eu/rapid/press-release_MEMO-13-815_en.htm
7. Data collected by BUSINESSEUROPE. See BUSINESSEUROPE (ed.) (2014), Industry matters – Recommendations for an industrial compact, p.6
8.. See Veugelers, Manufacturing Europe's future, p.8
9. See JM Rueda-Cantuche, N Sousa, V Andreaoni, and I Arto (2012), The Single Market as an engine for employment growth through the external trade, Joint Research Centre, IPTS, Seville.
10. From its current level of around 16%.
11. See: http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=OJ:C:2007:306:TOC
12. European Commission (2012), A stronger European industry for growth and economic recovery, COM (2012) 582 final.
13. For a more detailed analysis of the priorities of three member states (France, Italy and UK), see the longer version of the article.
14. This group of 17 member states met for the second time in January 2014 and agree upon a joint communication. See: http://www.amblavalletta.esteri.it/NR/rdonlyres/54799E38-077A-43F4-8F36-E2FFC17699A6/73652/Final_Declaration_rev.pdf

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Putting fairness at the heart of our tax systems

Algirdas Šemeta is European Commissioner for Taxation, Customs, Anti-fraud and Audit

Taxation has been a crucial policy in addressing the extreme economic crisis we have faced in Europe. And it is just as pivotal in the recovery period. While the primary role of taxation is to raise revenues – much needed during this period – it certainly isn't the only role. The impact that tax policies also have on wider economic and social objectives is immense. And in the context of our deeper economic governance and coordination, the EU has promoted tax reforms that support growth, competitiveness and, crucially, fairness.

How equitable a tax system is; how balanced the burden-sharing; how even the playing field is when it comes to tax competition. These are now all yardsticks for assessing the overall effectiveness of tax policy. In fact, we have reached a point where fairness has become a fundamental principle, without which the legitimacy of taxation is severely compromised.

The economic crisis provided the fuel to stoke this fire, both in the EU and internationally. Understandably, when ordinary citizens were being asked to bear the brunt of higher taxes and deeper spending cuts, often at huge personal expense, they expected balanced burden-sharing and a fair approach. Political action for fairer tax systems, where everyone pays their share, was not an option – it was an urgency. It was crucial for social acceptance of our economic model, as well as for sustainable public revenues.

The campaign to clamp down on tax evasion and aggressive tax planning has been central to the drive towards greater fairness. An estimated €1 trillion a year is lost in the EU due to evasion, according to one study – equivalent to the GDP of Spain. The VAT gap alone amounted to €193 billion in 2011. Not only are such figures impossible to justify to austerity-hit citizens, but they highlight how much revenue can be reclaimed with more efficient, more effective and more targeted tax collection.

The European Union has always been a strong proponent of good governance in taxation. We were the first block in the world to automatically exchange information between tax authorities, and we have a Code of Conduct in place to harness harmful tax competition for over 15 years. However, with the challenges of the crisis, high-profile cases of corporate tax dodging and mounting tensions between member states over tax competition, we had to up our game. It was time for a fundamental review of our tax policies, laws and attitudes, to ensure that we were doing everything we possibly could to clamp down on tax evaders and those who encourage them.

In 2012, the European Commission presented an ambitious Action Plan against tax fraud and evasion, setting out 30 different measures to combat these problems, and recommendations to tackle tax havens and aggressive tax planning. I am proud to say that this was the ignition for what subsequently became a global movement towards greater tax transparency and fairer tax competition.

Since then, we have seen good progress in the fight against tax evaders and corporate tax avoiders. In the EU, the Savings Directive was adopted in March 2014, after six years of deadlock on the file. Together with another proposal I put forward, which should be adopted before the end of the year, this will ensure that automatic exchange of information will be applied in its widest form in Europe. Essentially, member states are now fully committed to helping each other collect taxes from those who might try to hide their revenues abroad. On the VAT side, we have put new tools in place to tackle large-scale fraud. A Quick Reaction Mechanism, for example, allows member states to respond more swiftly and efficiently to complex fraud schemes, such as carousel fraud, thereby reducing potential financial losses.

Fair tax competition – whether between member states themselves or between companies – has been another key area in our tax evasion campaign. National measures that encourage tax shopping or seek to steal the tax base of neighbours are unacceptable in the EU. Likewise, smaller and less 'well advised' businesses should not be at a disadvantage compared to their tax-avoiding competitors. Nor should they have to compensate for the aggressive tax planning of some companies, by carrying a higher tax burden. Therefore the Commission has used every tool at its disposal - including state aid rules and the Code of Conduct on Business Taxation – to ensure that member states play fair amongst themselves. And we have worked to tighten up EU tax legislation – namely the Parent-Subsidiary Directive – against aggressive tax planning. This will close loopholes, bridge national mismatches and basically block off opportunities for corporate tax avoidance, which are currently being exploited.

Furthermore, new political impetus has also built up around the proposal I put forward for a Common Consolidated Corporate Tax Base (CCCTB). This initiative was originally conceived to simplify life for businesses and improve the tax environment for companies in the EU. By creating a single European tax base, the CCCTB reduce the administrative burden, compliance costs and legal uncertainties that businesses in the EU face in dealing with 28 different national systems for determining their taxable profits. However, it is now also recognised as a potentially powerful tool against tax avoidance – offering a double dividend in terms of results. By eliminating the need for transfer pricing, the CCCTB would render many aggressive tax planning schemes entirely redundant. While I do not expect

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"Taxation has never been a word that strikes joy into the hearts of our citizens. But if we can show that we are 100% committed to making this taxation fair and effective, it will at least gain greater popular acceptance"

final adoption of the CCCTB by the end of this political mandate, I do anticipate that it will continue to occupy a central place in the agenda of the next Tax Commissioner, as the answer to ensuring fairer corporate taxation amongst member states.

Meanwhile, the EU has not limited its ambitions for fairer taxation and greater good governance to within its own borders. We have actively pushed for similar progress internationally too. We have embarked on negotiations with our closest neighbours – namely Switzerland, San Marino, Andorra, Monaco and Lichtenstein – on new tax agreements that would ensure the highest tax transparency. Many positive signals have already come from these discussions – which only started in the last few months – and I expect to be able to present a very positive outcome to our member states before the end of this year. I have also personally visited major financial centres, such as Hong Kong and Singapore, to entice them to embrace the global transparency movement too.

More widely, the EU has also been integral to a major overhaul of international tax standards. We have used our experience and expertise in tax good governance matters to actively contribute to two ambitious projects steered by the OECD. The first is the move to make automatic information exchange the global standard of tax transparency. We are at the point now where around 40 countries – including the USA, China, Russia, Switzerland, and Singapore - have committed to automatically exchanging information between each other's tax authorities. Such a development would have been inconceivable even five years ago, and essentially sounds the death-knell for banking secrecy.

The second project aims to tackle Base Erosion and Profit Shifting (BEPS), by creating an international framework for curbing aggressive tax planning and ensuring that taxation better reflects where economic activity takes place. Given the globalised nature of corporate tax avoidance, this global approach is essential and should be highly effective when finalised. It should create a fresh approach to concepts such as permanent establishment, transfer pricing and criteria for source taxation, which better reflect our modern economy and help rise to the challenges that it poses.

All in all, I believe that over the past few years we have seen a paradigm shift in taxation. Openness and cooperation are overthrowing secrecy and self-servitude. Major political commitments have been made which will change the entire landscape for tax evaders. Fairness has been accepted as the fundamental guiding force. What is important now is that it translates into real action. We must strike while the iron is hot, and deliver on all our commitments with sustained ambition.

While speaking of ambition, I can move to another major project at EU-level which has fairness at its very core. The Financial Transaction Tax is founded on the idea that every sector in society should make a fair contribution to the public purse – including the financial sector. As a result, it has the strong support of EU citizens, with over 2/3 of those surveyed claiming to be strongly in favour of the FTT. This tax was first proposed by the Commission in 2011, and relatively quickly became the first ever EU tax initiative to move to 'enhanced cooperation'. Under this process, 11 member states threw off the shackles of unanimity, usually required for any tax decision at EU level. When agreement amongst the 28 member states

Press conference by Algirdas Šemeta on the European corporate tax base

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was proving unlikely, this smaller group decided to move ahead with a common FTT by themselves. Once they have reached a deal on the final details – which I hope to see before I leave office at the end of the year – these member states will have the first ever regional financial transaction tax in the world.

The benefits of this are manifold. It will strengthen the Single Market by avoiding a patchwork of national taxes. It will ensure a more equitable input into public finances from financial institutions. And it will complement EU regulatory measures for financial stability. While the final FTT that the 11 member states adopt is likely to be more cautious than what the Commission had originally proposed, it will nonetheless be a major achievement when it becomes a reality. And it will be an important signal to EU citizens that member states can deliver on a tax initiative together which promotes fairness and responsibility.

The third pillar in my mission to inject greater fairness into EU taxation over these past years is tied into the EU's new economic governance structure, which was developed in direct response to the challenges thrown up by the economic crisis. Taxation is a key pillar in what is known as the European Semester, through which country specific recommendations are issued to member states on how they can better orientate their public finances and other policy measures towards smart, sustainable and inclusive growth. This has been an important framework for raising the potential of taxation beyond mere revenue-collection. The Commission has used it to direct member states towards more growth-friendly tax policies, which facilitate business, encourage investment and support wider social objectives. We have also advised member states to focus on the distributional effects of their reforms and their impact on the social groups that are most at risk.

Protecting the weakest and safeguarding the ability to pay principle is not just politics to please the citizens. There is increasing evidence that preventing socio-economic inequality from rising too high has benefits for all. So fair makes economic sense too. The message seems to be getting through, slowly but surely. From our analysis of the tax reforms being undertaken across the EU, we see that things are gradually moving in the right direction. For example, we see a trend towards greater tax progressivity in many member states, and targeted measures to protect vulnerable groups. However, tax reform is not an overnight process, nor one that can be done and dusted and then left aside. The Commission will continue to press member states to further improve the quality of their national tax systems, and to ensure that fairness is kept at the forefront of their mind when developing their tax measures.

As I approach the end of my mandate at EU Tax Commissioner, I can say that I am proud of what has been achieved to push forward our goal of greater fairness in taxation. That is not to say, however, that I believe our work is done. Far from it. We have taken very important steps forward over the past five years, and seen commitments, initiatives and decisions that injected more fairness into our tax policy at national, EU and international level. However, challenges still remain and work that has started must be completed. It is worth the effort. Taxation has never been a word that strikes joy into the hearts of our citizens. But if we can show that we are 100% committed to making this taxation fair and effective, it will at least gain greater popular acceptance. ■

It's the parties, stupid!

Prospects for a trans-national European democracy

Jo Leinen MEP is President of the European Movement International

During the campaign for the 2014 European elections many parties campaigned in favour of further democratisation of the European Union. How exactly this should be achieved remained somewhat vague, especially given that the EU's political system already fulfils a lot of democratic standards comparable to the systems of the Union's own member states. However, progress can and should be made especially through an evolution of the European political parties.

With only a few exceptions EU legal acts require the approval of the directly elected European Parliament. As in other federal systems a 'second chamber', the member states, also need to agree with a majority in the Council. The Lisbon Treaty has created more links between the democratically elected European Parliament and the election of the President of the European Commission. That is not to say the system could not be improved upon. One could point to the abolition of the remaining unanimity voting procedures in the Council and the few legislative processes, in which the European Parliament plays no or only a consultative role. However, unused potential exists with regard to a true European democracy - for that national parties calling for a more democratic EU would have to join powers at the European level.

In any representative democracy, but especially in parliamentary governmental systems, political parties are of prime importance. As an intermediary between the people and the political institutions they are indispensable to the articulation of the electorate's interests. At the European level, parties have

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> *"Europe needs a common electoral law with transnational lists decided democratically by the European parties"*

existed for some time already, although not necessarily in the traditional sense.

Parties such as the PES (Party of European Socialists/since 1992), the EPP (European People's Party/since 1976), ALDE (Alliance of Liberals and Democrats for Europe/since 1976) and the EGP (European Green Party/since 2004) are missing the means, legal recognition and powers to effectively fulfil the classical functions of political parties, which continue to be carried out by the national parties. This makes it almost impossible to run effective election programmes and election campaigns - and thus hold political debates - beyond the national context.

So far European parties have found recognition only within the EU institutional architecture in the narrower sense through the grant of EU funds under certain conditions since 2004. How narrow the limits of this recognition were becomes evident from the fact that, in absence of a European legal statute for political parties, European parties had to register themselves as national civil society organizations (mostly in Belgium or Luxembourg) and were treated as such by national authorities.

In addition, the electoral programmes of the European parties were barely perceptible in the election campaigns, because the seats of the European Parliament are awarded solely under national quotas to national parties. Moreover the German Federal Constitutional Court does not recognise European parties as real parties and referred in its judgments (in which it declared the five- and three-percent hurdle in European elections unconstitutional), that in 2009 more than 160 parties were represented in the European Parliament and further party fragmentation therefore would not constitute a real threat. The judgement clearly referred to national parties; the 13 European political families represented in the European Parliament were largely ignored in the verdicts of the court. The role of European parties is therefore limited to a coordinating role for the national member parties and the members of their respective party-families in national governments, for example in advance of meetings of the Council.

The 2014 European elections have brought with them a historical novelty insofar as the European parties are now given a voice in the nomination of top candidates for the President of the European Commission. This was possible due to the rules of the Lisbon Treaty, which were applied for the first time and according to which the European Parliament elects the Commission's President.

Indeed the nomination of frontrunners and the gradual personalization of the election campaigns has had a very positive impact and helped to stop the tide of decreasing voter turnout. Thanks in part to the televised debates, media coverage started to look beyond national borders, focusing far more attention to European topics than in all previous European election campaigns. Despite this, the election campaigns were still conducted by the national parties, which have the necessary resources and structures. This led to the paradoxical situation that while there were candidates for the most important office in the EU, their faces and names - just like the names and emblems of European parties - were hardly seen on any billboard, let alone on a ballot paper.

An exception was Martin Schulz in Germany, since he was also the leading candidate of the national social-democratic party, SPD. The German conservatives, the CDU, however, almost exclusively showed Chancellor Angela Merkel on their posters - who did not even stand for elections. Thus, for most voters, the link between a particular candidate and a party was not clear.

This ambiguity can only be made transparent if democracy is trans-nationalized by strengthening the position of the European parties. An important step in this direction was already realised in the final plenary session of the European Parliament prior to the European elections. This plenary session was the last chance for the Parliament to complete legislative processes within the 2009-2014 period and was loaded with important decisions, such as the completion of the banking union.

The adoption of new rules on the statute for European parties therefore escaped media attention. Nevertheless a small revolution took place: for the first time in history, a European legal status for political parties was created. When the regulation enters into force in 2017, this legal status will give automatic legal recognition to European political parties in all member states.

In other words, all member states would accept that the European parties exist at the European level, which would then create the basis to develop their activities and campaigns in future. The newly elected European Parliament must now build on that decision by advancing a unified European electoral law. The Lisbon Treaty clearly states that members of the European Parliament are 'representatives of the Union's citizens', and not anymore, as in the previous treaties, 'representatives of the peoples of the States'. If the members of Parliament are representing all European citizens, how can it be defended that the seats in the Parliament are still solely distributed according to national quotas among national parties?

Ever since the Treaty establishing the European Coal and Steel Community (ECSC) of 1951, the European Parliament - then still called the Parliamentary Assembly - and the Council have had a mandate to adopt a uniform European electoral law, whereupon Parliament can *"draw up a proposal to lay down the provisions necessary for the election of its members by direct universal suffrage in accordance with a uniform procedure in all member states".*

This constitutional mandate was poorly implemented through the European Elections Act of 1976, which specified only a few basic common principles for the relevant national provisions on the European elections, for example that the elections must be based on proportional representation using either the list system or transferable vote system and that members of the European Parliament should not hold a similar office in one of the member states. With the Treaty of Amsterdam in 1992 this practice was legitimised ex post by the alternation of the article in question into a softer version, stating that the common rules shall provide for an electoral law *"in accordance with a uniform procedure or in accordance with principles common to all member states".*

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There was truly no lack of attempts to provide for a uniform European electoral law in the history of European integration, but all attempts were deemed to fail because of the resistance of national parties, national governments, or sometimes from within the Parliament itself. In 1998, the European Parliament proposed, on the initiative of the then Vice-President Georgios Anastassopoulos, for the first time, an option that would have introduced a transnational constituency comprising the whole territory of the European Union.

This idea was particularly controversial in the debate, even though only a small part of the deputies would have been selected via pan-European lists. According to the proposal the voters would have had two votes: one for the allocation of the national quota among the national parties, and another one for one of the European parties, which would have been responsible to select the candidates running on the transnational lists.

The importance of the European parties would thereby increase significantly, as they could actively take part in the campaign to present their candidates and programmes. Although according to the 'Anastassopoulos proposal' only 10 percent of the deputies were supposed to be elected on transnational lists, member states blocked the proposal. A similar initiative by the British liberal Andrew Duff in 2011, which foresaw 25 additional MEPs to be selected on the basis of transnational lists, failed to secure a decision in Parliament.

In the new legislative period the new European Parliament as well as member states, and the national parties, have the opportunity to prove that their calls for a more democratic Europe are more than mere lip service. It is high time that the political public debates are freed from their national chains and conducted across country borders, as has been the case within the European Parliament for a long time, where MEPs already organise themselves into political groups rather than into country delegations.

To this end, Europe needs a common electoral law with transnational lists decided democratically by the European parties. This would be the final breakthrough towards election campaigns and a European public space with European personalities and programmes - and a milestone for European democracy. ■

Focusing on the right things

Alisdair McIntosh is Director of Business for New Europe, an independent coalition of business leaders advocating a positive case for reform in Europe

The European elections have been and gone. The jury is in. And the verdict is - well, what exactly? In the UK, the headlines were captured by the gains made by the UK Independence Party, which secured 27 per cent of the vote, an increase of 11 per cent on the previous European elections. In France, the main story was the onward march of the Front National – 25 per cent and counting. Elsewhere, anti-Europe, anti-immigration and 'anti-austerity' parties made significant progress.

Depending on how you classify them – and that is an art-form in itself - 'parties of protest' will make up some 15 cent of the new Parliament. The big centre-left and centre-right groupings, which used to make up over 60 per cent of the seats, now have not much more than half. But the turnout remained low – 43 per cent across the EU, and just 34 per cent in the UK, as low as it has ever been.

The political classes across Europe and in the European institutions have clearly been given a shock. But what do the results mean, and what should they do about it?

The one glaringly obvious point is that many of the people who cared enough to vote aren't happy: either because they do not like what the EU is doing (or what they think it's doing); or because they do not like what their own national government is doing; or because of the economic and financial hard times of the last few years; or because they are disillusioned with the whole political system. Or a combination of all of these factors. And a lot of people either weren't aware of the European elections, or did not care enough to vote (except in Belgium and Luxembourg, where voting is compulsory).

So what conclusions should Europe's politicians draw from all of this? First, that collectively - and with one prominent exception - they have not managed to make their case in a way which either addresses popular unhappiness or enthuses the electorate. European leaders need to show they understand that. David Cameron, Angela Merkel, Francois Hollande and Mark Rutte have all talked - in broad strokes - about learning the lessons, and about the need for reform to address people's concerns. They need to find a way to make good on those messages.

The big exception to the rule was Italy, where Matteo Renzi's centre-left, pro-European party scored over 40 per cent, on a 60 per cent turnout, with a message of hope and optimism at a time when Italy is struggling with some pretty stiff domestic challenges. Renzi's counterparts could perhaps take some tips from him.

The second conclusion is that the EU institutions need to get off on the right foot for the new five-year term. This begins with the

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"... national and European politicians both need to show to disengaged and mistrustful citizens that they are working hard for a more prosperous and secure EU"

choice of top jobs, in particular the presidency of the European Commission. The stage is set for a bout of arm-wrestling between the new European Parliament - many of whose members think that it has a clear right to decide who gets the job - and the Council - many of whose member governments are equally firm that it does not.

The search is on for a candidate who has the personal qualities to lead the Commission; who can simultaneously win support of a majority of national governments and 376 votes in the EP; and who can, ideally, persuade European voters that new management will do better than the last lot. Herman van Rompuy, the outgoing President of the Council, has been tasked with finding a person who can deliver that. As they say, 'Good luck with that one'. Many names have been put forward, and many objections raised. The only safe prediction is that the process will take some time to resolve – which means that the new Commission may not get off to a flying start.

But whatever happens on the top jobs, the EU needs to show that it will be focusing on the right policies. For most people, that means action to promote growth and create jobs. There is a lot that can be done from Day One, with the number one priority being to complete the Single Market, ensuring that all member states obey the rules, and taking action to make sure that the playing field is genuinely a level one.

The Commission and Council need to act to removing barriers to cross-border provision of services, from construction, to architecture, to accountancy; to make cross-border e-commerce seamless, including tackling practical measures like product delivery and sales promotion; and to making a reality of the internal energy market, to deliver security of supply and bring down costs to businesses and individual consumers alike. Achieving this could give a massive boost to growth and jobs across Europe.

And the EU needs to step up its efforts to secure ambitious free trade agreements with the USA and Japan, which could have a dramatically positive impact on the European economy over the medium term.

Focusing on the right things also means showing a commitment to reduce burdens on business – to regulate less and better. And the EU needs to provide a convincing response to the charge that it interferes too much in things which are better left to individual member states. The Council has a golden opportunity to set down some new ground rules here - the Commission should respond clearly and positively.

More broadly, national and European politicians both need to show to disengaged and mistrustful citizens that they are working hard for a more prosperous and secure EU. The relationship between national parliaments and the European Parliament has to be, and to be seen to be, closer and more productive. This will demand a lot of politicians in national capitals and in Brussels and Strasbourg. The Commission and the Council Presidency have a tricky role to play in seeking to manage the tensions which will inevitably emerge.

The Italian government takes the EU's rotating Presidency in July. It has said that its key priorities will be the Single Market, jobs, and trade - exactly the kind of agenda that Europe needs. The backdrop is a challenging one. But perhaps, having succeeded on his own home turf, Renzi can help create some momentum on the European stage. ■

WORKING WITHOUT BORDERS

Why free movement of labour should be untouchable

Klaus F Zimmermann is a professor of economics at the University of Bonn, Germany, and director of the independent Institute for the Study of Labour (IZA), the world's largest research network in labour economics with more than 1,300 economists from over 50 countries

The free movement of EU citizens and workers within the European Union is one of the cornerstones of European integration. It is enshrined in the European Treaties.

In a free and integrated Europe, there is no place for first and second-class citizens. And yet, individual member states and interest groups are currently contemplating to turn back the clock and to restrict citizens' rights to accept jobs wherever they like within the EU.

Even if supported only by a minority within our single European market, this development must be viewed with growing concern. The intent to restrict the free movement of labour as a fundamental right runs against Europeans' well-understood

interests for a dynamic and prosperous economy. The calls for restricting this freedom are especially poisonous in the context of the ongoing political debate, aimed as they are to influence the results of the 2014 elections for the European Parliament.

A genuine European labour market – one without borders – is also a prerequisite for a functioning single market economy and the stability of the euro. Without it, growth prospects are hampered – as is any hope for a Europe which manages to balance the laws of supply and demand.

Actively embracing the unrestricted movement of labour has therefore many benefits. Beyond installing a new economic dynamism in the European Union, and helping to overcome serious economic imbalances among EU member states, it also dampens adverse demographic developments.

As a matter of fact, free labour mobility does not end in any welfare seeking migration but serves as a means to better allocate shrinking human capital capacities within the EU.

In short, the free movement of labour can lift all boats, promote economic growth and advance the competitiveness of our countries.

Tackle remaining restrictions

This is not the time to turn back the clock. Instead, the moment has come to tackle all existing obstacles that stand in the way of a truly free and integrated European labour market.

Only when we make that goal a reality will the core promise of the European Union – to continuously raise the standards of living of all of our citizens, wherever they live – not ring hollow. To fulfil our commitment, we must strive to take a number of specific measures:

- First, we need to adjust our tax and social security laws where needed – and better coordinate occupational and private pension systems.

- Second, we need to introduce an effective Europe-wide job placement system, so that workers can find opportunities in sometimes far-away places.

- Third, such a system also requires that we have transparent and effective rules to determine the benefits which job seekers are entitled to while looking for work in another EU country.

"... the free movement of labour can lift all boats, promote economic growth and advance the competitiveness of our countries"

- Fourth, we must enhance Europe-wide mobility by designing affordable language and relocation services. One critical way to encourage workers to take a chance outside their home country is to enhance exchange programs for trainees and workers, and further boost the successful models of international student exchange.

- Fifth, we must agree on standards that allow the EU-wide recognition of professional qualifications and degrees, so that those which such recognized degrees can seek work wherever they choose to.

- Sixth, we must open our minds to a European Union where even public-sector jobs in any member state may be filled by qualified candidates from another EU state.

- And seventh, we must do a better and more convincing job about informing EU citizens of the advantages of working abroad and receiving labour migrants at home.

It is, therefore, that a number of leading European labour economists have joined me in calling for an EU Charter that serves as a joint commitment to *'Working Without Borders'*.

To move the agenda forward decisively and irrevocably, an action committee should be composed of policymakers, representatives from the private sector and academia.

We need joint forces to expand the European dream, rather than narrow it down well before it has reached its full potential. ■

Transatlantic Trade and Investment Partnership - what EU business is looking for

Luisa Santos is Director of International Relations at BUSINESSEUROPE

The transatlantic economy is already the largest marketplace in the world and the most integrated one both in terms of trade as well as investment. The dominant size and wealth of the transatlantic economy implies that the relationship between the EU and the US also shapes the global economy as a whole.

The EU and US economies account for more than 50% of the world GDP in value, 41% of GDP in purchasing power and one third of world trade flows. Also: the US and Europe are, by far, each other's primary source and destination for foreign direct investment.

Trade ties are also important. The EU is the destination of 17% of US exports, making it the second most important trade partner behind Canada, while the US receives 17.3% of the EU exports, making it also the first export market. In 2012, the EU ran a surplus with the US in merchandise trade of €86.5 billion and of €13.9 billion in services.

The Transatlantic Trade and Investment Partnership (TTIP) is an unparalleled trade and investment deal that will bring the two biggest and most integrated economies in the world even closer to each other. Of course, this can only materialise if we have a deep and comprehensive agreement with no carve-outs, addressing both tariff as well as non-tariff barriers.

Major areas of interest for the EU business

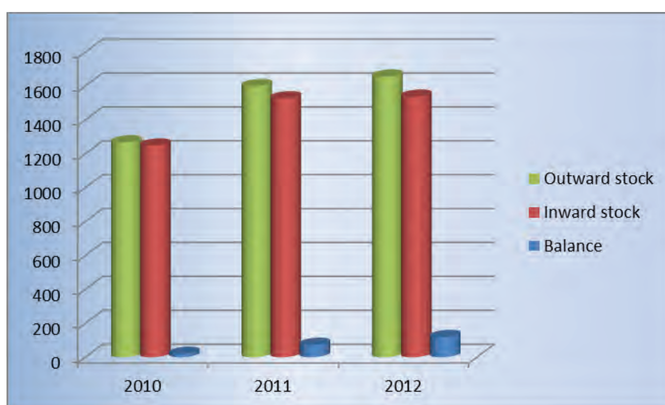
In terms of tariffs: in spite of the low average tariffs, the huge volumes of exchanged goods and services will allow for considerable gains from tariff dismantling. However, in certain sectors EU exporters are still confronted with very high duties - textiles and processed food[1]. So we are looking forward to an ambitious roadmap with significant front-loading and relatively short periods for phase out in the most sensitive products. This will allow consumers on both sides of the Atlantic a wider choice of goods at more competitive prices.

In regulatory cooperation different technical regulations and specifications, standards and conformity assessment procedures represent important market barriers. In many cases companies, in particular SMEs, have to manufacture two families of products or undergo similar testing procedures twice. Apart from increasing costs this may also delay market entry of innovative products. The agenda is complex and ambitious, and will require critical decisions on both sides. Both horizontal rules, as well as specific commitments in sectors, are important.

The objective is not to lower standards in the EU or limit the right of the EU or member states to regulate. **Horizontally** the objective is to set a framework that favours progressive convergence by encouraging cooperation and information exchange between EU and US regulators and increases transparency. At **sectoral level** the objective is to encourage sectors to come up with concrete proposals of legislative convergence whenever the differences are not of a substantive nature. These proposals should afterwards be taken up by the regulators.

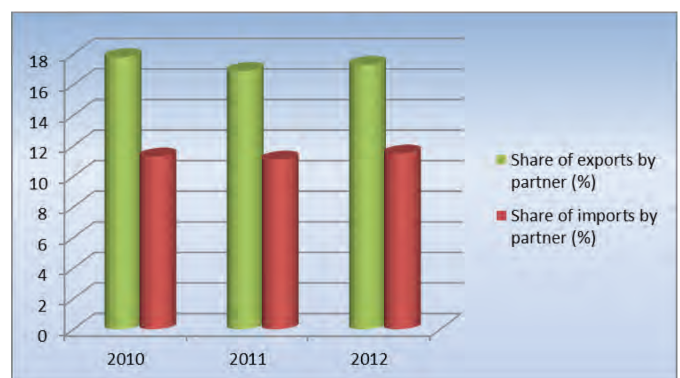
After the EU the US has the world's second largest **public procurement** market. TTIP is a unique opportunity to obtain

EU direct investment with the US (stocks, billion euro)



Source: Eurostat

Trade with US, share in EU trade



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This deal is not expected to be an easy one. Our economies are heavy regulated and we have a complex system that aims at ensuring a high level of protection for our citizens

additional public market opening - going further than the WTO Government Procurement Agreement that both EU and US are members of. TTIP should also effectively address all measures that promote positive discrimination towards national bidders. In the US public tenders often include 'buy-American' clauses that give preference to domestic companies over foreign ones. These clauses have increased significantly after the 2009 financial/economic crisis. A frequent restriction is represented by local content requirements, which make it compulsory for bidding companies to use American-made goods. TTIP should address these issues giving EU companies the same treatment as US ones.

In terms of investment TTIP should aim at ensuring that EU companies will be able to invest in the US without being discriminated *vis à vis* US companies (eg. by foreseeing in the agreement key principles like 'national treatment' and 'fair and equitable treatment'). Moreover it should grant security to investors by including an investor-to-state dispute settlement (ISDS) mechanism. ISDS allows for protection and adequate compensation of foreign companies' investments in cases of expropriation for example, or when there is absence of 'fair and equitable treatment'.

Investors will be able to launch legal action on 'neutral ground' and without politically sensitive considerations, in case the state breeches the rules established in the agreement. The aim is not to favour frivolous or unfounded claims against the states or prevent the states from regulating. ISDS should be a last resource mechanism and for this reason we look positively at ways to improve it.

That being said ISDS is common practice both in free trade agreements (FTAs) as well as bilateral investment treaties (BITs) worldwide. EU member states have been including ISDS provisions in their BITs and that is why it should be included in TTIP as well. The fact that the US is an OECD country in itself does not guarantee adequate protection for foreign investors.

The EU and the US cover more than 45% of world trade in **services**. The general rule in the agreement should be that full market access and national treatment should be granted for the provision of all services in all modes of supply, with very limited exceptions to this commitment explicitly spelled out ('negative list' approach) at a narrowly defined level. As many sectors as possible should be covered by the agreement, including financial services, banking, insurance and telecommunications.

To ensure an effective improvement in market access conditions we should be looking at commitments both at central/federal level but also at state/sub-federal level.

Energy has become even more important area with the recent developments in Ukraine and Russia. The EU urgently needs to diversify its sources of supply. Of course we need to do our job internally and also find new energy sources within Europe. However, we also need to look for alternative sources elsewhere; this means looking at new suppliers that can provide reliable and long term solutions. The US is certainly a possibility and we believe that TTIP could be the right framework to establish a long-lasting partnership between the EU and the US in this area.

For this reason we defend the inclusion of a chapter or specific energy provisions in the agreement addressing all existing measures that limit or set conditions to energy exports.

This deal is not expected to be an easy one. Our economies are heavily regulated and we have a complex system that aims at ensuring a high level of protection for our citizens.

However the gains of this agreement are also potentially bigger not only for the two partners directly involved but also for the rest of the world. If the EU and the US can manage to conclude an ambitious and forward looking agreement effectively the spillover effect will set golden standards in a number of areas that can be taken up both at bilateral and multilateral level.

European businesses remain strongly convinced that TTIP is a unique opportunity to further integrate the EU and US economies, reducing unnecessary costs and generating new business opportunities that will be translated into concrete welfare gains for companies both big and small, as well as for workers and consumers. ■

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The true face of neoliberalism

Mark van de Velde is a political scientist at the Telders Foundation, the Dutch liberal think tank

In the run-up to the elections for the European Parliament left-wing parties in many member states of the European Union blamed 'neoliberalism' for the dismal state of the European economy. The leading German social democrat, Martin Schulz, who currently acts as the EP's president and is running as a candidate for the presidency of the European Commission, posted an article on his LinkedIn page in which he drew some 'lessons' from the economic crisis.[1] The first lesson he offered is that *"the invisible hand of the market does not work and needs a robust regulatory framework... For the last three decades neo-liberalism has set the agenda. Deregulation, privatisation and tax-cutting became the dogma."*

The neoliberal blame game

If a lot of red tape, high taxes and state-run companies could have prevented the economic crisis, one wonders why precisely Portugal, Spain and Greece ran into economic trouble. None of these countries was known as a neoliberal paradise. But the point I want to make here is that Schulz, like so many other critics of free market economics, indiscriminately uses the word 'neoliberalism' without bothering to define the 'neo' in neoliberalism. And if neoliberalism is a full-fledged ideology, who and where are its adherents, the neoliberals? The European Parliament, which is chaired by Schulz, has been dominated for decades by Christian-democrats and social-democrats, and so have the parliaments of most EU member states. There is a liberal group in the EP too, though rather small, but none of its members has ever used the label 'neoliberal' self-descriptively.

Others have argued before that neoliberalism is often used as swearword or catch-all phrase for an enormous variety of politico-economic phenomena, some of which are contradictory.[2] For example, the breakdown of Bretton Woods and the introduction of floating exchange rates is often touted as a neoliberal victory, engineered by Chicago economist Milton Friedman (1912-2006), who is regarded as the pontiff of neoliberalism by the European left. At the same time, however, the introduction of the common European currency and, consequently, the austerity forced upon debtor countries, is blamed on neoliberalism too. These conflicting claims are ironic, for Friedman warned explicitly that a common currency for a continent as diverse as Europe was bound to wreak economic havoc and would deepen instead of erase political divisions within Europe.[3]

The end of laissez faire

Despite the fuzziness surrounding neoliberalism today, there is a historic form of neoliberalism. One of its main contributions to economics was precisely its insistence on the need of a regulatory framework. The origins of this neoliberalism can be traced back to interwar Europe, where a group of mostly German speaking economists in Austria, Germany and Switzerland feared that the rise of left-wing and right-wing collectivism would destroy the last vestiges of the liberal political order in Europe. Socialism and fascism regarded each other as the enemy, but from a liberal perspective both represented a totalitarian attack on individual freedom and human dignity.

To preserve, or rather restore economic and political freedom, these men wanted a new, positive liberal agenda. In the popular mind liberalism had become more and more equated with laissez faire, the idea that the less a government does the better it is. According to the neoliberals, however, laissez faire in practice led to random and distortive government intervention in the economy. One of them, Alexander Rüstow (1885-1963), who worked at the impotent German antitrust office, witnessed firsthand how a weak state falls victim to organised economic interests. He said in 1932: *"The new liberalism... calls for a strong state, a state above the economy, above interest groups"*.[4] Rüstow's friend and colleague Wilhem Röpke (1899-1966) blamed the proliferation of cartels on the feudal and absolutist history of Germany, where a cartel *"was next in rank to Court and Church"* and speaking disrespectfully of monopolies was *"as plebeian as the public use of a tooth pick"*.[5]

It is a grave mistake, said Röpke, to assume that the market is an autonomous system that can maintain itself without a legal, ethical and institutional framework. Without that framework capitalism will degenerate into corporate capitalism. The lines between economics and politics will blur: rather than trying to please consumers, entrepreneurs will try to win the favours of politicians and civil servants. The neoliberals often compared the required framework to speed limits and traffic signs, which regulate the behaviour of road users but leave them free to drive where it pleases them; whereas under collectivism each driver would be told which route to take.

The revival of liberalism

Across the Atlantic president Roosevelt had just announced his interventionist New Deal for the American people, which inspired famous journalist Walter Lippmann to write *The Good Society*. On the occasion of Lippmann's visit to Europe, a group of like minded intellectuals gathered in Paris in 1938 to discuss the revival of liberalism, the topic of Lippmann's book. Among the members of this group were Rüstow and Röpke, as well as Ludwig von Mises and Friedrich Hayek; the latter of the two had acquired some fame in Great Britain as a vocal opponent of John Maynard Keynes. They are often dubbed neoliberals, retrospectively, although quite a few of them were actually trying to resuscitate classical liberalism – in the tradition

stretching from Adam Smith (1723-1790) to John Stuart Mill (1806-1873) – rather than seeking a new liberalism. Their efforts were aborted by the outbreak of World War II, but they met again in 1947 to form the Mont Pelerin Society. Friedrich Hayek (1899-1992), who had taken the initiative for the society, spoke in his opening speech of *"a great intellectual task"* that was required to revive shared ideals for which *"there is still no better name than liberal"*.[6]

During the war Hayek had done his bit with the publication of *The Road to Serfdom*. The reputation of this book lives on as a plea for minimal government, but when reading the book one is struck by the firm rejection of laissez faire. *"Probably nothing has done so much harm to the liberal cause as the wooden insistence of some liberals on certain rough rules of thumb, above all the principle of laissez faire,"* Hayek argued.[7] The key difference between liberals and others was that the first are committed to *"planning for competition"* and the second to *"planning against competition"*, as Hayek called it. Key elements of the positive neoliberal programme were a social safety net, free trade, monetary stability, a free price system and antitrust politics. Half a century on, these are tested and proven conditions for prosperity and, at least in theory, cornerstones of the single European market.

The lasting legacy of German neoliberalism

Were the likes of Martin Schulz pushed to clarify what they mean when talking about neoliberalism, they would probably refer to Margaret Thatcher, Ronald Reagan, Milton Friedman and – perhaps – Friedrich Hayek, but certainly not to a bunch of interwar German economists. It is easy, therefore, to dismiss historical neoliberalism as an intellectual tour de force without consequences for the real world.

Yet this would be a mistake. First, Wilhelm Röpke acted as economic advisor to Ludwig Erhard, Germany's post-war minister of Economics and later Chancellor. Erhard, himself a member of the Mont Pelerin Society, is regarded as the architect of the Wirtschaftwunder, the 'economic miracle' in West Germany. He did away with the price and wage controls, broke cartels and monopolies, reformed the currency and popularised the concept of the 'social market economy'. According to Erhard, the adjective 'social' meant that *"the market as such is social not that it needs to be made social"*.[8] A free market is social because it serves customers best and because it is the only economic system compatible with democracy. This meaning was lost on social democrats who later appropriated the term, but it was well understood by Margaret Thatcher, who

"A free market is social because it serves customers best and because it is the only economic system compatible with democracy"

co-founded the Centre for Policy Studies in 1974. One of its first publications was a pamphlet titled *Why Britain needs a social market economy*.[9]

A second example of neoliberalism's lasting influence is European competition policy. Contrary to popular belief, the neoliberals did not think that the market should be left to itself. The essence of a free market is competition, and competition law is required to protect the market – ie. ordinary citizens – from monopolistic tendencies and cozy cartels. It is because of the insistence of the Germans that these ideas found their way to European competition law.[10] It is no coincidence that a close ally of Erhard, Hans von der Groeben, became the first European Commissioner for Competition Policy in the late 1950s.

A final example of how German neoliberalism – the real existing neoliberalism, not the bogus version that social democrats made of it – continues to shape the European economy is that price stability is the primary objective of the European Central Bank. Since the outbreak of the economic crisis this objective is frequently attacked. According to critics, the ECB should, for example, aim for full employment or kick-start the economy by creating inflation.

This may sound social, but the neoliberals argued convincingly that it is the ordinary man who suffers most from inflation. The new money that is being pumped into the economy does not reach each and every citizen at the same time, but it ripples gradually through the economy. Civil servants might benefit if they are the first to get a wage increase and spend the extra money buying products for 'old' prices. But people further down the line will be confronted with higher prices, while their wages or pensions are not (yet) adjusted for inflation. Inflation, particularly politically engineered inflation, is a perverse process of income redistribution. If those calling upon the ECB to push up inflation really care about social justice, they will take that neoliberal lesson to heart. ■

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What now for EU-Russia relations?

Fraser Cameron is Director of the EU-Russia Centre

Introduction

The EU has frozen its relations with Russia following Putin's annexation of Crimea and on-going machinations in Ukraine. Both the EU and US have imposed sanctions on Russia while G7 leaders reiterated their opposition to Russian policies at their meeting in early June in Brussels. This article considers the impact of the crisis on European security. It then examines the situation in Ukraine after the presidential elections and what the EU should do to support Ukraine. It then assesses the prospects for EU-Russia relations.

Impact on the European security system

The Russian annexation of Crimea and its destabilisation of Eastern Ukraine have refocused transatlantic attention on European security. In advance of the Wales summit in September NATO has turned its attention to Eastern Europe. The OSCE is also focused on the region. When Russia invaded Georgia in 2008 and helped establish two autonomous provinces of South Ossetia and Abkhazia it only received a mild slap on the wrist from the West. Many considered that the mercurial Georgian President Mikhail Sakashvili had brought the conflict upon himself. The EU led by President Sarkozy helped broker a cease-fire but Georgia's territory was emasculated and its ambitions of joining NATO put on hold.

The Eastern European members of the EU and NATO warned that Putin's ambitions would not be satisfied until he ensured control of Ukraine and other countries of the EU's Eastern Partnership. Their fears appeared justified when just a few weeks before the Vilnius summit in November 2013 Russia pressed Armenia to drop its plans for an association agreement with the EU. This was followed by similar pressure on President Yanukovich of Ukraine who overnight reversed his country's policy on moving closer to the EU. It was this move that led to the Maidan demonstrations in Kiev and the eventual ousting of Yanukovich.

To many experts it seemed that President Putin could not face the prospect of a pro-EU government in Kiev that might just carry out the reforms that would be required for a closer association with the EU. A successful, democratic Ukraine choosing its own foreign policy path was too much to contemplate. What kind of example would it be to Russians? As soon as the Sochi Olympics were concluded Putin ordered the annexation of Crimea arguing that he was righting a wrong, namely the 1954 decision by Khrushchev to give the Crimea to Ukraine. The West immediately condemned this move and refused to recognise Russian sovereignty over the peninsula. EU-Russia relations were frozen. Russia was expelled from the G8 and limited sanctions were imposed.

Although some thought that Putin's ambitions would be satisfied with the annexation of Crimea it soon became clear that Moscow's ambitions were much wider. Foreign Minister Lavrov gave the EU's high representative Catherine Ashton and US secretary of state John Kerry a list of Russian demands including clearance of pro-government demonstrators from the Maidan, a new federal system with the direct election of regional governments which would have substantial new powers, and acceptance of Russian as an official state language.

When these terms were rejected by the West, Russia's next move was to incite pro-separatist movements in Eastern Ukraine to occupy government buildings. And when the legitimate authorities in Kiev moved to retake the buildings they were denounced as 'fascists' by Moscow. Just before the illegal and provocative referenda in Eastern Ukraine on 11 May, Putin seemed to have a change of heart stating that the referenda 'would not be helpful'.

But it was too little too late. He also changed his mind on the 25 May presidential elections saying that they would be a 'step in the right direction'. Previously he had opposed the elections as a Western plot, along with the internet being a 'CIA plot' and the biggest plot of all - the desire of Brussels and Washington to take control of Ukraine.

So what will happen now? There has been a flurry of diplomatic activity to try and find an acceptable way forward for all parties. Russia refuses to attend another Geneva style summit. Germany has proposed a roundtable under OSCE auspices to try and secure an agreement among the warring factions in Ukraine.

The 25 May elections were deemed free and fair and led to the election on the first round of Petro Poroshenko, a chocolate oligarch, who enjoys some standing in Moscow. If Russia is seen to continue to undermine the new government in Kiev it will likely lead to the imposition of further sanctions. This is not the route that EU member states wish to follow but they all recognise the gravity of the situation and the challenge to the post Cold War security order in Europe.

The Ukraine crisis has given a new life to the OSCE and NATO. Many alliance members had always been sceptical of Russia and now their scepticism seemed warranted. NATO-Russia relations have been frozen and NATO has augmented its training in Poland and the Baltic States. In the run up to the Wales summit in October this year the agenda is less about the future of Afghanistan after NATO leaves but how to deal with the Russian bear. EU leaders are also under pressure to increase defence

expenditure as a result of Russia's aggression. This can hardly be viewed as a successful outcome for Russia.

Ukraine's future

Despite the successful 25 May presidential elections the future of Ukraine still hangs in the balance, not least because of the continued activities of the Russian-backed separatists in eastern Ukraine. The EU and US have no illusions about the parlous state of the country, the endemic corruption, and the failure to introduce economic reforms. But they are still prepared to offer a major support package for Ukraine, including a large IMF loan, and the accelerated signature of parts of the association agreement, if Kiev demonstrates a commitment to reform.

The problem is that Ukraine is still highly dependent on Russia for its energy supplies and more than a third of its trade is with Russia. Russia thus has many levers to influence the future of Ukraine without resorting to a military invasion. The fact that Putin has kept thousands of troops ready on Ukraine's eastern border is an unpleasant reminder of the military imbalance between Russia and Ukraine.

While Moscow may not want to invade Ukraine, with all the unforeseen consequences that such an invasion would bring, there is still a danger that it could be drawn into a conflict if the current high tensions were to lead to civil war. Putin has been granted authority by the Federation Council to use Russian arms to protect Russians under threat – anywhere! Under these threats from Moscow the interim government in Kiev has already announced a number of concessions including reform of the constitution and regional language rights. President-elect Poroshenko has promised to reach out to Moscow and try and accommodate the wishes of the Russian-speakers in eastern Ukraine without weakening the unity of the country. It will be a difficult balancing act although the election results showed there was no majority for separation in any region.

The EU has signalled that it is ready to increase technical assistance to ensure that key reforms in areas such as energy pricing are implemented quickly and effectively. The EU also reiterated its willingness to sign the Association Agreement (AA), including a Deep and Comprehensive Free Trade Area. There also needs to be an increased public information campaign to explain the benefits of the AA for Ukraine. The EU also needs to reiterate to Moscow that a prosperous, EU-aligned neighbour should pose no threat to Russia's interests.

The EU also needs to help Ukraine strengthen its political institutions, offer guidance on the separation of power, an independent judiciary, a strengthened parliament, a free media and civil society. It can also help promote national unity by promoting an inclusive language regime, equality of all ethnic groups, and a crack-down on xenophobic and anti-Semitic remarks and statements. Financial support should go hand in hand with economic and administrative reforms to ensure that these funds are not misappropriated. To this end the assets of Ukrainian politicians, bureaucrats and oligarchs in the EU should be examined and where appropriate returned to the Ukrainian government. Apart from reducing its own dependency on Russian energy supplies the EU needs to help Ukraine with a fundamental overhaul of its energy policy.

In the medium term there should be trilateral discussions with Russia on the practical questions arising from the completion of the EU-Ukrainian Association and Free Trade agreements. All sides should support the continuation of legitimate cross border trade between Russia and Ukraine, transparent energy cooperation, reciprocal investment agreements and maintenance of free movement of people between the two countries. The EU should speed up negotiations with the new government to remove the visa requirement for Ukrainian citizens. It should do more to provide more information about the Association and Free Trade Agreements in both Russian and Ukrainian. Should the EU offer a membership perspective to Ukraine? Some member states have argued yes but a majority remain against such an offer. The current agreed EU line is that the AA 'is not the final goal in EU-Ukrainian cooperation.'

"In the medium term there should be trilateral discussions with Russia on the practical questions arising from the completion of the EU-Ukrainian Association and Free Trade agreements"

Prospects for EU-Russia relations?

European leaders were swift to condemn the Russian annexation of Crimea. At a special European Council they agreed to suspend all negotiations with Russia, to impose limited sanctions and to approve Russia's suspension from the G8. Restoring EU-Russia relations will take time as trust has been broken.

This is illustrated by the two very different narratives on what happened in Ukraine. The Russian storyline is that the democratically elected leader, President Yanukovich, was overthrown in a coup orchestrated by armed, neo-fascist, Russophobes with the assistance of the West. Russia, at the invitation of Yanukovich, was forced to intervene to protect the lives of Russians and Russian speakers in Crimea.

The Western narrative is that mass demonstrations protesting corruption and President Yanukovich's decision not to sign an association agreement with the EU led to the use of lethal force on the demonstrators. The 21 February agreement brokered by three EU foreign ministers and Yanukovich did not hold because it was unacceptable to the population. Although Yanukovich fled the country in haste, there was never any threat to Russian speakers apart from a hasty law rejecting the use of Russian as an official language, a move that was quickly vetoed by the legitimate interim government.

The Russian justification for occupying Crimea was thus without any foundation and contrary to international law and many international agreements. Russia also claimed (wrongly) that it had been kept in the dark about the EU-Ukraine AA negotiations. EU officials had kept Moscow fully informed about the negotiations and the possible implications for the Customs Union.

So far the EU has imposed only limited economic and financial sanctions. But there are signs that the potential impact of further sanctions has led to capital flight and a dramatic fall off in new investments in Russia. The EU is reviewing its energy policy to reduce further its reliance on Russian supplies which make up almost 30% of the EU's requirements. Almost half of Russian gas to the EU comes via Ukraine which is another security problem. Russian gas supplies to Europe have always been based upon

mutual dependency. But given the annexation of Crimea, the threat to Ukraine and the prospect of further aggression, mutual dependence is no longer a reliable principle for the EU to count on. An aggressive Russia may begin to see natural gas more as a political lever than a source of revenue.

It is fortuitous that there are abundant supplies of LNG coming on stream through the shale gas revolution in the US and elsewhere. The EU is also speeding up work on inter-connectors to minimise the impact of any Russian move to cut off gas supplies. And the EU has threatened tougher steps against Gazprom for its anti-competition behaviour in the EU. There are also voices arguing for visa bans on the Russian elite and much tougher action against money laundering. If the Russian elite cannot use Western banks, buy property or shop in London, or educate their children in the West the impact would be enormous.

If and when sanctions are lifted will depend on Moscow. The EU and Russia have a substantial win-win agenda on which to cooperate covering trade and finance, the environment, terrorism, as well as regional security (Afghanistan, Iran, Syria, etc). But relations will remain frozen as long as Russia continues to challenge international borders. As President Barroso has said Russia has no real answer against the EU's soft power. The appeal of democracy and the rule of law is something that all educated Russians want in their own country. Putin's paranoia and populism may win him some short-term popularity. But in the long-term it leads nowhere. The EU's biggest weapon, therefore, is simply that it exists as a beacon to inspire others. ■

EU expansionism and the crisis in Ukraine

Robert Oulds is the Director of the Bruges Group and the author of *Everything you wanted to know about the EU: But were afraid to ask*

The recent events in Ukraine have caused even the most timid among the political class to express their views on the Kremlin and its attempts to sabotage the integrity of the Ukrainian state. The cascade of increasingly strong rhetoric coming from Washington, London, Paris, and even Berlin was recently joined by none other than Herman Van Rompuy, the President of the European Council.

In a press statement in Kiev on Monday, May 12th, Mr Van Rompuy firmly rejected the credibility of the two independence 'referendums' held in the eastern provinces of Donetsk and Luhansk the day before. *"We do not recognise the so-called referendums of yesterday. They are illegal, illegitimate and not credible"* he asserted – believing, no doubt, that he represents all that is legal, legitimate, and credible.

Though Van Rompuy's statement does not greatly differ from those of other Western leaders, where he stands out is as the personification of the proverbial pot calling the kettle black. How? Primarily in the fact that he has reached the position of Council President (who presides over 28 elected heads of state and government) without ever appealing to the peoples of Europe, and without ever being elected.

His office was created by a treaty that was designed to circumvent the voices of Europeans, as it was drafted in the wake of its predecessor's demise following the 2005 EU Constitution Referendum. One must at least commend the EU in its conspicuous attempts to avoid the ballot-box, rather than the farcical 'democratic' masquerades that were the three so-called 'referendums' held in Ukraine's eastern provinces. Though the appointment of Van Rompuy is 'legal', the legality of his position was devised in the wake of three resounding 'no' votes by the French, Dutch, and Irish electorates. Democracy is therefore as inconvenient to Brussels as it is to Moscow, if not more so.

As for legitimacy, Van Rompuy has no lessons to bestow upon Russia. For all his electoral fraud, some Russians actually voted for Mr Putin. Even a single genuine vote for the Russian president or the independence of a 'People's Republic' between Ukraine and Russia garners more legitimacy than that of the European Council's President, for whom not a single vote was cast.

In terms of credibility, the man with the title 'President', who has no popular mandate and whose position exists due to the systemic avoidance of public consultation, holds absolutely no weight on the global stage. When compared to Angela Merkel, who not only holds a strong public mandate by Europe's largest electorate, but stands at the helm of the continent's strongest economy, Van Rompuy is a side note.

When political leaders point to the 25th of May as the only important day for Ukrainian democracy, they do not realise that it is in fact the only important day for democracy on the whole continent. While Ukrainians hold their presidential elections, the voters of the EU's Parliamentary elections expressed their true sentiment towards Brussels, and Herman Van Rompuy's claim to legality, legitimacy, and credibility.

We do not have to be enthusiastic advocates of Vladimir Putin's policies to recognise that this entire Ukrainian crisis was avoidable. Nor to recognise that the Crimea – handed over by Khrushchev within the Soviet Union to Ukraine in 1954 – has

been and remains a vital national security and defence interest for Russia, including the Black Sea and its fleet for centuries. The European Union's Eastern Partnership and Association Agreement were clearly anticipated to be Ukraine's stepping stone to membership of the European Union, and probably of NATO as well. On both counts the EU has pursued a remarkably naïve foreign policy.

There has undoubtedly been fault on both sides, and the best thing is to be realistic. Ukraine itself is said to be in such financial turmoil that it would require a bailout of something of the order of $35 billion over the next two years – much of which would presumably fall on British taxpayers. But the original fault lies with the EU and the way in which it has gone about all this.

Whilst not arguing that there should not have been some form of political cooperation and trade – because they are essentials – a key problem has been the manner in which the EU Eastern Partnership and Association Agreement was pursued, and the terms on which EU negotiation was presented and the EU attitude towards Russia – all of which was compounded by the refusal to attend the Winter Olympics in Sochi.

There has to be a rational and statesman-like way of dealing with the Ukrainian situation and to guarantee that it becomes a truly democratic country. The interim government with which the EU has been negotiating with was not even elected and in fact achieved power after a violent putsch overthrowing a democratically elected President, and yet we hear extravagant claims of democracy and the rule of law. Both are conspicuously absent.

"Western backed regime change in Ukraine has only succeeded in bringing to the fore and provoking divisions in a fundamentally divided nation"

For example, when the new interim unelected government was set up, the Ukrainian Parliament passed a law that would have stripped the Russian language of its special status in the constitution – despite this having been pivotal to Crimean voters and interests during the 1991 referendum on Ukrainian independence. Oleksandr Turchynov, the then interim President, then vetoed the law that would have demoted the Russian language, in a move aimed at reducing the hostility of Russian-speakers in the east of the country.

The dismal failure by the EU over the last several years properly to take into account the sensibilities of Russia in relation to the Crimea and the Ukraine in their relentless pursuit of the Eastern Partnership and the Association Agreement is a matter of grave concern.

The EU's ambitions for the Eastern Partnership and the Association Agreement and its Deep and Comprehensive Free Trade Agreement is responsible for damaging the relationship between Russia and Ukraine.

The agreement between the EU and Ukraine is not just about trade. It includes foreign policy, defence and regulatory integration with the European Union.

In Article 7 Ukraine must now, *'…promote gradual convergence in the area of foreign and security policy, including the Common Security and Defence Policy (CSDP) ...'*

In Article 10, *'... increasing the participation of Ukraine in EU-led civilian and military crisis management operations as well as relevant exercises and training activities, including those carried out in the framework of the Common Security and Defence Policy (CSDP).'* and:

'... explore the potential of military-technological cooperation. Ukraine and the European Defence Agency (EDA) shall establish close contacts...'

This is alarming Russia. What is more as most of Ukraine's industrial exports depend upon the Russian market the peoples of east Ukraine do not want their jobs to be threatened by the re-orientation towards the EU. It is not just a matter of economic links, the industrial east also has close family, linguistic and cultural ties with Russia. The Moscow Patriarch is their religious leader. What is more, the Donetsk region was briefly an independent republic in the early 1920s. The referenda in the east have reconfirmed this status.

It is understandable that the east of Ukraine would reject the western putsch and seek to determine their own future.

The genesis of the crisis was the overthrow of the elected President Yanukovych who had postponed signing the Association Agreement with the EU in the hope of achieving a free trade deal with the EU and with Russia. This suggestion was rejected by Brussels in December 2013. Yanukovych saw that Ukraine could be neither solely Western European nor Russian but in fact both. This neutrality was rejected by the west and Russia has understandably reacted.

To understand the rationale for Russia's actions, we need to view recent events in Ukraine from Moscow's point of view. Ukraine is regarded as the cradle of Russian civilisation with the founding of the first eastern Slav state in the 9th century. The majority of present day Ukrainian territory was only transferred to the province during the time of the Russian Empire and much of it had historically been Russian.

Far from condemning inflammatory statements by far-right groups and dampening anti-Russian sentiment, from Moscow's perspective the EU appeared to be actively encouraging it. The new Ukrainian parliament's first actions exacerbated Russian speakers' fears. Recent events have shown us that the far-right in Ukraine holds a growing and disproportionate influence in the new government – and it is wrong of the EU to overlook this just because their hostility is directed towards Russians.

Events in Ukraine have been presented as a simple case of good versus evil, of democracy versus dictatorship, and of Europe versus Russia. Viktor Yanukovych is often described as being 'pro-Russian', as if that in itself was sufficient reason to depose him, while Russia has been accused of bullying Ukraine to keep it in Moscow's sphere of influence.

Although he was hardly a role model for selfless public service, Yanukovych did try to chart a course for Ukraine that sought to balance relations with Russia against European aspirations. He was no pro-Russian politician, supporting intervention in Iraq, refusing to follow Moscow in recognising the breakaway republics of South Ossetia and Abkhazia as independent, and continuing cooperation with NATO.

Russia undoubtedly placed pressure on Ukraine to reject the Association Agreement, but the reality is that the EU also did a lot of bullying and exacerbated the crisis by trying to force Ukraine to choose between a European future and ties to a country with which it feels a deep and historical cultural affinity. The EU placed restrictive quotas on Ukrainian exports to the Single Market. These would only be waived if the Ukraine entered into the Association Agreement with Brussels. Forcing Ukraine to adopt EU regulations that would harm the industrial east of Ukraine.

The EU refused to countenance Yanukovych's suggestion of a trilateral EU-Russia-Ukraine commission to address trade disputes. They made it clear that they would lobby the IMF to refuse Ukraine the bridging loans it needed to cover its external debt if he did not sign the agreement. It refused to offer any concession to address the real pain and bankruptcy that would be caused if Ukraine were to surrender free trade access to the Russian market. Rather than recognise that Ukraine will always have complex and intertwined relations with Russia and that its economy is largely dependent on Russian goodwill, the EU instead demanded a clean break.

Faced with an impossible situation and both sides placing Ukraine under unbearable pressure, Yanukovych had little option but to postpone the agreement. That his decision to do so would prompt protests should not have been unexpected, but what was deeply unwise was the open support given by Baroness Ashton and EU foreign ministers to those who called for the overthrow of Ukraine's elected government. Moscow's statement that the West has shown little regard for international law in its handling of the Ukraine crisis has an element of truth. They should also have anticipated that the east would object.

Russia also has a valid point that the EU has shown double standards in its application of the principles of territorial integrity and self-determination, supporting the independence of Kosovo but refusing to countenance the demands of those who would prefer to break away from other European states to look towards Moscow, regardless of how valid their claims might be. Compared to Kosovo, Russia's actions in Crimea appear moderate – at the time of production there has been no warfare, no killings, no pogroms or ethnic cleansing, and there appears a clear democratic mandate for its incorporation into Russia. Compare this to the violence, bloodshed and ethnic cleansing that followed Western intervention in Kosovo, or similar interventions in Iraq and Afghanistan.

Western backed regime change in Ukraine has only succeeded in bringing to the fore and provoking divisions in a fundamentally divided nation. The intolerance of the EU, backed by the United States, to Ukrainian neutrality has brought this country to disaster. It is now time to recognise that it is a failed state. ■

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POST-SOCIALISM IS OVER

TRADE REALLOCATION BETWEEN THE EU AND RUSSIA

Igor Bagayev and Boris Najman are affiliated to the University Paris-Est Créteil, ERUDITE. Boris is also a Fellow at CASE - Centre for Social and Economic Research, Warsaw

Recent political background: post-socialism is over, crisis in Ukraine

2014 marks the 25th anniversary of political changes in the former communist countries. Yet, it seems that 'post-socialism' is over. We have now entered a new period of high political and economic instability. The recent events in Ukraine, including the Russian intervention in Crimea and in Ukraine's South and Eastern regions, raise multiple questions about the future trade relations between Russia and EU countries. It is therefore important to discuss their possible consequences for the EU trade with Russia, as EU is the main trade partner of Russia.

In this paper, we investigate the trade trends, structure, and main partners of Russia between 1992 and 2012. We can observe in detail the dynamic of the sectorial trade for Russia since 1992, and we can discuss the possibility for Russia the reallocate (or not) the trade flows from and to the EU. For the EU, we discuss the efficient and feasible sanctions on Russian economic sectors.

The aim of the paper is to discuss trade perspectives for Russia in the next decade. We are using historical data for trade over last twenty years and we aim to underline the vulnerabilities of trade relations with Russia. The global picture shows that Russian economy is very linked to the evolution of its exports, and especially the fuel sector exports. Almost all the GDP trend can be explained by the oil sector exports (see graph 1).

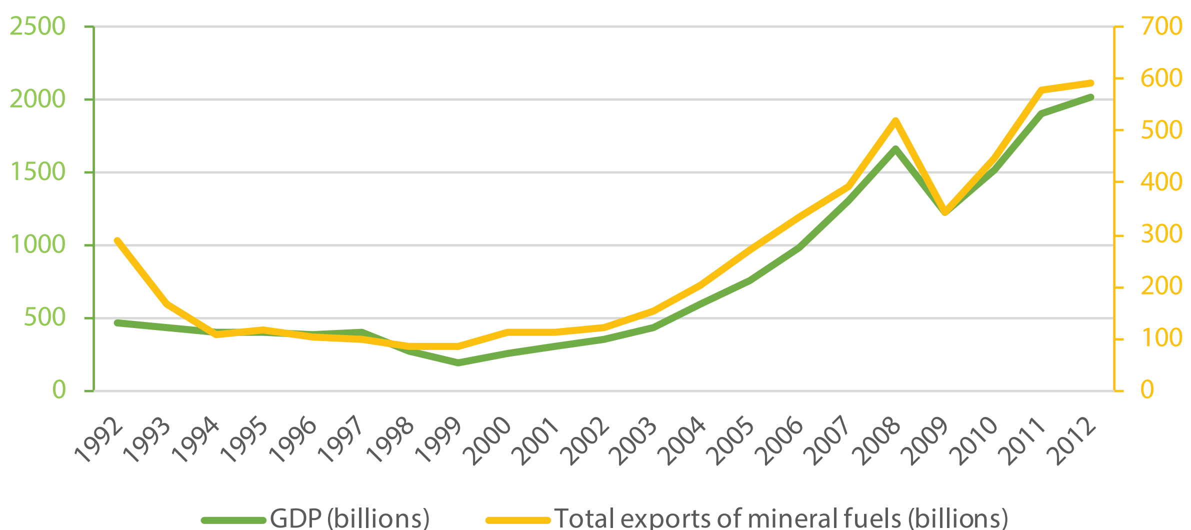
Trade overview: Russia is highly dependent from the EU

EU is the main Russia's trade partner. During The Yeltsin Presidency, Russian exports to the EU have increased from less than 10% to almost 50% of total Russian exports (see graph 2). The trade reallocation was fast and has allowed Russia to increase substantially its trade surplus (see graph 7). Since 2000, the trade openness (at around 50% of GDP) and the EU share in trade are stable (around 45% of total exports). The lack of deeper economic reforms and trade diversification has stopped further trade development in Russia. Today, Russia mainly remains an oil economy.

For the EU, the situation is asymmetric: Russia represents only 7% of total EU exports (4th partner) and 11% of its total imports. EU has a very diversified trade and is able to export high value added products.

Within the EU, Germany is by far the main trade partner of Russia. Italy, Netherland and France are somehow important but not as a single partner (see graphs 3 & 4). The former trade

Graph 1: Evolution of GDP and total exports of oil and gas in Russia, 1992-2012



Sources: UN COMTRADE, all values expressed in current US $

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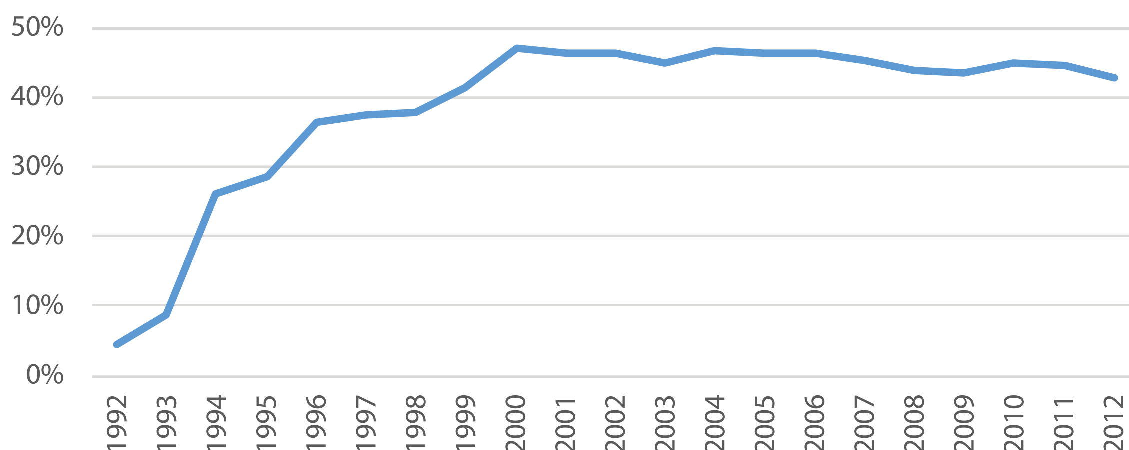
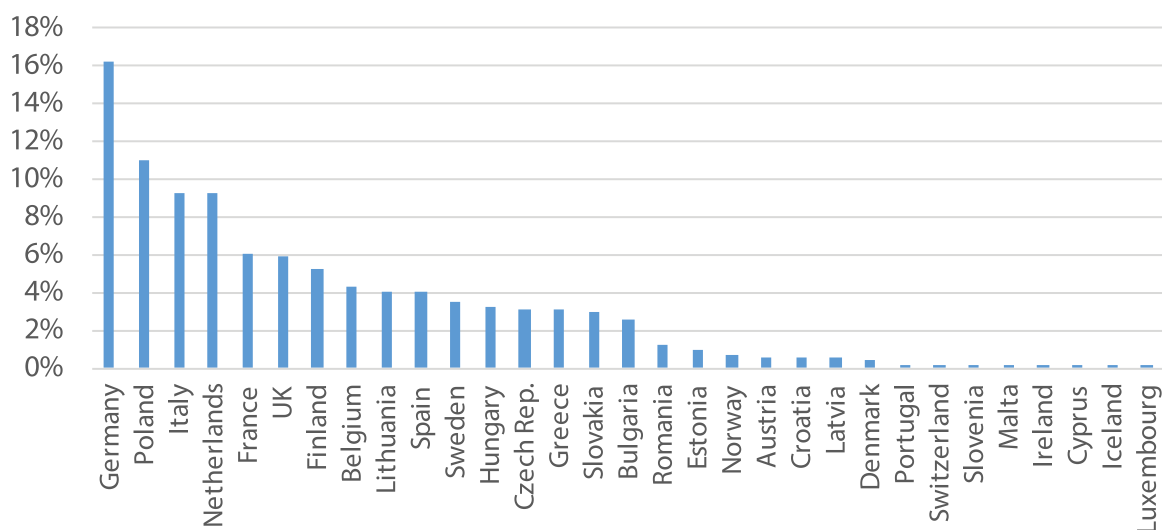
Graph 2: Share of exports to EU in total Russian exports, 1992-2012



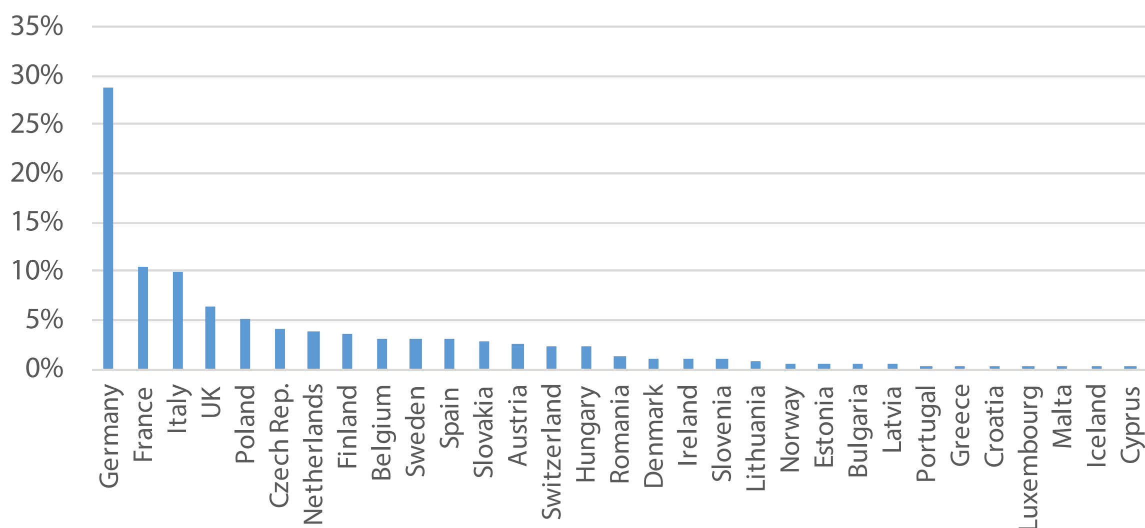
Sources: UN COMTRADE

Graph 3: Share in total European imports from Russia in 2012, by countries



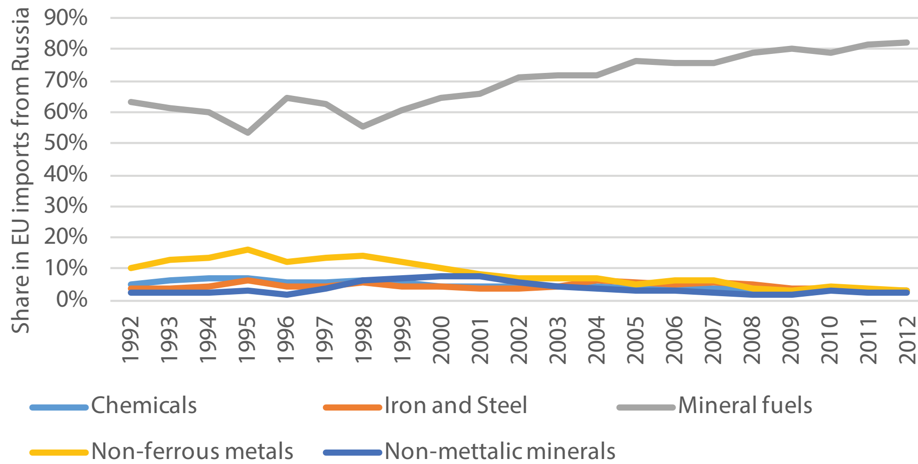
Sources: UN COMTRADE

Graph 4: Share in total European exports to Russia in 2012, by countries



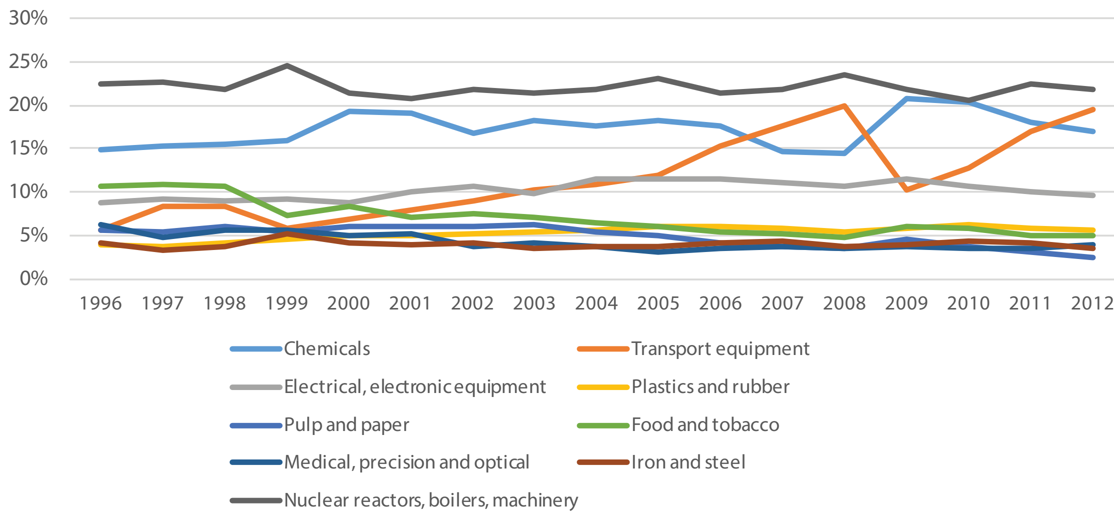
Sources: UN COMTRADE

Graph 5: Evolution of the structure of main Russian exporting sectors to EU, 1992-2012



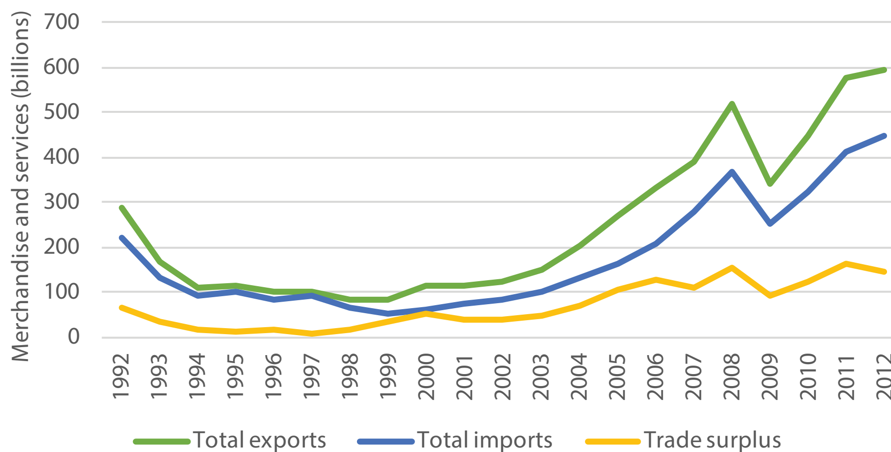
Sources: UN COMTRADE

Graph 6: Evolution of the structure of main Russian import sectors from EU, 1996-2012



Sources: UN COMTRADE

Graph 7: Evolution of total exports, imports and trade surplus (merchandise and services): 1992-2012



Sources: WDI, World Bank, all values in current US $

"On the long run, the issue for the EU is what can be done to protect European independence from Russian energy and its new political influence and regional destabilization. This is the main task for EU energy and trade policies in the next decade"

partners from the USSR period are still present, such as Poland, the Czech Republic, Lithuania, Slovakia or Hungary, but on a lower scale. Hence, in all scenarios on possible trade sanctions against Russia, Germany will be in the centre of the decisions.

Trade specialization: Russia dependence on oil and gas

When we look at trade data, the first surprising fact is that Russian trade structure remains very stable since 1994. The main evolution is coming from the energy sector (oil and gas). The oil and gas sector has increased its share in total exports and represents more than 80% of total exports to the EU in 2012. This is essentially due to energy price increase. Russia is mainly an oil and gas rent economy. Oil, compared to gas, is largely dominant in all trade relations.

Other sectors, mainly metals and mineral sectors, have progressively decreased their share in the Russian exports. Russia faces a deep 'Dutch disease' phenomenon. The oil and gas sectors dominate all its exports and made all other productions uncompetitive. Russian economy is addicted to energy and therefore very dependent on EU for its exports, especially for the fuel sector.

The structure of Russian imports from the EU across sectors is also relatively stable in time, but much more diversified. Half of the imports from the EU are in machinery (and nuclear equipment) sector and durable and semi-durable consumer goods (electrical and transport equipment sectors) (see graph 6). Russia is very dependent on EU for those technologies and is not able (or not competitive) in producing most of them.

Ruble devaluation and trade

Russian interference in the political turmoil in Ukraine led to a sharp devaluation of the Ruble. Since the beginning of the Crimean crisis in February the Russian currency lost about 10 percent of its value against the US Dollar. And without the intervention of the Russian central bank, the ruble would have devalued even more sharply. Could this depreciation support international competitiveness of Russian exports? It is very unlikely.

Russian exports are outrageously dominated by fossil fuel trade (see graph 5). But oil and other commodities exports (as metals) are traded in Dollars on global markets, and thus are not positively affected by more affordable Ruble. At the same time Russian imports become more expensive. One of the first direct consequences of the current Ukrainian crisis should be a serious deterioration of the Russian trade surplus balance vis-à-vis the EU.

Trade perspectives: what can be the road?

Since the 1990s, Russian economy has become very globalized, the trade openness is over 51% of GDP (2010-12) and the economy is highly dependent from oil exports. It is therefore impossible for Russia, on the short or medium term, to diversify exports both in terms of sectors and/or partners. For Russia, the EU needs to remain the main trade partner. This is particularly true for natural gas as necessary infrastructures (especially pipelines) freeze trade reallocation at the short run.

Russia is trying to establish new energy partnership with China, but the agreement on gas will take time and resources to be a real alternative for Russia. Russia has no possibilities and interests to reallocate trade relation from EU toward the CIS. Russia largely gains from trade with the EU: the Russian merchandise trade surplus in 2012 is about 195 billion and is over 107 billion with the EU (see graph 7).

EU is not so much vulnerable to a 'trade war' with Russia. For the EU it will be possible, but somehow costly, on the medium term to diversify both in terms of partners and sources of energy. This will be the main challenge for the EU energy policy in the next decade. On the energy issue, the EU independence is at stake.

The main geopolitical concern about the EU-Russia trade involves also natural gas. About 30 percent of gas consumed in EU is provided by Russia, which used in recent years the fear of gas supply disruptions as political weapon (2005, 2009). To some extent EU member states may replace Russian gas delivery to be less vulnerable. In the short term, alternative supply – via LNG from Algeria, Nigeria or Qatar, or piped gas from Norway – or coal substitution, could at least partly replace Russian gas.

In both cases, additional economic or environmental costs will be associated with, even partial, Russian gas replacement. Price of further potential LNG imports should be about 30 % more expensive than current price of gas delivered by Russia. But in the longer run increased renewable facilities (in particular wind), US LNG exports and, most of all, energy efficiency improvements should relax the energy dependency constraint that weigh on many EU member states. Several incentives currently undertaken in EU are pushing in this direction.

What are the feasible sanctions for the EU?

As the political and military situation may deteriorate in Ukraine and in former CIS countries, it is very important to discuss the possible sanctions that EU can impose on Russia. In the energy sector, Russia is very vulnerable to trade sanctions imposed by EU, but most of them are difficult to implement. The oil market is open and the EU has no possibilities to block Russian exports. EU Sanctions in the gas sector are more feasible, but are not as powerful as oil on Russian economy. Probably the most efficient sanctions will be in the financial sector, since Russian banks are very vulnerable. The financial approach will most likely be the most powerful in order to bring back Russia to reasonable and peaceful relations with Ukraine and the EU.

On the long run, the issue for the EU is what can be done to protect European independence from Russian energy and its new political influence and regional destabilization. This is the main task for EU energy and trade policies in the next decade. ■

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The energy triangle: the EU, Ukraine and Russia

Olesia Ogryzko is an associate researcher at the Madrid-based think tank FRIDE

Energy has always played a crucial role in European policy, often being a system-building factor. In fact, European integration in part began in the energy domain, through the European Community of Coal and Steel, – and later on, the European Atomic Energy Community. Energy – in particular the oil and gas sector – is a top factor when assessing European advancement. It is also a key issue in the European Union's relations with third countries.

Ukraine is a key energy partner of the EU. Its transportation network, until recently comprising 4,600km of pipelines running through its territory, makes it the largest transit country for hydrocarbons into Europe. This predetermines Ukraine's energy relations with the EU, and its success or failure will have a significant impact on EU (and Ukrainian) energy security. It is thus in the interest of both parties to establish and maintain a mutually-beneficial cooperation in the energy sector, in particular with a view to ensuring an efficient, reliable and safe gas supply.

The energy chain consists of three basic elements: the supplier, the transporter and the consumer. Most importantly, good relations with the supplier must exist in order to ensure an effective interaction. Hence, for the EU and Ukraine to be able to collaborate effectively, both have to maintain at least normal relations with Russia.

An analysis of the Russia-Ukraine energy relationship after the collapse of the Soviet Union shows quite the contrary, as relations have been marked by blackmailing, price hikes, gas wars and the like. Most significantly, two Russia-led gas pipeline projects – North Stream and South Stream – will undermine Ukraine's role as a major transit country into the EU's energy market.

North Stream is a 1,224km offshore gas pipeline directly connecting Russia and Germany. It runs under the Baltic Sea, avoiding therefore the need to use traditional transit routes through Ukraine and Belarus. Construction works began in April 2010 as a joint project involving four major European energy companies – E.ON, Wintershall, Gasunie and GDF Suez – as well as the Russian Gazprom, the biggest advocate and funder of the project. It has a total capacity of 55 billion cubic meters (bcm).

This initiative, however, is largely considered a political project rather than a purely energy-related one. As Russian President Vladimir Putin has put it: *"Gas will be supplied directly by the shortest route, linking the major Russian gas reserves to European markets without transit risks, steadily and smoothly. We can guarantee this"*.[1]

For its part, South Stream is expected to be completed by 2015 with a total capacity of 63 bcm of gas annually. This envisaged 930km-long pipeline is to provide Italy with Russian gas by running under the Black Sea and through a few European countries, namely Bulgaria, Slovenia, Serbia, Hungary and Austria.

With a total combined transit capacity of 118 bcm, these two pipelines will imply huge economic losses for Ukraine, and constitute a major threat to Ukrainian energy security. North Stream, which is operational, has already led to a considerable drop in the volumes of gas transported through Ukraine. After the launch of the first line in 2011, transit fell by 15 per cent. After the launch of the second one in 2012, the drop was over 21 per cent. Currently the pipeline is only 30-40 per cent operational and so Ukraine's losses are expected to increase further. Estimates forecast that when both pipelines become fully-operational, Ukraine (with a GTS of around 142 bcm) will essentially lose its role as a transit country.

The EU, by either supporting or not objecting to the implementation of these projects, is contradicting its pledge to enhance the transit of oil and gas through Ukraine embedded in the 2005 Memorandum of Understanding, as well as in some provisions of the Energy Community Treaty. In May, Energy Commissioner G Oettinger affirmed that the EU would not block the construction works as long as Russia respects the internal rules of the EU, which is striking, in particular in light of the Ukraine crisis and Russia's illegal annexation of Crimea.

That said, the Bulgarian-Russian bilateral energy agreement on South Stream gives preference to the companies of the respective countries, something that runs contrary to EU internal competition rules. Despite US imposed sanctions on G Timchenko, the Russian tycoon who is a major shareholder of Stroytransgaz (the Russian company that won the tender for the construction of South Stream), the consortium is reportedly building the Bulgarian stretch of the gas pipeline. Similar agreements have been negotiated with Austria, Italy and Hungary.

The absence of a single external EU voice in energy matters also stands in the way of a fruitful cooperation between the EU and Ukraine. First, it makes Ukraine's adaption process to EU energy structures as well as the negotiations between the two actors more difficult. Differing positions inside the Union also complicate matters for Ukraine. A clear example was Slovakia's resistance to proceed with the reverse flows to Ukraine. Slovakian companies, tied to Gazprom's supply contracts, were blocking the advancement of Ukraine's diversification efforts

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(until the EU intervened). Imports from Slovakia via the reverse flow to Ukraine could amount to nearly 10 billion bcm per year – satisfying up to 20 per cent of Ukraine's demand.

While such an absence of a unified European external energy project can be negative for the EU and Ukraine, Russia in contrast stands to gain. First, by creating competition among member states Russia gains a huge bargaining tool to negotiate long-term gas and oil supply contracts. Second, it hinders the elaboration of coordination mechanisms that could potentially restrict Russia's special position in the European energy market. Third, this provides Russia with a sound basis to lobby for various energy projects, including transit routes (such as the North and South Streams) which can be advantageous for individual states rather than for the European Union as a whole. Opting for a bilateral mode of cooperation with separate EU member states, Russia aims to secure its monopoly on the EU's energy market.

EU-Ukraine bilateral energy cooperation is also challenged by Russia's efforts to present Ukraine as an unreliable and unstable transit country, evidenced in 2006 and again in 2009 when Russia repeatedly used energy as an instrument of political pressure. Although many EU member states acknowledged that Russia cut off supplies unauthorised, some saw it as an indication of a lack of transparency in Ukraine's transit service. To this one must add Russia's energy lobby in Europe and well-organised information campaigns implying that Ukraine was stealing gas destined for the EU.

A solution would be to grant European partners access to Ukraine's gas counting stations, as well as allow for the purchase of fuel on Ukraine's eastern boarders, contrary to the current practice on the western EU-Ukraine border. But despite numerous statements from Ukrainian as well as EU officials on the readiness to change the place of purchase (lifting the curtains over the transit process in Ukraine), Russia has so far vetoed the process.

For a country whose energy trading accounts for over 50% of its annual budget, this is a way to secure income and stability. Russia's Energy Strategy until 2020 states that the country's energy resources should serve as an instrument of foreign policy. Ultimately, Russia wishes to remain the EU's key external gas supplier and therefore any major energy project or agreement without Russia's participation is seen as a direct threat that must be confronted.

Not much analysis of the current hybrid war in the East of Ukraine mentions energy. However, it is not a coincidence that the fiercest terrorist actions are being conducted in the Donetsk region in Sloviansk. According to recent studies, Sloviansk is one of the richest sources of unconventional gas in Europe, which could transform import dependent Ukraine into a fuel exporter. In the short-term, Ukraine could potentially increase its own production by 30-40%, or approximately 10 bcm. The crisis could also threaten the recent announcement by the energy company Shell to invest 200 million USD to start operations in 15 drilling stations in the area.

"Strength via unity, the principal behind the European project, should really become the cornerstone of EU action"

Nevertheless, some progress has been registered in EU-Ukraine energy relations. Numerous projects outlined in the 2005 Memorandum of Understanding attest to this.

First, the harmonisation of technical norms and standards has already begun. The EU has carried out several feasibility studies and impact assessments alongside with permanent consultations with European expert groups on corresponding energy standards. The EU has also helped in the transposition of several important EU energy directives and regulations, the improvement of Ukraine's investment climate, increasing the transparency of the financial system, corporatisation and restructuring of state gas companies, among others. Most significant is Ukraine's accession to the Energy Community in 2011, which aims at promoting EU energy standards in Southeast and Eastern Europe. This constitutes a major milestone in Ukraine's energy policy.

Second, Ukraine's Boyarka Gas Metrology Centre has been modernised and is now fully operational, serving as a monitoring system and an oil laboratory to certify oil quality. There are further plans to transform this centre into an international hub in the long term.

Third, various energy infrastructure projects are already underway, in cooperation with the European Investment Bank and the European Bank for Reconstruction and Development, aiming at enhancing the transparency of hydrocarbons transit.

Ukraine could become a success story of the EU's energy policy. By contributing to Ukraine's energy market development and liberalisation Europe will be guaranteeing its energy security. The EU should live up fully to its commitments to enhance not only supply but also transit security. A broad EU-Ukraine energy cooperation will depend mainly on two things: a realistic assessment of Russia's energy policy and a unified European stance. The EU and its member states should look beyond narrow national commercial interests and think about the long-term energy security of the EU as a whole. By speaking with one voice in energy matters, the EU can secure a stronger negotiation position vis-à-vis third countries and avoid internal tensions that could spill-over to other areas of cooperation and harm the Union's performance in general. Strength via unity, the principal behind the European project, should really become the cornerstone of EU action. ■

1. http://www.reuters.com/article/2012/10/08/russia-nordstream-idUSL6E8L8EKJ20121008

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A Perfect Match

For over 28 years Kelleher International has been creating exclusive matches. In a Q&A with *World Commerce Review*, Amber Kelleher-Andrews talks about how her company finds love for top-level executives

Can we begin by learning about the history of Kelleher International?

My mother, Jill Kelleher, founded Kelleher International in 1986 after working for a video dating service in the early 80's. Similar to on-line dating, people would go through photographs and videos of members and select who they wanted to meet based on pictures. If people had really good photographs they would get asked out more than others. My mother felt compelled to start matching the clients before they went through the superficial selection process and in doing so, was very successful in putting relationships together. She realized there was a need for this personalized service and started her own matchmaking company in the San Francisco Bay Area in 1986. Nine years later, I joined my mother as CEO of Kelleher International. Shortly after, I became a partner as we expanded the business across America and into Europe and still remain today remain a family owned business.

Kelleher International is renowned for ensuring compatibility between individuals; how does your unique approach work?

Our clients tend to be very similar. We receive thousands of submissions globally, but look for similarities that match well with our existing clientele base. They are cultured, educated professionals, who are stylish, interesting and ready for a serious relationship. When interviewing our clients we find out what's important to them and then customize a search for the person that they wish to meet.

It is important that our matching process stays close to our clients original criteria, and that the learning curve for us as facilitators goes up after each introduction. We also truly love putting people together and enjoy working with such a fascinating and exciting group of eligible singles. I have always said that I love to live vicariously through our clients and because of them I have truly discovered the world.

What is your message to those who are slightly nervous of finding their partner?

Dating for many can be a stressful experience but it doesn't have to be. You simply need to change your point of view on dating. Keep in mind that this is a just a date. You are going to meet someone new for a few hours and see if you want to see this person again. It's best to have no expectations other than the fact that you will have company over a meal. Let's face it you won't meet anyone if you stay at home, so it is important that you increase your social opportunities. Meeting new people must be a priority if you truly wish to find the one.

The concept of using a professional matchmaker can remove a lot of the stress from the dating game. The advantage of working with Kelleher International for example is that we meet your match first so that there is no room for misrepresentation. This is the catalyst for so much frustration with on-line dating- no one is screening the people that post themselves, so time is wasted meeting incompatible matches.

As professional matchmakers we not only screen everyone, but we meet everyone in person that we work for and hand select introductions for our clients based on their personal criteria. Sometimes, best friends forget to consider your criteria, and in neglecting to do so, are responsible for very uncomfortable dates being set up with the best of intentions. We like to call these spaghetti matches... friends will throw you and another friend together, and wait to see if the match sticks.

From our client's experiences, simply by putting a few simple measures in place, dating can be both enjoyable and meaningful!

What sort of people do you help?

We work with passionate people who are single, divorced, and widowed. We are not a dating service nor fill a need for a social calendar. Those that we invite into our exclusive group are searching for a lasting relationship usually leading to marriage. Our clients range from 22 to 80. Most of our clients are between 25 and 60, they are picky, worldly, passionate and refuse to settle. They are accomplished and selective. When describing a lifetime partner, they see Kelleher as an executive search firm designed to save them time, money and frustration.

Kelleher International has an amazing record of matching people. What contributes to this success?

We have been matching clients for nearly three decades with tremendous success. Longevity, experience and hiring the right

"They see Kelleher as an executive search firm designed to save them time, money and frustration"

people contribute to this success. We interview each and every client we work with and we closely follow their experience throughout their membership. If not the 'one', each match helps us get to know that much more about our clients, hence we move closer to reaching our goal.

Over 40% of our clients come from referrals. We started matching people before the .com era and we made the conscience decision to stay personalized, as a boutique family owned business. We continue to learn and grow as a matchmaking company year after year.

It must be hugely satisfying to see couples you have matched succeed in their relationship.

That is our goal. Our clientele are educated professionals committed to finding a life partner. When someone gets engaged, the director of matchmaking at Kelleher will announce to the whole KI Team which one of our local matchmakers is responsible for the successful match.

It is very exciting for everyone to acknowledge the one who placed the happy couple together. As an owner, to watch the joy come from the matchmaker(s) who receive the news of the engagement for the first time is wonderful. Followed by the marriage and the children that are born and grandchildren that follow is really something else. You can't put words to how rewarding this is for all of us.

We have a couple who married through us decades ago and sent us their adult son, and we introduced him to his wife and maybe someday we will work with their children. I remember the card they sent my mother so many years ago to thank her. The card was of a bicycle in heaven... 'a match made in heaven'.... it said. They told us that their first date was a bicycle ride.

In some faiths, it is said that if you introduce two people and they marry you earn your wings to heaven. Right now relationships are happening more often than ever, which is very rewarding and fulfilling.

How does the CEO club help elite clients?

Our CEO Club is comprised of elite members at the top of their respective fields of industry: finance, technology, business, medicine, politics, sports, fashion, philanthropy and entertainment, etc. Many are extremely successful entrepreneurs; all prefer to have priority status during our matchmaking and search process.

This level is confidential and perhaps a bit more discreet for those who require it. As owners, my mother and I oversee each Elite membership and I serve as a personal scout/recruiter for the CEO Club when attending functions both in the US and abroad. We also invite our CEO Club members to attend philanthropic events such as Leadership Gatherings on Necker Island and other exciting destinations around the world.

Most of our Elite clients come from referrals and we only accept approximately 10 new CEO Club members per calendar year with the intention to keep it small.

You have a global reach; how does this help?

We love having a global reach because our clients can meet interesting people in multiple countries as they travel for work and pleasure. For example, we currently have a beautiful female client who resides in Chicago but she is spending this summer abroad. I am literally matching her in London as we speak!

I love matching clients in the world's most romantic cities. My mom and I are romantic's at heart! We actually have a young couple who met during our recent philanthropic event in May that I co-hosted in the BVI's, with Virgin Unite. They are now in Morocco having a wonderful time together seeing the sights!

The world doesn't seem so big and intimidating when you work with the globe trotters that we have the opportunity to know.

How does the process work within Kelleher International?

The experience begins within the client first. It's all about timing for those that join... Most come to Kelleher after years of seeing our advertisements. Perhaps they recently broke off from a relationship and now they are available. Many are referred to us or have attended a wedding that resulted from one of our introductions.

But it always does come down to timing, and when the timing is right for the individual, we receive the call.

Our prospective clients are fine dating on their own, but they have yet to find that elusive partner. They contact Kelleher, because they prefer not to waste their precious time with random dating. The steps are easy; most go to our web-site and simply fill out a confidential form. Once we receive the confidential profile, we set up a complimentary phone consultation.

Speaking with one of our team members, whilst being constructive and valuable, is also enjoyable - because we have so much knowledge and insight into the world of dating. Our phone consultations are designed to put you at ease and start the 'getting to know you' process. The next step is a face to face meeting.

Kelleher International has representatives in most major cities in the US as well as in London and Stockholm so it's convenient to meet with us. Once on board, we customize each membership based on your specific criteria.

The search begins! You will have now embarked on an adventure which could prove life-changing!

We currently have over 50,000 files of eligible single men and woman to choose from and our incredible database grows every day. We keep our memberships to a minimum to ensure maximum attention unlike the mass market dating services out there. Our matchmaking firm is the old fashion hands on approach. We meet, screen and select each match. It's an enlightening, enjoyable and extremely effective process and is, of course, highly confidential at every stage.

What is your advice to potential clients seeking their life partner?

Let us do the leg work. Whilst you're busy working, travelling and enjoying life, we are busy searching for your lifetime mate! ■

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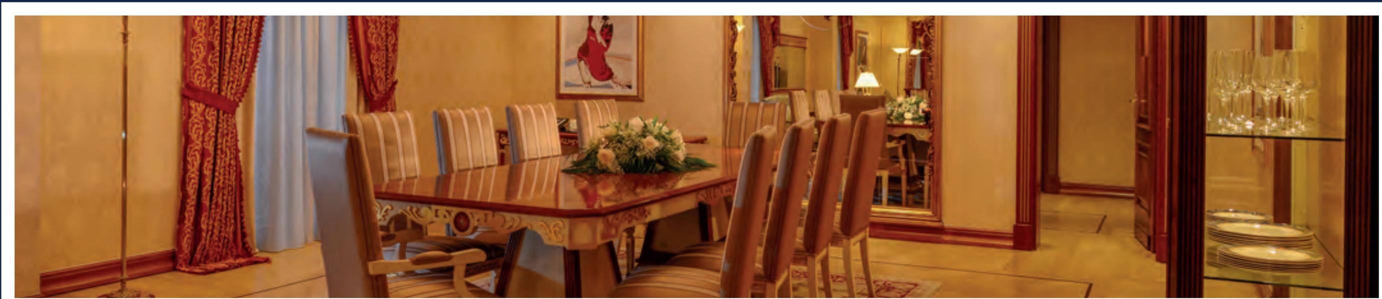

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A world of luxury

A business platform to shape the G20 agenda

It has now been five years since the Group of Twenty (G20) was elevated to Leaders' level in the face of an unprecedented global financial crisis. Despite a number of challenges to the group's cohesion, the G20 remains uniquely positioned to address some of the world's most important and intractable economic problems and will increasingly shape intergovernmental policies that affect business internationally.

For these reasons, the International Chamber of Commerce (ICC) has been deeply engaged in the work of the G20, and formed the ICC G20 CEO Advisory Group to intensify top-level international business engagement and to ensure the inclusion of business views in the deliberations of G20 Leaders. Chaired by Marcus Wallenberg, the Group of approximately 40 CEOs has established itself as enduring platform to engage with the G20 governments and provide business input on an ongoing basis.

Among the activities of the ICC G20 CEO Advisory Group has been participation in the annual Business-20 or 'B20' process, which brings together groupings of the world business community to share business views and present policy recommendations to the G20 leaders. G20 governments now recognize the B20 as an important stakeholder in the G20 process and the B20 Summit in Sydney in July will constitute the fifth consecutive year of CEO-level business engagement in the G20 policy agenda. CEO members of the ICC G20 Advisory Group continue to be deeply invested in the development of annual policy recommendations and their ongoing engagement, going back to the B20 Summit in Seoul in 2010, creating important continuity of business input, given that the B20 presidency changes from year to year.

To ensure the delivery of balanced and substantive business recommendations to G20 leaders, the ICC G20 CEO Advisory Group hosts a series of regional policy consultations to solicit priorities and recommendations from companies and business organizations of all sizes and in all regions of the world. In 2014, G20 consultations have been held in Washington, Turkey and most recently on the sidelines of the ICC Asia Pacific CEO Forum in Kunshan, China. Following the consultation, ICC Chairman and Chairman of McGraw Hill Financial Harold (Terry) McGraw III led an ICC delegation meeting with the Premier of the People's Republic of China Li Keqiang in Beijing to discuss ICC priorities, including the importance of multilateral trade and investment.

While engagement of international CEOs is important to convey business messages to world leaders, we must not forget the critical role that small- and medium-sized enterprises (SMEs) play in creating long-term economic growth; SMEs alone account for approximately half of total employment in OECD countries and 70% in Japan. As the world business organization with a global network reaching over 6 million companies, chambers of commerce and business associations in more

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"Compilation of the annual Scorecard reflects ICC's belief that if the G20 has better information on how its actions are interpreted by the business community this will help it set priorities, honour commitments, measure its own progress over time and identify deficiencies that deserve greater attention"

than 130 countries – ICC is committed to ensuring that the voice of SMEs are heard, and their interests taken on board by policymakers at the highest level.

As part of this mission, ICC Australia and its local host the Australian Chamber of Commerce and Industry (ACCI) and the Australian Minister for Small Business will host a one-day international conference on SMEs on 20 June as part of the work programme of Australia's G20 Presidency. The event will bring together Australian and international thought leaders and experts from government, business and academia to discuss key challenges facing the SME sector and will help identify business policy reforms to address the sector's needs.

In addition to developing policy recommendations, ICC also recognizes the need to evaluate the impact of past business recommendations. With this in mind, ICC has developed the ICC G20 Business Scorecard to rate the overall responses by G20 governments to key business goals.

Compilation of the annual Scorecard reflects ICC's belief that if the G20 has better information on how its actions are interpreted by the business community this will help it set priorities, honour commitments, measure its own progress over time and identify deficiencies that deserve greater attention. Evaluation of past recommendations also helps business leaders pick up where the past B20 left off, so that they can better tailor future recommendations. The third instalment of the annual Scorecard, published earlier this year, shows a year-on-year improvement in score since ICC's monitoring began, demonstrating the value of a business scorecard as well as the need for continued monitoring efforts. ■

The ICC G20 Business Scorecard is available from: http://www.iccwbo.org/Global-influence/G20/Reports-and-Products/ICC-G20-Scorecard/

Second WCO Global AEO Conference under the spotlight

Laure Tempier works for the World Customs Organization

It is now widely acknowledged that building collaborative relationships with trusted traders is advantageous for governments facing the challenge of growing trade volumes and increased security requirements on the one hand, and the need to develop efficient cross-border processes that allow businesses to be more competitive on the other hand.

Over the past decade, specific programmes have been put in place, opening up a new chapter in traditional Customs-business partnerships, namely Customs compliance programmes and Authorized Economic Operator (AEO) programmes.

Customs compliance programmes focus on traditional Customs requirements, such as the payment of Customs duties, while AEO programmes include security requirements as prescribed in the WCO SAFE Framework of Standards to Secure and Facilitate Global Trade (SAFE). Under these programmes, economic operators who demonstrate that they meet minimum standards and best practices receive trade facilitation benefits.

Given that these programmes all share similar challenges, although they may differ in terms of scope (import/export), types of operators and requirements depending on the country, the WCO launched its Global AEO Conference two years ago, to serve as an open platform for business, Customs and other border agencies to exchange ideas and share views on each other's expectations, and how to enhance the partnership.

Highlighted below are just some of the many issues discussed and experiences shared during the second Global AEO Conference, which took place in Madrid, Spain from 28-30 April 2014, with more than 800 delegates from more than 90 countries in attendance.

Communication

"We have to make it as easy as possible for those trying to comply and make it as hard as possible for those trying to avoid paying their fair share or to undermine our country's security. The Key to this approach is ensuring that taxpayers and traders understand

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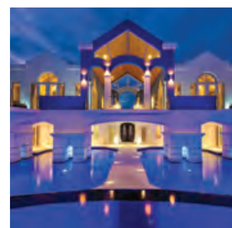

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"Implementing an AEO programme enabled many Customs administrations to change the culture of their staff, and private sector representatives recognized that this can be seen in practice"

their obligations," said a South African Customs representative.

Communication was on everybody's lips. There can be no trusted traders or AEO programme unless Customs knows its customers and engages with them. *"There are five main modes of stakeholder engagement,"* explained a WCO expert during one of the Conference workshops, *"namely informing, consulting (asking for input from stakeholders), involving (get stakeholders to participate), collaborating (actively partnering with stakeholders to consider options and make decisions), and empowering (placing final decision-making in the hands of stakeholders)."*

"When we launched our AEO programme in 2011, we realized that we needed to communicate our message to all traders. We engaged with the media and consulted companies directly after undertaking a mapping exercise of national stakeholders, identifying their needs according to the different categories of business", explained a representative of Uganda Customs.

Communication is also important when incidents occur. *"It is important to adopt the right approach on how you solve issues"* stressed a representative from New Zealand Customs. *"To err is human. You should not blame, but understand and of course take proportionate action".*

"When we implemented our trusted trader programme, we realized that some companies needed training in Customs matters," said the representative from South African Customs. *"Some did not even understand their errors at times. We developed a guide containing basic knowledge, and we started offering training, enabling us to pick up issues and thereafter sit down and discuss them with companies."*

The WCO took the opportunity to present its capacity building project, which aims to provide advice on improving the communication, consultation and negotiation skills within Customs administrations, and to support the formulation of a stakeholder engagement strategy, as well as the establishment of dialogue platforms and structured consultation mechanisms.

The Conference was also the ideal venue for business and government representatives to discuss how they each perceive and manage risk. Some companies explained how they formulate their Customs policies to ensure compliance, as well as how they secure their supply chain, while some Customs administrations described how they identify high-risk cargo, and how they integrate the trusted trader/AEO element into their risk management policy.

Practical guidelines for securing shipments were provided to companies, with one presentation focusing on seal integrity for example, and another focusing on container inspection presented in the form of a live exercise; participants were shown how to control the integrity of a container and what to be on the lookout for, during the 7-Point inspection techniques demonstration.

A US Customs and Border Protection (CBP) expert reviewed seal affixing procedures in great detail, and explained what a seal inspection process entails, insisting that seals should be implemented throughout the supply chain, at all foreign and domestic locations.

Success evaluation

After more than a decade of implementing trusted trader/AEO programmes, we should be able to measure their success. But how do you measure success? As the programmes are voluntary in nature, counting the number of participants may seem relevant; however as Customs representatives explained, it makes more sense to look at their share of import and export volumes.

For example, AEOs in Europe only represent 0.37% of the total number of operators, but are responsible for 50% of the volume of trade entering and leaving European territory, and are the source of 50% of all import and export declarations.

In China, in December 2013, after almost five years of implementing the Chinese AEO programme, there were 2,910 certified companies, representing 0.5% of the total number of operators, but they are responsible for 15.92% of all Customs declarations, and in terms of value, their imports and exports represent 27.95% of all transactions processed. These percentages are rising with more and more companies getting what is called 'Class AA' certification level.

The fact that few companies have a predominant place in trade activities is also true for South Africa, where 70% of all import declarations and 80% of all export declarations are submitted by 10%, ie. 4,000 of the active traders.

But it seems the older programmes are reaching a plateau in terms of the number of participants. *"The question is how AEO programmes can further develop, and what innovations can we add so that they can flourish,"* said a representative of United Kingdom (UK) Customs.

Benefits and incentives

"Our economy will not survive a security incident and we need to make sure our exports are safe. We are selling predictability" explained the representative from New Zealand Customs whose AEO programme is aimed at exporters. *"But it is a lot of hard work to convince companies to join our programme, as the risk of an incident may appear quite theoretical until the situation actually emerges".*

The SAFE states that benefits for AEOs should be 'meaningful, measurable and reportable'. It also gives an indicative list of benefits, which include a reduced data set for cargo release, expedited processing and release of shipments, a minimum number of cargo security inspections, priority processing following an incident requiring the closing and re-opening of ports and/or borders, and increased paperless processing of commercial import and export shipments.

Benefits, said private sector representatives, should be meaningful to the extent that they should justify the additional costs sustained by economic operators in meeting prescribed AEO requirements, and provide real improvements and

facilitation gains for AEOs above and beyond the normal benefits enjoyed by non-AEOs.

"Internally, we have to up our marketing game, as the first thing our top management will ask is "what will I get for becoming an AEO"! *"Convincing senior management is not an easy task"* explained a representative from a global express mail service provider.

Asked whether they had seen benefits in action, business representatives were divided. Most of the freight forwarders and logistics sector representatives were seeing benefits in terms of being an AEO, considering it as a market requirement.

Regarding expedited processing and release of shipments, all pointed out that in many countries inspection levels were already so low and border procedures so effective that they saw little benefits in terms of clearance time. *"Countries where there is already a lot of facilitation may run out of benefits, but developing countries may have more benefits to offer to their trusted traders or AEOs,"* said the representative from Uganda Customs.

"We are not an AEO," said a representative of a UK company, *"but we are considering joining the programme to benefit from the guarantee waivers that will allow us to defer payment of some Customs duties. That's the only real benefit that we have identified so far."*

Other participants highlighted that being allocated with a dedicated AEO account manager at Customs was one of the main benefits of becoming an AEO. Implementing an AEO programme enabled many Customs administrations to change the culture of their staff, and private sector representatives recognized that this can be seen in practice.

"What is most important for us," said a representative of a French AEO, *"is the relationship of trust which we have now established with the administration. We appreciate the fact that if we encounter an issue with the automated online Customs clearance system for example, we just need to pick up the phone to get it resolved."*

"You have to see the global picture. In Europe, if you do not have the right process in place and if you do not embrace the right logic of process control, you will not be able to enjoy the dematerialization of documents, which will constitute a seam for cost savings in the future," he continued.

Other benefits that are not very well known have to do with the internal structure of a company; traceability and sound management of procedures impact positively on cost reduction. For example, some AEOs have enjoyed lower insurance premiums for the same rate of damages by implementing security requirements.

A representative from a Jamaican company highlighted another positive impact of going through the AEO application process. *"We were one of the pilot companies used by Customs to test its new AEO programme. We had to get everyone involved, to get the ears of our management and the support of our key staff, such as the security department personnel. The whole project had a very positive effect on the staff, as we all got together, sat back and looked at our supply chain. We consider that we own this programme."*

Border coordination

"We hear a lot from the trade that we have to improve how we cooperate with the 23 other agencies in the UK. This is high on their wish list. Regarding AEO implementation, we still have quite a long way to go in building cross-government programmes," said the UK Customs representative.

All Conference delegates contended that determining how operational cooperation, coordination and communication can be optimized between different border enforcement agencies responsible for matters of safety and security, human and animal health, and the economy and the environment, is of utmost importance.

"In the UK," explained the UK Customs representative, *"one of the things that we started to have a conversation on is how*

© Royal Thai Customs

we can use the concept of a trusted trader with our own internal agencies, whatever those agencies may be, for all the licensing and regulatory requirements, ie. to apply the trusted trader concept across the board."

"One government clearance and one government clearance for AEOs through all of our different organizations can be achieved technically through a Single Window environment, but we have to think about how we do that through better, joined up processes," the UK representative added.

Colombia adopted a 'whole of government' approach when designing its AEO programme. The certification process is managed through an inter-sectoral commission consisting of Customs and several other national actors, such as the police – in charge of container security, the Colombian Institute for Surveillance of Food and Medicines (INVIMA) – handling the sanitary aspects of the processed food trade, and the Colombian Agricultural Institute (ICA) – responsible for issuing sanitary import permits for non-processed products.

In Jamaica, a public sector inter-agency committee had been created in order to coordinate the activities of all agencies with responsibilities at the border. Issues related to the AEO programme are discussed within this forum. On a day to day basis, the AEO account manager at Customs acts as an intermediary between AEOs and other agencies. *"If our shipments are being inspected, let's say by the food security agency, I can call our account manager and enquire about the status of our goods,"* explained a representative of a Jamaican certified company.

SME participation

Another issue of particular interest was the participation of small- and medium-sized enterprises (SMEs) in AEO programmes. It was agreed that SMEs should be given more attention as they play a driving role in national economic growth, and in generating and sustaining employment.

Governments should use every available opportunity to educate and inform SMEs about the value of participating in AEO programmes, as well as provide adequate assistance to SMEs wishing to enter the validation process.

In the UK, a private company developed, in partnership with UK Customs, a learning programme for potential AEOs/company auditors, to ensure that a linked set of resources and processes are in place for the safe handling and delivery of goods, and related services within the supply chain.

In France, 'Business Advisory Offices' have been created in every Customs regional division, offering potential applicants personalized support. The local advisory team approaches companies about the AEO programme and what AEO status means, assisting interested companies to prepare themselves, including the filling-in of the 'self-assessment questionnaire'.

Another interesting initiative is the sponsorship project developed in France by the Customs administration together with the Union des entreprises de Transport et de Logistique de France, or TLF, an association representing transport and logistics companies, in order to assist their SMEs to become AEOs.

As companies in the logistics and freight forwarding sector use many subcontractors, it is critical for them to ensure that all transporters in the supply chain are certified. However, for many, especially small trucking companies, becoming an AEO is time-consuming and tedious. Under the project, large certified companies provide free support to SMEs, offering them training and helping them to review their process according to the AEO programme requirements, if needed.

For its part, Jamaica Customs decided to grant flexibility to SMEs having difficulties to fulfil the new requirements put in place following the revision of the administration's AEO programme. *"Since we implemented our trusted trader programme in 2009, we thought that we had an AEO programme, but we realized that the security elements were missing, so we decided to revamp the programme in order to align it to the SAFE,"* explained the representative from Customs.

"We did not want to pull the rug from under the feet of our SMEs, so we allow those that cannot fulfill all the requirements yet, to keep some of the benefits they enjoyed before during a transition period; such benefits now only being granted to AEOs. We gave them two years to comply with all the requirements. If they do not make it, we will withdraw all their benefits," she added.

Technology and transparency

"You may compare an AEO certification with a driving licence, it does not stop you from speeding," declared a representative from a technology provider. *"There are always high-risk situations. To use the same analogy, people may know where the radars are located."*

Some benefits entail more risks than others. Time is a predictor of change, but not the best one, and some data needs to be checked more regularly than other data. Guarantee waivers, for example, are seen as a high-risk benefit by most Customs administrations, requiring careful watch and regular checking of a company's financial situation on a continuous basis.

Some technology solutions enable Customs authorities to better monitor AEOs in this area, such as those using 'big data'. These systems collect open information on companies in order to create as realistic a picture as possible of their financial situation. The idea is to be able to predict future behaviour, and take action accordingly. Dutch Customs is using such a system to monitor the solvency of its 1,400 AEOs as a means to mitigate financial risk.

It was also clear from the discussions that high-risk shipments can become low-risk shipments when using the right technology, such as track and trace systems for example, by creating transparency and building trust.

Conclusion

Schemes like that of the AEO or trusted trader, which provide Customs administrations with some degree of certainty around the actors in the supply chain, are seen as being part of the solution that enables Customs to lessen controls on legitimate businesses, thereby offering these businesses a transparent and predictable trading environment, and facilitating their sustainability.

By implementing such programmes together with sound data management – getting the right data at the right time and in the right quality, and ensuring the integrity of both the data and the providers of the data – and improved coordinated border management, Customs should be able to provide what businesses are looking for in the least burdensome way. ■

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Envisioning a sustainable Black Sea: the role of the ICBSS

Dr Zefi Dimadama is Director General of the International Centre for Black Sea Studies (ICBSS)

The Black Sea area constitutes an economic, geopolitical and trade hub, and serves as a crucial energy trade corridor connecting Asia with Europe. It includes twelve countries out of which six are littoral states (Bulgaria, Georgia, Romania, Russia, Turkey and Ukraine), while the rest (Albania, Armenia, Azerbaijan, Greece, Moldova and Serbia) are connected to it by historical, economic, environmental, social and cultural ties and legacies.

The region of the Black Sea is of global importance. Over the last decade, interest towards the Black Sea has grown and matured regionally and internationally, and it has become clear that part of the region's future will be driven by trends and developments in the areas of sustainable development, innovation, science and technology, but preferably also through the green development/growth concept. The current economic environment and the climate change impact bring the importance of the Black Sea Region to the fore, and create an urgent need for the adoption of a new plan for sustainable development.

Taking into account that sustainable development is based on the three main pillars of economic development, social cohesion, and environmental protection, it is important to promote multilateral cooperation among international stakeholders, regional players, the cross border cooperation peripheries and the business sector in order to set the conditions for climate and energy security, and a safe environment for investment and trade opportunities.

In this regard, the priorities of sustainable growth, innovation, and good governance that could strengthen the area's capacity and lead to the creation of a dynamic hub with multiplying effects in the wider Black Sea region should focus on:

1. The efficient use and management of natural resources with a special emphasis on (a) the vital energy sector and (b) the sustainable management of water resources/supply of the Black Sea.

2. Activating and enhancing human capital in Knowledge Networks. Promoting good governance by fostering cooperation with NGOs and civil society actors; supporting involvement in Knowledge and Innovation Networks (eg. the Horizon 2020); establishing training programmes; presenting best practices in research and innovation; and strengthening relations with educational institutions and young researchers that will be introduced to subjects concerning the Black Sea area.

3. Promoting a policy and target-oriented framework for the region's sustainable development prospects, with a particular emphasis on cross-border cooperation, trade, transport, and new investments, thus making parallel use of key policies such as 'green entrepreneurship', 'green transportations', etc.

4. Raising the visibility of the Black Sea area and the awareness of the international community towards it, and the BSEC specifically as of a reliable and resourceful partner.

In view of the contemporary needs of the region, the International Centre for Black Sea Studies (ICBSS), founded in 1998 as the official think-tank and related body of the Organisation of the Black Sea Economic Cooperation (BSEC), is fostering sustainable development, innovation and good governance as its primary objective, through the promotion of multilateral cooperation among the organisation of the BSEC, the BSEC member states and its related bodies, the European Union and other international organisations in key issues of common interest.

The Centre carries out a various number of activities including policy recommendations, research projects and publications in order to elaborate and promote this vision, fostering relations with multiple international partners.

Over the years, the ICBSS has evolved beyond its strictly institutional role and is at the forefront of research and analysis concerning the wider Black Sea region, while since 2010, the Centre has focused more actively on the environmental aspect of sustainable development.

Moving towards 'Greening the Black Sea' is the Centre's new perspective, one characterised by a focus on development, culture, as well as economic and social prosperity, one that goes beyond the traditional approach and makes the concept of sustainable development/greening, innovation, and governance our driving force. Thus, the environmental dimension runs through all of our actions and aims.

Within this framework, since 2011, the ICBSS has established a *Green Cluster of Knowledge Institutions of Black Sea: A Roadmap on Renewable Energy Sources and Energy Efficiency for Research and Academic Institutions*, in cooperation with the University - Higher School of Economics in Russia and the Marmara Research Center of the Scientific and Technological Research Council of Turkey.

The project's main objective was the voluntary implementation of a roadmap with an informative character that would provide recommendations for the application of innovative and specific tools in order to achieve environmental protection, sustainable development and ecological strategies, all based on success stories from the EU and good case stories from partner countries.

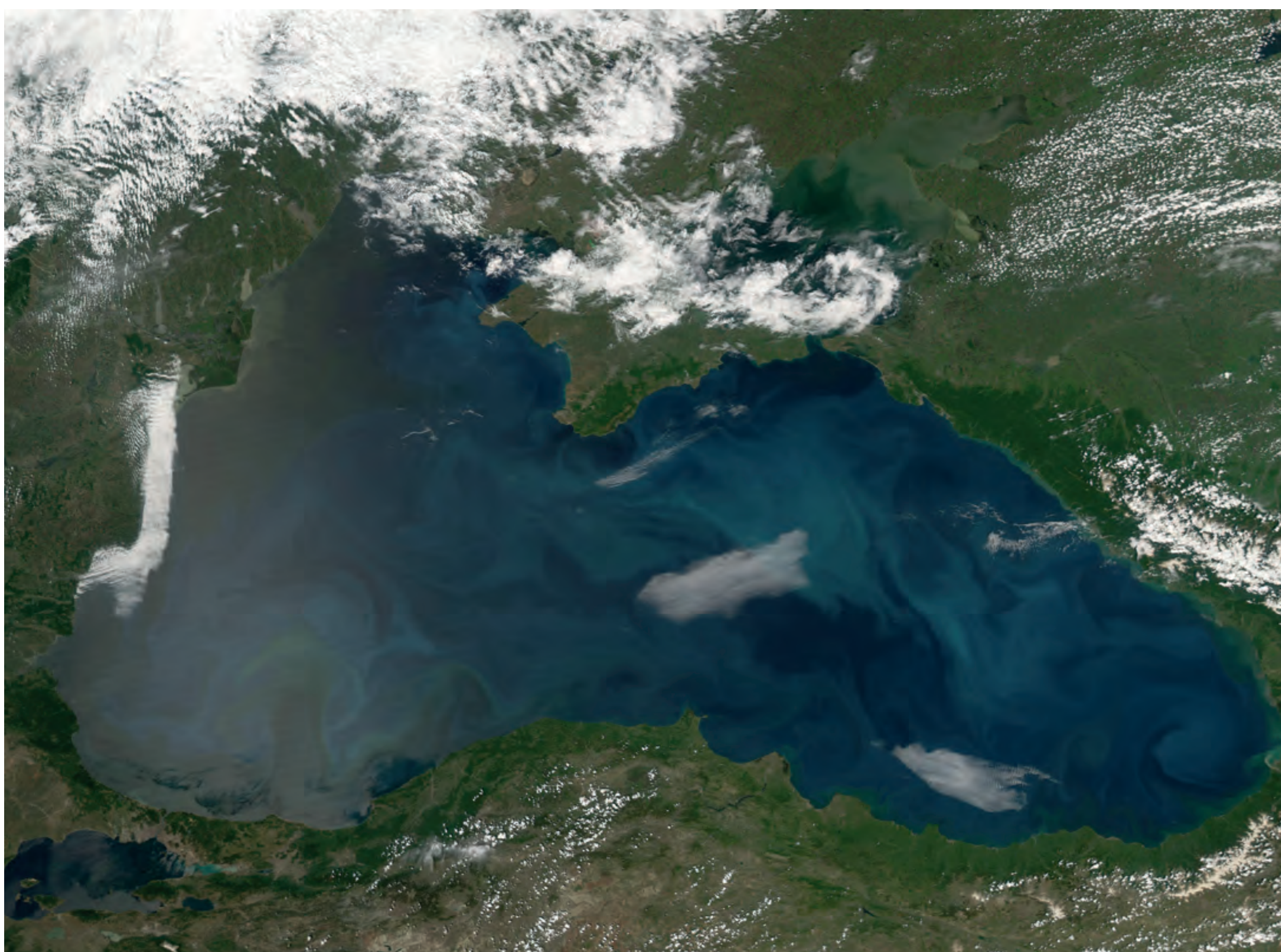
The roadmap aimed at the transfer of technology and know-how among the Black Sea Partners. The Green Cluster is a pioneer for the implementation of innovative technology that can promote and encourage energy efficiency, environmental awareness of the public and practices that have an impact on reducing gas emissions and consequently, the climate change impact. The starting point is a network of academic and research Institutions, committed to implement green practices.

Another way of achieving all that is through the creation of the *WEB-GIS Observatory Network for the Environmental and Sustainable Development of the Black Sea*. The Observatory that was funded by ICBSS is an established mechanism and a strategic tool that constantly gathers new statistical and geographical data of the region. It is an ongoing progress and aims at providing information services, data extraction, and production of customized thematic maps. It supports policy makers who need to compare data and similarities/differences between countries and provides valuable information to NGOs and local development agencies. It aims at providing focused knowledge regarding main figures of the area.

The Observatory provides data for geographical position, environment and natural assets, economic strength, social integration and accessibility. It is developed in a simple way in order for users to easily find and understand the features and data provided. One can insert queries of data and indicators to create a selection of them and according to this information, the application will display a thematic map.

"The ICBSS promotes synergies across regions with the aim to foster sustainable and innovative policies for the environment, energy, transport, science and technology within the wider Black Sea region and beyond"

The ICBSS promotes synergies across regions with the aim to foster sustainable and innovative policies for the environment, energy, transport, science and technology within the wider Black Sea region and beyond. The development of cooperation schemes and research networks constitutes the key element for growth, prosperity and longevity. Sustainable development should not be merely a choice but a way of living for the Black sea region and its peoples. ■



BERMUDA

THE 'WIRED ISLAND'

In an interview with World Commerce Review, Dr. the Hon. E Grant Gibbons, Bermuda's Minister of Education and Economic Development, discusses the most important factors when deciding on a digital hub.

What is Bermuda's medium- to long-term digital strategy?

Bermuda's strategy has always been to create an environment that would allow the island as a whole to leverage the opportunities brought about by the digital age, from online services through to e-skills.

The country's efforts have been recognised in the last four Economist Intelligence Unit (EIU) Digital Economy studies, where Bermuda has consistently ranked in the top 22 countries in the world for e-readiness. The World Information Technology Services Alliance (WITSA) has also presented the Government of Bermuda with an *ICT Industry Development Award in 2010*. In addition, Bermuda has been ranked *Best Digital Jurisdiction* by *World Commerce Review* in 2013 and 2014.

When it comes to ICT, Bermuda provides a state-of-the-art regulatory and technological infrastructure that facilitates e-business and provides a sophisticated, nimble, and supportive environment for businesses and other entities to thrive on- and off-island. This is no surprise and is at the heart of what Bermuda has been for centuries: a land of explorers, innovators, and early adopters.

To help achieve that, we were among the first in the world to adopt an Electronic Transactions Act in 1999 that includes a Code of Conduct which provides minimum standards for e-commerce service providers and which has the force of law. The Certification Service Provider Regulations (CSP) were passed in 2002 establishing guidelines for CSP providers and issuers of Accredited Digital Certificates, allowing reliable security and authentication, an important tool in our hyper-connected business community.

To further enhance ICT infrastructure, the independent Regulatory Authority was established in 2013 to supervise the Telecommunications sector and aims to benefit businesses and consumers by increasing competition, speeds, and service offerings. It is capitalizing on the fact that Bermuda is an excellent test bed environment for apps and other technologies with global marketability given the significant bandwidth available, ensuring that the island provides a more robust launch pad for further ICT innovation.

Already, recent developments on the telecommunications landscape have created a more competitive and agile industry that has provided us with reduced pricing and higher speeds. We've also seen significant new investment in the sector, which we expect will result in a next-generation telecommunications and fibre to the home infrastructure across the island.

We are also developing a unique privacy model and accompanying legislation to facilitate and secure local and transnational data flow and provide an additional level of comfort for international customers who have their data hosted in a Bermuda cloud. This will allow Bermuda to achieve the balance of protecting sensitive personal information and respecting international privacy principles, while acknowledging diverse economic ties.

All of this will allow us to provide our locals and visitors, individuals and companies, with an attractive package in this era of big data and cloud computing.

What advantages does Bermuda offer?

Many *Fortune 500* companies have a Bermuda presence and have capitalized on the fact that, among its other advantages, the island is ideally positioned at the crossroads of North and South America and Europe, with excellent air links to the east and west.

The island is a world leader in insurance, reinsurance, international business and finance. When it comes to ICT, we have been known as the wired island for over a decade. Bermuda provides a full complement of IT services and support, redundancy capability, cloud and digital certificate services, in addition to disaster recovery services. For ICT products, global pricing is honoured on our shores and there are no customs duties or taxes on any software product.

The high internet penetration in the island's homes and schools has produced a highly technology-literate population. In fact, 91% of Bermuda residents have internet service in their home, and 95% of households own a mobile or smartphone.

Bermuda has fostered a booming e-business environment: 100% of corporate entities have a computer at work, and 95% of them use ICT for business-to-business transactions. On a similar note, 100% of medium as well as large companies have a disaster recovery and business continuity plan, an indication that even Bermuda's SMEs are embracing technology. The country boasts local success stories in e-business, both in security and payment processing, and these local companies have gone on to become recognised leaders providing services to global customer bases, including some European governments.

On the macro level, Bermuda's first-rate ICT infrastructure includes five (5) redundant fibre optic cables linking the island directly to international markets. There is a proliferation of mobile and data providers offering 3G, 3G+, and 4G networks, (and LTE is coming) and high speed connections.

Our focus on innovation also has us reaching for the stars, literally, as Bermuda has a developing satellite industry that will provide a number of global business opportunities given the position of our orbital slots. We are also set in a prime geographic location for the location of Tracking Stations for rocket launches.

The Bermuda advantage can be summed up as a supportive regulatory framework, along with a sophisticated ICT industry and infrastructure, all aimed at enabling the new e-business models created by the next generation of ICT evolution.

What sectors are exploiting Bermuda's digital/IT infrastructure?

By virtue of the prevalence of ICT in most aspects of life on the island, all sectors are taking advantage of its sophisticated infrastructure: from education to the financial sector, healthcare and energy, to name a few.

Software development is alive and well. Innovation has occurred in insurance and risk modelling but other kinds of developments are

"We are also developing a unique privacy model and accompanying legislation to facilitate and secure local and transnational data flow and provide an additional level of comfort for international customers who have their data hosted in a Bermuda cloud"

thriving as in the area of environmental research with, for instance, RPI2.0, the Risk Prevention Initiative at the Bermuda Institute of Ocean Sciences, which links science and insurance through technology.

Bermuda is also enjoying a proliferation of computer applications in tourism, banking, insurance, reinsurance, arts, and media sectors, as well as technology innovation that is supporting energy, healthcare, and the life science industry through ICT. Last but not least, the third sector is linking charitable organizations, donors, and volunteers through technology as well as sites such as www.volunteer.bm.

Further encouraging innovation, Bermuda hosts its own annual TEDx series, in addition to the annual *Global Entrepreneurship Week* which is part of GEW Global and involves the whole island, including students and businesses. Part of GEW, TechAwards – and specifically PitchTech - rewards start-ups who use technology as their primary means of interacting with their client base, and provides the competition winners with seed money and support services.

Do Bermuda schools support these plans through their syllabus?

In the late 1990's, Bermuda started with the Bermuda Technology Education Collaborative (BTEC), which brought a customized Stanford University computer curriculum into Bermuda's public schools. Now, the Bermuda College, the island's tertiary education institution, is a member of Cisco's Networking Academy. Primary and secondary schools have also incorporated ICT in their everyday life, from laptops and SMARTboards to online portals and workshops about digital citizenship, ethics in cyber research and cyber safety.

At the extracurricular level, BizCamps is an annual programme that marries ICT and entrepreneurship for young teens, and robotics clubs have gone on to win local and international awards. For students specifically interested in a career in ICT, the Department of e-Commerce publishes an annual IT student career guide. Last but not least, the Technology Leadership Forum matches ICT college students with employers and provides an intensive training programme developed and delivered by the local leaders in the sector, and updated annually.

Consequently, our country's significant ICT infrastructure and penetration at home and in schools has youngsters continuously connected and communicating through social media, using a plethora of mobile devices (smartphones, laptops, tablets, etc) at school and at home. In fact, 30% of Bermuda's youth under the age of 18 own a Blackberry. For this reason Bermuda continues to be dedicated to online safety and has developed a rich resource online: www.cybertips.bm. The Cybertips programme not only makes regular presentations at schools and other organizations, but provides abundant information to parents, teachers, and employers across the island. Bermuda has also passed child protection legislation that focuses on online safety.

What assistance/advice/support is offered to companies locating to Bermuda to access its digital advantage?

The Bermuda Business Development Agency offers a Concierge Service to all new businesses who are locating/relocating to Bermuda. It acts as the entry point to all the relevant entities, from government ministries and departments to the Bermuda Monetary Authority (BMA) and relevant business contacts.

Businesses locating on the island can expect to find the full complement of traditional ICT services and support – right here on our shores. Bermuda's ICT sector is a tight-knit community where associations keep members abreast of the latest developments. The Government and the private sector work closely together to advance the Bermuda brand and reputation, and to guarantee a coherent, transparent, and supportive foundation upon which businesses can grow and thrive.

How digital and IT are the government in their day-to-day work?

Bermuda's e-Government Department leads the Government's efforts in the creation and deployment of online content, transactions, systems and services that meet the needs of government, citizens, businesses and the voluntary sector. It also is instrumental in establishing system requirements and in strengthening governance.

Throughout Government, many processes have been streamlined in various areas including health insurance, immigration, community education, social insurance, transport control, and tax returns, which has been advantageous to businesses and individuals alike. Technology use in business-to-government transactions is therefore significant: 86% of corporate entities routinely employ them to their advantage.

Initiatives to help foster growth in e-business also include legislative initiatives such as privacy and ensuring best practice in IP protection. Also, the Internet Governance Policy Advisory Committee, through a multi-stakeholder approach, is tasked with discussing public policy issues related to key elements of internet governance in order to foster the sustainability, robustness, security, stability and development of the internet.

Last but not least, the Government has a Digital Certificate programme, enhancing its security practices.

What would be your message to an organisation looking to partner with Bermuda?

Bermuda is a self-governing UK overseas territory with a common law legal framework and a history of stable government and political structure. Its legal system is founded on English Law and is internationally respected. The island boasts one of the

world's highest per capital incomes, levies no personal income tax, and provides an excellent quality of life that is enhanced by its education and healthcare systems. The island's legal and regulatory framework is designed to support business, whether electronic or brick-and-mortar.

The Bermuda Stock Exchange (BSX) is the world's largest offshore, fully electronic securities market, and is a member of the World Federation of Exchanges. It offers a Mezzanine Market which is a unique pre-IPO market listing for start-up, high-growth potential companies.

The majority of *Fortune 500* companies have a Bermuda presence, as do several other multinationals. This is a tribute to the island's many advantages which enable global companies to thrive, thanks to the balance that Bermuda has reached with its focus on innovation, infrastructure (financial, legal, regulatory, and ICT) and a highly-educated talent pool.

International companies find levels of banking, trust, accounting, custodial, and legal services in Bermuda that are equivalent to those to which they are accustomed around the world. The local ICT sector has strong ties with the major IT service organisations globally and is used to working with offices in multiple jurisdictions.

Bermuda's time zone and location are a plus for in-person or virtual interactions with stakeholders on both sides of the Atlantic. As a matter of fact, more than half (55%) of the companies which operate in Bermuda use video conferencing technology.

Bermuda's currency is pegged to the US dollar and the country is also a tax neutral and a tax-efficient jurisdiction. It is a leader in tax transparency with its more than forty (40) Tax Information Exchange Agreements. Importantly, the US Consulate General on-island processes visa application for business travel to the United States.

It is easy to incorporate in Bermuda and the island's financial services businesses are licensed, regulated, and monitored to international standards. The oversight provided by the BMA has been endorsed by the International Monetary Fund as well as by a number of varied international regulatory and standard-setting bodies.

All of these advantages also make Bermuda the perfect landing spot for IT companies that provide services onshore to North American clients.

Bermuda enjoys an excellent reputation and continues to be seen as the Gold Standard in offshore business. The island's GDP per capita is one of the highest in the world. We have a highly skilled population and a sophisticated and tight-knit network of support services along with a world class telecommunications infrastructure. It is the perfect "test bed" environment, in an ideal geographical location. As we like to say in our tourism campaigns, Bermuda offers *"so much more"*. ■

Dr. the Hon. Grant Gibbons graduated from Brown University and subsequently, Oxford University as a Rhodes Scholar in Philosophy, Politics and Economics. He received a PhD in Organic Chemistry from Harvard University in 1982. Dr. Gibbons has had an active career in both politics and business. He is currently the Minister of Education and Economic Development and is the Member of Parliament for Paget East. Dr. Gibbons is also chairman of the Colonial Insurance group of Companies and has held various management positions and directorships at a number of public and private companies.

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China's trade policy. The hegemon in waiting

Hanns Günther Hilpert is Deputy Head of the Asia Research Division at the Stiftung Wissenschaft und Politik (German Institute for International and Security Affairs - SWP)

China's epochal economic rise is manifested most of all in international trade. In less than thirty years China has risen from a marginal player to become the largest trading nation in absolute numbers. By 2013 exports and imports totalled $4,157 billion, corresponding to 11.2 percent of world trade, thereby surpassing the United States and taking the lead in the table of trading nations (see figure). Even as the existing domestic and external economic growth curves level off, it is foreseeable that China will come to dominate international trade in the way the United States did until into the 1970s. It is all too evident that China's secular rise as a leading trading nation has immediate repercussions on the production and income of its trading partners and it has far-reaching consequences for multilateral trade policy.

Given the importance of China's trade policy for the economic wellbeing of its trade partners and for the future of the multilateral trading system, there is still a surprising lack of understanding and interest in the matter. It is true; China's trade policy is still in a transitional mode and has not reached its final shape. It is also true, that the motives and the organizational structure of China's trade policy appears to be somewhat opaque from the outside. But it must be recognized that China plays an ever more important role in shaping international trade relations and structures since it has entered the WTO in December 2001.

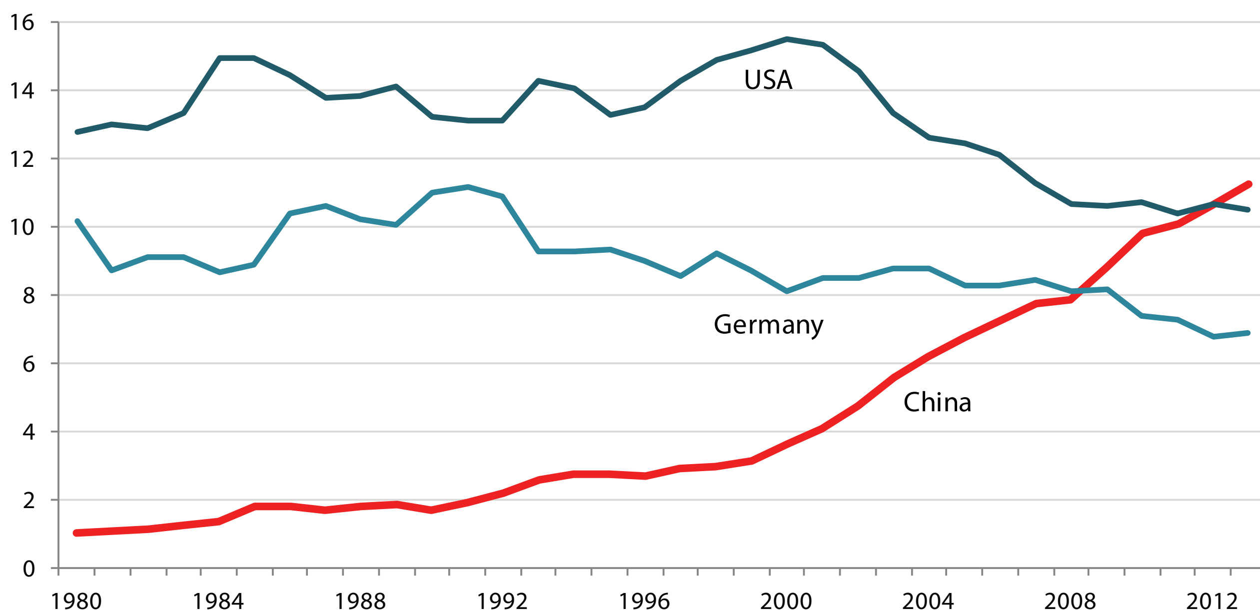
China not only stands at the centre of numerous trade conflicts, it also has a huge impact on the trade policy actions of its trading partners worldwide, even though China does not yet possess the ability or will to lead. Against this backdrop it should be asked: how can China's trade policy be characterized so far? What lessons can be drawn for Europe's trade policy?

Incomplete implementation of WTO accession obligations

Despite far-reaching tariff reductions, market opening and liberalisation, China's implementation of its WTO accession obligations remains incomplete. Yet it is true the country has poured enormous effort into far-reaching adaptations of legislation and jurisdiction to comply with WTO norms and opened its markets considerably wider than other major emerging economies. But deficits persist, in particular in observance of general WTO principles such as non-discrimination, transparency and rule of law.

Towards the middle of the last decade the process of unilateral non-discriminatory liberalisation ended and since then the opening process appears to be going into reverse. Foreign

China's rise to leading trade power: share of world trade (percent)



Source: IMF, Direction of Trade Statistics, May 2014

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"It would be both sensible and advisable to integrate China into the ongoing development of international trade rules, ideally by reviving the current Doha Round"

investors and importers are confronted with new barriers to market entry, while privileged domestic investors are backed and protected with taxes, subsidies and public contracts. Special measures 'behind the border' discriminate effectively against foreign businesses. These include mandatory approval for direct investments, restrictions on company acquisitions, restrictive licensing in the service sector, discrimination against foreign investors through special provisions on establishing a corporation, test procedures, environmental regulations, minimum local content requirements and public procurement, and complex conformity and certification requirements, which are generally also a source of technology leakage.

To further the domestic development of income and employment, the external economic priority of the past Hu Wen administration (2002–2012) lay in protecting the large state-owned enterprises and establishing globally competitive industries. In retrospect it might have been unrealistic to expect that China would abandon industrial policy favouring its domestic enterprise.

Maturing to become an established actor in the WTO-system

Such non-compliance notwithstanding and in spite of the frictions incurred with China's growing presence in world trade, fears expressed before its WTO accession that it would undermine the multilateral system have proved to be unfounded. China behaves like an established actor in the WTO world trade system. It sometimes breaks rules and grants its own trade interests greater importance than the existence and stability of the system as a whole, but in general it respects the status quo and pragmatically pursues its own economic interests. This development is all the more surprising as China - in comparison to the 124 founding WTO-members - had to assume additional obligations on accession, but received fewer rights.

As a non-market-economy, China is specifically disadvantaged by special safeguards permitting its trading partners to impose various import protection measures (until the year 2016). Pointedly formulated, China is still a second-class member. Since China draws great benefits from integration into the world economy, however, anger and criticism from the ongoing discrimination is not targeted at the WTO and the multilateral trading system, but on concrete protectionist measures directed against China.

What is more, China's participation at the WTO dispute settlement mechanism has been taking a decisively positive turn. Both as a defendant and as a complainant, China is participating increasingly actively. Since China correctly implements adverse rulings, the WTO mechanism offers good chances of depoliticising trade conflicts and bringing about legally objective resolutions.

Passivity in the Doha Development Round

China would have little to gain from a successful conclusion of the Doha Development Round, but is, as a trading nation, exceptionally dependent on the world market and has a lot to lose from its failure. China plays an ambivalent role in the current multilateral negotiating process.

While it remains reserved and passive in talks, the successful global market campaigns of Chinese industry reduce the willingness of emerging economies to compromise on the issue of market access for industrial products, as market opening would cause them further losses of sales and profits. Thus the failure to date of the Doha Round can partly be explained by the failure of the WTO negotiating framework to take adequate consideration of China's new position in world trade.

China's rise has both fundamentally reconfigured the Doha negotiating calculations of many WTO members and it has shifted the power structures of international trade politics. In the face of powerful Chinese import competition, many emerging economies are practically no longer willing to compromise on the topic of non-agricultural market access (NAMA), for example when they were called upon to open their markets beyond the existing reductions in unbound tariffs.

What is more, the rise of China and other major emerging economies has broken up the former GATT negotiating monopoly of the 'Quad' group (Canada, European Union, Japan, United States). Now Brazil, China and India together form an effective opposition and blocking power that can prevent any conclusion it regards as unfavourable – but is itself not yet capable of shaping trade policy.

Active conclusion of bilateral FTA deals

To attain its trade policy goals, such as recognition of market economy status, securing and improving access to markets, resources, technologies, and insuring itself against Western protectionism, China has signed bilateral free trade and economic partnership agreements with fifteen partners to date, entered into negotiations with six further partners, and is considering the start of talks in six more cases.

Bilateralism permits China to play up its status as a major power and indirectly strengthens China's position as the centre of gravity of Asian trade. It is precisely the biggest trading powers that profit most from a shift to bilateralism, because the pull of their import markets lends them asymmetrical negotiating power and puts them in a position to wring concessions from smaller countries. Indirectly, discriminatory bilateral trade policies promote the emergence of centre/periphery structures that favour the businesses and production facilities of the centre.

Thrown on the defensive by mega-regional trade deals

However, at the same time, Beijing is on the back foot in the global trade bilateralism game because the Transatlantic and Trans-Pacific free trade initiatives of the industrialised countries would discriminate against China. Left out from these mega-deals, China would almost inevitably suffer from the creation of trade between their most important trading partners. If China were to seek to join the talks or later join the TPP, it would have to observe the complex, newly-drafted trade rules and accept stringent standards in the fields of social affairs, environmental standards, intellectual property rights and state-owned industries. And it would have to reckon with being confronted

with more or less arbitrary demands from the United States and other TPP members.

In order to remain in the game China will either seek to join the TPP (or even the TTIP) after all, forcing it, as in the case of WTO accession, to accept market opening and domestic liberalisation measures, or it will attempt, via free trade agreements with its Asian neighbours or the BRICS countries, to establish a trading counterweight. However, the latter course will be very difficult to achieve together with trade defensive nations such as Brazil, India, Japan and Russia, and it will be less attractive measured by the growth potential incurring.

Inside China's trade policy: no single unified strategic actor

A closer look at the actors, institutions, interests and debates reveals that the simplistic idea of a monolithic Chinese trade policy cannot be upheld. Any sweeping characterisation of China's trade politics as liberal or mercantilist, as compatible or incompatible with WTO rules, can easily be proven wrong in the complexities of Chinese reality. The different actors' interests and manifold possibilities of action and influence instead demonstrate how contradictory and erratic China's trade policy really is.

Generally, China's trade policy structures can be characterised as pluralistic, untransparent, reactive and unpredictable. As a result of the activities of interest groups and a sometimes nationalistic agenda, economic rationality and actual trade policy sometimes part ways. In general politics follows rather pragmatic, opportunist considerations more than paradigms or strategies. Although China's general political priorities are decisive for the substantive thrust and institutional framework of its trade politics, actual policies are driven more by hard calculation or crude economic interest than by paradigms or grand strategies. Thus China's trade policy is open to external influence, sometimes also to nationalistic instrumentalisation.

Both government actors and regional and sectoral interest groups play a role in shaping the negotiating and implementation processes. It's consequently sometimes less than perfect implementation of binding trade agreements devalues China as a serious negotiating partner. China's trading partners cannot and must not depend on the implementation of contractually promised agreements.

What is more, China's trade policy is in permanent flux. Whereas the influence of the central institutions of government waned under Hu Jintao and Wen Jiabao, the interest groups became ever stronger. The liberal episode under Prime Minister Zhu Rongji with a powerful Ministry of Commerce and efficient negotiating mechanisms is already history. It remains an open question whether the trend towards state capitalism and protectionism will continue under Xi Jinping and Li Keqiang, or a free-market comeback is possible.

The hegemon in waiting. Towards landmark decisions

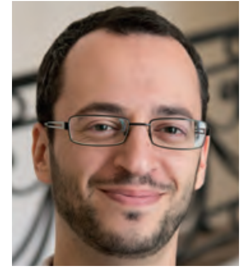
China's trade policy is heading for course-setting decisions for at least three reasons. Firstly, a new party leadership took charge in autumn 2012 and a new government in spring 2013. Where once the Hu Wen administration initiated a political shift to state capitalism and mercantilism, the new reform-oriented Xi Li administration can be expected to supply sustainable impetus for domestic and external economic liberalisation. The recent conclusion of free trade agreements with Switzerland, Iceland and Australia, China's interest in a WTO Trade in Services Agreement (TISA) and the opening of movement of capital and financial markets in the new special economic zone in Shanghai can thus be interpreted as the first indications of a more liberal alignment of trade policy.

Secondly, in trade policy China is directly challenged by the bilateralism of the EU, Japan and the US. Successful conclusion of the ongoing talks for Pacific, Atlantic and Japanese-European free trade agreements (TPP, TTIP, JAPEU) would cause China losses of profits and sales through trade diversion and exclude it from the ongoing development of international trade rules.

Thirdly, China has gained enormously in power and influence in international trade policy. While China could initially be 'primus inter pares' in a multipolar trade system, in the medium to long term hegemonic stability is even conceivable, where it would assume leadership and supply resources to support and stabilise the multilateral trading system. In any case, in future China will be in a position to decisively shape international trade policy through its own liberalisation proposals and by placing demands on its trading partners. It is unclear, however, how China's trade policy will respond to the internal and external pressures for realignment.

Despite numerous external economic controversies and conflicts, the European Union should not lose sight of the strategic objective of integrating China in the rule-based world trade system. In view of the growing number of free trade agreements, the West should take seriously the risk of a rift in the global trading economy. It would be both sensible and advisable to integrate China into the ongoing development of international trade rules, ideally by reviving the current Doha Round. Integrating China into TPP and TTIP could be a workable second best alternative. China itself also relies on an open global economy and a functioning WTO for maintaining domestic growth, modernisation and internal stability. There is plenty of room for meaningful negotiation. ■

China's reforms: is Beijing playing its hand well?



Jörg Wuttke is the Chair of BIAC's China Task Force, and Chief Representative of BASF China, and Jonathan Greenhill is a Policy Manager in the BIAC Secretariat

The drivers that have delivered China's impressive growth over the past several years – the country's demographic dividend and prior reforms – appear to be nearing their limits. Stimulus measures through monetary expansion can offer temporary help, and have been used extensively since the onset of the global financial crisis, but it is increasingly clear that fundamental reforms are urgently needed to secure strong growth that is sustainable in the longer-term.

For China's economy to succeed in the 21st Century, the government will need to adjust its level of involvement in the economy through a combination of strengthening certain roles while relinquishing other responsibilities. In some areas, the government is too absent from the market and needs to strengthen its capacity to formulate top-level regulations while enforcing existing regulations in a transparent and fair manner. In other areas, the government is too dominant and needs to step back in order to strengthen market forces, primarily through institutional reforms to the financial system and to the role of State-owned Enterprises (SOEs), as well as through the reduction of industrial policies and costly subsidies that are distorting markets.

Encouragingly, at the China Development Forum in Beijing in late March 2014, Vice Premier Zhang Gaoli hinted at reforms aimed at freeing up market forces on the mainland which would result in a reduced role for government. Market forces, depicted as an 'invisible hand', would play a bigger role, while the government, viewed as the 'visible hand', would use its powers more effectively and transparently.

Reforms for better governance and new roles for the 'visible hand'

The drive towards a more effective state was already evident in May 2013, when the State Council abolished or decentralised a number of administrative approval items, reduced the number of ministries and commissions under the State Council from 27 to 25, and merged several agency-level regulators in order to reduce overlapping and conflicting responsibilities. Two other symbolic steps were taken in July 2013: the People's Bank of China took additional measures, including the elimination of the lending rate floor for commercial loans, towards a liberalisation of interest rates; and the State Council announced the creation of the Shanghai Integrated Free Trade Zone, though that zone is still lacking details and direction.

While these are positive steps, this is only the start of a long and difficult process to strengthen the regulatory system to better suit an increasingly complex economy. There is significant opportunity for streamlining at many levels. Some parts of the central level government still remain highly bureaucratic, with a number of ministries holding overlapping responsibilities for important regulatory and enforcement functions. This frequently results in added burden and reduced efficiency for enterprises that have to comply with either duplicative or contradictory regulations, and may give rise to instances of corruption.

In some cases, there is a conflict of interest due to the government being both a regulator and service provider, resulting in a typical principal-agent problem. Government, business and society would benefit from a more independent government. A strong regulator needs to be free from commercial influence.

Despite a sound framework of regulations for the business environment in most areas, problems still remain due to weak and inconsistent enforcement of existing regulations. A lack of enforcement at local levels of government and a lack of punishment for regulatory violations hinder the valuable legislative efforts of the central government.

As the economy becomes more complex and in order to meet growing societal needs, greater focus should also be given to developing guidance to assist business compliance. Business welcomes consultation with the government, including through its participation in international fora in order to benefit from international best practices and to ensure business understands and complies with the eventual decisions. A strong government is an open government.

While the government should be inclined to simplify pre-market approval processes by devolving some self-regulatory and risk management powers to companies, at the same time there should be a strengthening of the government's role in terms of regulatory impact assessments to ensure appropriate implementation of supervisory standards. A successful economic transition must be preceded by a regulatory transition in which the government finds its proper role in an increasingly modern economy. Regulating a huge and complex economy is an extremely difficult task. The government therefore needs to increasingly focus its efforts and resources on building up the regulatory capacity that is required to foster a vibrant market economy.

The case for structural reforms and increasing the role of the 'invisible hand'

Equally important to better governance is leveraging the contributions that business can make through greater structural

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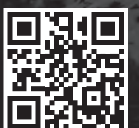

"Until China creates the sort of market access to its markets that it receives elsewhere in the world - and particularly in OECD countries - it will not be seen by other countries as an equal and fair player"

reform. For China to achieve its goal of moderately fast growth in the new era, new catalysts for economic growth need to be identified - and already have been - through reforming the state-led development model. This includes implementation of reforms to financial services, industrial policy, SOEs, and market access.

The government is currently not only setting and enforcing the rules of the game, but also carrying out commercial activities through SOEs and directing the flow of investment through control over the financial system and industrial policies. While this model enabled incredible growth through massive fixed-asset investments and export-oriented practices, it has generated a reliance on capital injections and is causing resources to flow to inefficient areas of the economy. This has led to market-distortions, mispriced capital and overcapacities, stifled consumer demand and innovation, local and corporate debt, and other undesirable results.

Financial reform

China's financial system, and the privileged relationship between the State-owned banks, SOEs and local governments that it serves, means that household savings are used to subsidise lending, much of which is directed at marginal investment projects to prop up unproductive SOEs and to finance inefficient local government projects. This results in risk being built up in bank, corporate and local government leverage. Financial reform should give banks the freedom and incentives to fulfil their intended role in evaluating returns on investment and directing capital to productive areas of the economy, free from political interference from local governments and SOEs.

The use of market price signals - in particular in more flexible interest rates - would also serve to reduce the current high levels of credit growth and incentivise economic efficiency by requiring borrowers and banks to reassess marginal investment projects. This would also create a more level playing field for credit allocation to private industry and end financial repression of household savings, potentially leading to a more equitable distribution of wealth and increased domestic consumption spending.

Industrial policy reform

The government uses a plethora of interventionist measures to attempt to develop domestic industries. Such industrial policies are practical tools used by most governments. However, due to the government's goals to become a global leader in various strategic sectors, to develop 'national champions' and, in some sectors, to reach target market shares for its domestic industry, China's industrial policies often function in practice as protectionist measures and serve to favour SOEs.

These policies include various and vast forms of subsidies in particular to domestic heavy industries and the manufacturing sector, which have resulted in a large number of companies becoming reliant upon government support. Local government implementation of industrial policies usually serve to support SOE 'local champions' as well as companies that are major local employers in pillar industries. Local governments have provided direct and indirect subsidies, as well as favourable treatment to local companies in a number of sectors into which the Chinese government has encouraged significant financial investment. This is a major cause for market inefficiencies and overcapacity in many of these sectors.

SOE reform

SOEs can play an important role by providing public goods and services at affordable prices in sectors where demand is not sufficient to generate an efficient or effective market-based response from the private sector. SOEs can also play a role in sectors of special strategic interest to the government, though should not be protected from competition or enjoy special privileges to the detriment of the private sector, or at a significant cost to Chinese taxpayers.

However, the reality in China is that SOEs' privileged position has inevitably led to preferential treatment and subsidies, and a vast amount of the state-led investment

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on which the economy has come to rely is directed through SOEs.

This system has also created inefficiencies as it provides a mechanism to provide inefficient cycles of economic support from household savings in the banking sector to value-destroying companies, overcapacity sectors, and to support the often narrow aims of local governments, meaning that poorer services and higher costs are frequently transmitted to the Chinese end-user.

SOE reform and orderly privatisation has the potential to unleash a wealth of innovative potential and efficiency in key sectors currently dominated by SOEs that constitute the foundation of China's economy, including telecommunications, energy, financial services, transportation, logistics and construction. Allowing equal competition and greater opportunities for all could bring considerable societal dividends and economic growth through boosted productivity, more efficient allocation and utilisation of capital, increased tax revenues, strengthened regulatory capabilities and decreased corruption.

China's sustainable economic development and economic rebalancing relies upon private enterprises being able to fully develop alongside SOEs in an environment of fair competition. As the SOE reform process develops, the result would be greater opportunity for the private sector. Indeed, a number of government ministries have issued guidelines over the last couple of years to permit private investment into a number of heavily state-controlled and monopolised sectors, including telecoms, financial services and health care.

Market access reform: a two-way street

It is concerning that most government pronouncements to encourage 'private capital' only include Chinese capital and not foreign investment. As the country's growth rate slows during its economic restructuring, Chinese companies will increasingly need to go global to ensure sustained growth. China's domestic policies have important international implications and can negatively affect the perception of its domestic companies abroad.

Until China creates the sort of market access to its markets that it receives elsewhere in the world - and particularly in OECD countries - it will not be seen by other countries as an equal and fair player. Protectionist domestic policies could therefore generate additional obstacles to the internationalisation of Chinese companies due to the trade tensions they generate with China's major trading partners and the growing calls for reciprocal treatment against Chinese companies abroad.

China's degree of openness to foreign business will therefore increasingly have implications for the interests of Chinese business on a global stage, especially as Chinese firms are stepping up their overseas investments, in particular in OECD countries. Reforms for open markets should be viewed as a two-way street.

The potential benefits of an opening of markets, in which all companies – public and private, domestic and foreign – can compete fairly, would bring about increased competition and would lead to increased efficiencies, innovation and greater economic development, ultimately to the benefit of consumers in China and the rest of the world.

The voice of the private sector

Recognising that China's success in the 21st Century will depend to a large extent on enabling the market to play a bigger a role, it is essential that the needs and views of the private sector can be heard through effective mechanisms for consultation and dialogue.

At the international level, the BIAC China Task Force supports China-OECD co-operation by providing OECD business expertise and advice. The OECD, equipped with its extensive knowledge on structural reforms and good policy practices, is uniquely well-placed to work with China and the business community to ensure strong and sustainable growth going forward. ■

Currency wars

Ben Southwood is Head of Macro Policy at the Adam Smith Institute

Introduction

In the popular business and economics press, as well as among interested laymen, there is a notion that countries can compete, or even fight a war, with their exchange rates. Cheaper sterling makes the stuff Brits produce cheaper to foreigners without reducing the amount of pounds firms can get for it, while it makes foreign-produced goods more expensive to import. This raises exports and cuts imports, and it's understandable that people see imports as money flowing out of the country, and exports as money flowing in.

Thus, there is the idea that exchange rates are zero-sum: one country can raise their net exports (and economic wellbeing) only at the expense of other countries. One devaluation will provoke a series of 'competitive devaluations' – a currency war.

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"... trying to fix a currency is swimming against the market tide and can't be achieved in real terms"

But this is wrongheaded.

I will explain in general why there cannot be such thing as a currency war, and then explain specifically why this general idea applies to the situation in China. There are two principal points: firstly, so long as the macroeconomy is being managed well, exports are a cost and imports a benefit; secondly, real exchange rates cannot be controlled and are set in the market - governments cannot manipulate them.

Exports are a cost in equilibrium

If all prices were perfectly flexible, then markets would not suffer macroeconomic downturns, slumps, sluggish recoveries and so on. There would be no bouts of unemployment, few debt crises, or costly adjustments. But in the real world many prices, particularly the prices of debt and labour (ie. wages) are fixed in nominal terms, not correcting for inflation or other factors.

The total amount of demand, which is also measured in nominal terms, is split up amongst all the goods, and the prices make this split fit. If we see the economy as a game of musical chairs then prices clear markets by making sure there are exactly enough chairs to seat everyone. If the total amount of demand falls but price-setters don't realise the importance of this, then prices are too high and there isn't enough demand to pay them all. During this time there will be unemployment - workers are setting the price of their labour too high - and not just of human labour power, but also of all other factors.

Slowly, workers and debtors and creditors and investors will realise the changed macroeconomic circumstances and adjust their plans, offers and the wages they'll accept. But during macroeconomic disequilibrium like this, any extra demand is helpful and will help deal with what economist Bryan Caplan calls *"the grave evil of unemployment"*. Things are so bad that in John Maynard Keynes' view even paying workers to dig holes and refill them would be beneficial overall.

In the same way, these extraordinary economic times mean that extra exports - which add aggregate demand to the system - are good, and extra imports -which send demand out of the system - are bad.

Equilibrium

But it is not usually the case. In macroeconomic equilibrium, where there is sufficient demand to employ all capital and workers, extra capital or workers devoted to foreign demand (ie. exports) means less capital and fewer workers devoted to domestic demand. This means fewer goods for residents to consume and more for foreigners to consume.

In equilibrium, exports are the cost you pay for past, current and future imports. What we want is more goods to consume - more and better healthcare, more and better education, more and better housing, more and better clothes, more and better transport. If we do more exporting we can produce fewer of these things for ourselves, and if we do less importing we can bring fewer of these in from abroad.

Extra exports can in the short-run bring more workers into the labour force but this disequilibrium can only last for a short time, and only then by tricking workers into thinking that their wage offers are really worth more than they really are in real terms. This exploits what is known as 'money illusion' to pay workers less in real terms than they would be willing to accept.

The upshot of all this is that if countries could devalue their currencies to make their goods cheaper, and simultaneously make foreign goods more expensive, then what they would really be doing is making their citizens work harder to consume the same amount of goods, giving the extra chunk to foreigners on the cheap. Before we start worrying about this though (China is still a very poor country, and Yuan-holders probably shouldn't morally be subsidising the rest of the world's consumption) we'll note that adjustments cancel out exchange rate policy before it can have much effect.

Swimming against the tide

Consider: the Bank of China wants a cheaper Yuan/renminbi. How does it achieve this? Suppose it decreed that a dollar would now buy 元10 instead of 元6.25 (the going rate as I wrote this piece). Suppose the BoC said it would supply infinite Yuan at the price of $0.10. What we would expect to see is a huge flow of dollars to the BoC. But each dollar that the BoC buys means an extra flow of 元10 into the world economy.

These renminbi will all be spent in China, and more money, we know, means higher inflation and higher asset prices. Assuming that China had a stable macroeconomic picture at the beginning of the peg, the extra aggregate demand will not translate into any more real output or income. People will buy Yuan until they are worth only $0.10 each, with inflation and asset price rises the result. This is borne out empirically, and across the world inflation and a cheaper nominal currency go hand in hand.

Essentially, the point is that trying to fix a currency is swimming against the market tide and can't be achieved in real terms. If you unexpectedly print lots of extra money to devalue your currency you will, for a short time, make your goods cheaper to foreigners, but soon inflation will erode away those terms of trade gains. To sustain this into the medium term you would have to continually surprise the market with new devaluations - which is very hard.

The real benefits of currency wars

So exports are a cost, outside a recession, and imports are a benefit. And in any case it's impossible to fix a real exchange rate for long. So currency wars shouldn't bother us too much. In fact, they even have benefits. Consider the monetary-macroeconomic disequilibrium scenario raised earlier. In this scenario, a deficiency of demand – money - means that certain prices (particularly wages) are too high relative to nominal demand, and the time they take to adjust to the new situation is a recession.

A currency war involves printing lots of money and raising the total amount of nominal demand. And many economists, including Danske Bank chief analyst Lars Christensen and Bentley College Professor Scott Sumner, have pointed out that this is exactly how currency devaluation works its beneficial effects. It raises the total amount of demand to allow markets to clear even despite wage and price stickiness. This is why, they

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argue, Japan imported more after starting the massive money printing and devaluation that was Abenomics.

From this analysis, devaluations, far from being zero-sum - where a benefit to one country is a cost to another - are positive-sum. A devaluation in one country helps bring them out of recession, allowing more trade with other countries, in turn allowing broader and deeper specialisation and more goods for everyone to consume.

Conclusion

There are no such things as currency wars, and devaluations are not competitive. We cannot swim against the overwhelming tide of the market, and we wouldn't want to. In equilibrium exports are a cost we pay to get more imports in the past, present, or future. But that doesn't mean devaluation is useless - it may help get countries out of demand-side recession by increasing the amount of nominal demand in the economy. ■

Deepening financial reforms in China

Dan Luo is a Lecturer in Business and Finance at the School of Contemporary Chinese Studies, University of Nottingham

On 4th March 2014 a major Chinese solar energy company, Chaori, shocked the financial market. Its announcement that it was unable to pay the interest of 90 million RMB associated with its corporate bonds due in full the following day, made it the country's first default in the domestic bond market since 1997. The government did not step in to bail out the failing company, sending a clear signal that China's financial reform will start to remove the long-standing issues of soft-budget constraints, be it for state-owned or private firms.

Following the news, the copper price suffered an unexpected drop, pushing its stock level higher, and signalling that economic activities may be weakened as a result. Due to its strategic importance in the national economy, copper has been used by many investors as collateral for bank loans. However, the weakening of the country's property market and RMB in recent months implies that any such financing deals will become significantly less profitable.

2nd annual conference of the 12th National People's Congress (NPC)

With the government's efforts to tighten bank loans and to implement hard budget constraints, investors should be prepared for more challenges. If they are unable to secure loans, they may need to sell off their metal stocks. This will inevitably lead to more price volatilities and a downward pressure on profit margins in the metal trading industry.

However, given the small size of the company and the relatively stable market environment, Chaori's interest payment default is unlikely to trigger any large market contagion effect in the short term. Some economists may even argue that perhaps Chaori has been used by the government to test the potential impact of its deepening reform efforts to reduce overcapacity in certain industries and to allow the financial market to play a more important role in improving production efficiency and industrial upgrading.

As stated by Premier Li Keqiang after the incident, future defaults might be unavoidable as China's economy comes to a turning point and the government is no longer willing to step in to support failing companies.

In April 2014, another small building material company, Xuzhou Zhongsen Tonghao New Board Co, failed to pay interest on 180 million RMB of bonds, making it the second default on domestic bonds in a matter of only two months. The default by the company was also the first in China's high-yield bond market, which was launched in June 2012 in an effort to alleviate the financing difficulties of small and medium-sized private firms. The reaction of the market was muted and the Shanghai Composite Index was even up by 0.7% on the day. Nevertheless, investors should learn from this incident that taking high risks will be their own responsibility and the expectation of any state bailout may lead to an unexpected closure.

Conversely, to improve access to the financial market, in late February 2014 the Central Bank revealed details of trans-border RMB regulations in the newly-established Shanghai Free Trade

Zone (FTZ). Companies set up in the FTZ are permitted to borrow offshore RMB without the restraints which prevailed in the past. For example, the Bank of Communications Financial Leasing (BCFL) has managed to obtain a 700 million RMB loan from Bank of Communications Singapore at an interest rate of less than 4%; significantly lower than the mainland lending rate which stood at over 6% at the time. As a result, the borrowing costs of companies in the FTZ will be reduced, allowing them to enjoy a much lighter financial burden.

On the other hand, control measures related to money trafficking and the financing of terrorism have also been carefully drafted, showing the government's cautious attitude towards financial liberalization. All these policies are believed to be effective in preventing currency and interest arbitrage while assisting the globalization of RMB. The FTZ has been created as an experiment to assist the country's ambitious reform programme which may be rolled out to the rest of the country in the foreseeable future.

During the 2nd annual conference of the 12th National People's Congress (NPC) in March 2014, two new important financial and monetary reforms were announced by the central government. After the removal of the floor on the bank lending rate in July 2013, the central government further removed the ceilings on smaller foreign currency deposits in the Shanghai Free Trade Zone (FTZ). In addition, since last October, China has launched a prime interest rate for commercial bank loans. Instead of relying on the benchmark rate as a guideline for lending, the new prime rate is based on the weighted average rate of the nine biggest domestic commercial banks' loans to their best corporate customers.

Although this move will not fully eliminate government intervention, it has given key Chinese lenders more say in the determination of lending rates. All these new policies have been used to test market reactions so as to set up a solid foundation for full-scale interest rate liberalisation in the country. It is widely believed that as early as next year, China will scrap the ceiling on bank deposit rates to realise full interest rate marketization.

The other reform is of the country's controversial exchange rate regime. Since 17th March 2014 the daily fluctuation range of RMB foreign exchange rate has been allowed to double from 1% to 2%. The last such relinquishing of the tightly controlled exchange rate band was in April 2012, when the PBOC doubled its daily trading band from 0.5% to 1%. This is a major step in further reforming the foreign exchange regime and making the Yuan more competitive as a trading instrument on the world stage. Market participants have long anticipated a constant one-way appreciation of the currency.

The new policy shifts market expectation by allowing a two-way wider band. The increased flexibility will improve market efficiency and increase the decisive role played by the market in resource allocation. While on the other hand, companies in China - facing greater volatility in the Yuan's exchange rate - will have to learn how to manage their currency risks effectively.

Zhou Xiaochuan, governor of China's Central Bank, has made it clear that financial sector reform in China may be faster and deeper than generally expected. An official report at the recent NPC revealed a series of key proposals for the deepening of financial reform, including the introduction of a bank deposit insurance system, a plan to allow the private sector to set up small and medium-sized banks and other financial institutions, and a move to allow local governments to issue bonds.

"... it is clear that the government is determined to increase market competition, to reduce the monopoly power of the state sector, and to restrain government intervention in the financial market"

Along with the further opening up of China's financial system, it is necessary to reassure bank depositors that their savings are safe. At the moment, only deposits with the 'Big Four' banks are implicitly backed up by the central government, leaving smaller banks less attractive to depositors. The introduction of the insurance system has offered a safety net, giving the banks more power in interest rate setting, while on the other hand, sending a strong signal to the market that banks could fail. This could in turn stimulate market competition, pushing the banks to become stronger and more resilient to external volatilities.

Additionally, to ease the restrictions in the banking sector, ten private companies including Alibaba and Tencent were, since March 2014, allowed to set up private banks. As with other banks they must comply with the same set of banking regulations, but their main focus is on serving small and micro businesses. Currently, private investment only accounts for about 11-12% of the total assets of the Chinese banking industry. This move will inevitably loosen the government's control over the sector, allowing the market to play a bigger role in resource allocation.

Finally, to activate China's capital markets and to ease the financing difficulties of local governments, the National Development and Reform Commission (NDRC) has given the green light to local government bond sales in 2014. Currently, local governments mainly rely on land sales and Special Purpose Investment Vehicles (SPIVs), set up by local authorities such as Trust and Investment Companies (TICs), to meet their spending needs. Problems of revenue shortage at the local level have become even more serious, in particular after the world financial crisis.

According to the latest audit, by 2013, local government debts were about RMB 17.7 trillion ($2.9 billion), an increase of 70% from three years previously. Although the aggregate amount remains low compared with other developed nations, its speed of growth is worrisome. It is widely expected that the allowance of direct bond sales at the local level will phase out the opaque financing vehicles used by local governments and make the embedded risks more transparent. Over the long term, the establishment of a thriving municipal bond market would be the only solution for China to diversify the risks to a wider pool of potential investors.

Although it is currently hard to project the precise timeline for the full-scale implementation of these reforms, it is clear that the government is determined to increase market competition, to reduce the monopoly power of the state sector, and to restrain government intervention in the financial market.

China's new Prime Minister, Li Keqiang, considers market reform to be a dividend to sustain the country's economic growth and prosperity. The deepening reform methods to be implemented in the financial sector will enforce this message. ■

Berlin – Meeting Hub in Europe

Berlin is the perfect destination for any event: besides its modern venues, the innovative and open-minded city offers a unique setting and is host of international creative meetings and medical congresses.

New congress hall for Berlin: in early May, the German capital celebrated the official opening of the CityCube Berlin. The state of the art convention centre is an important asset for Berlin in the tough, competitive market for international conventions and meetings. The modern convention hall is bringing international high-profile events to Berlin and is booking up fast. Events have been planned in advance as far as 2021. The CityCube Berlin is becoming a key venue for the national and international convention and meeting industry.

The cube-shaped building with three levels is equipped with the latest technology and offers plenty of space for larger meetings and conventions for up to 11,000 participants. Movable walls allow the multi-purpose hall to be adapted to the particular requirements of any event. In addition, a walkway connects the hall with Hall 7 of the Messe Berlin, creating enough space for up to 18,000 people.

One of the first high-profile events in the CityCube Berlin will be the Annual Conference and 56th General Assembly of AIPC from 29 June to 2 July. This year's conference of the MICE industry will focus on the trends that will influence the market in the coming years. These include continuing globalisation, scarcity of resources, and demographic changes.

Berlin – the place to be for TEDSalon

On 23 June 2014, the most creative minds in the worlds of technology and entertainment will be converging at the TEDSalon in Berlin. The afternoon event is titled 'Bits of Knowledge' and features two sessions with 15 progressive speakers from around the world. The talks are open to the public and will focus on the forces of politics, science and technological innovation, including Big Data and 'What Facebook really knows about you,' and aim at fuelling discussions. Berlin and the TEDSalon are a perfect match: the city is full of creativity and entrepreneurial spirit and serves as a central hub of Europe.

On the morning of the TEDSalon, a special TEDx Workshop will be held. The workshop will bring together international organisers to connect with each other and the TED staff and share and discuss their views on some of the key issues impacting our world.

Medical Conventions: science meet in Berlin

Berlin is a popular location for science and medical events: According to the latest conference statistics*, 126,200 events took place in the German capital in 2013. Measured by the number of participants, meetings and conferences related to medicine, science, and research represented 14 per cent of the total.

High ranking summits illustrate Berlin's reputation in medical research and care – and strengthen the city's role as the leading location for medical conferences in Europe. In April 2013, the European Congress of Clinical Microbiology and Infectious Diseases (ECCMID) was held in Berlin and attracted 8,500 participants. In October, the 21st United European Gastroenterology Week (UEGW) brought almost 13,000 experts from 125 countries to Berlin.

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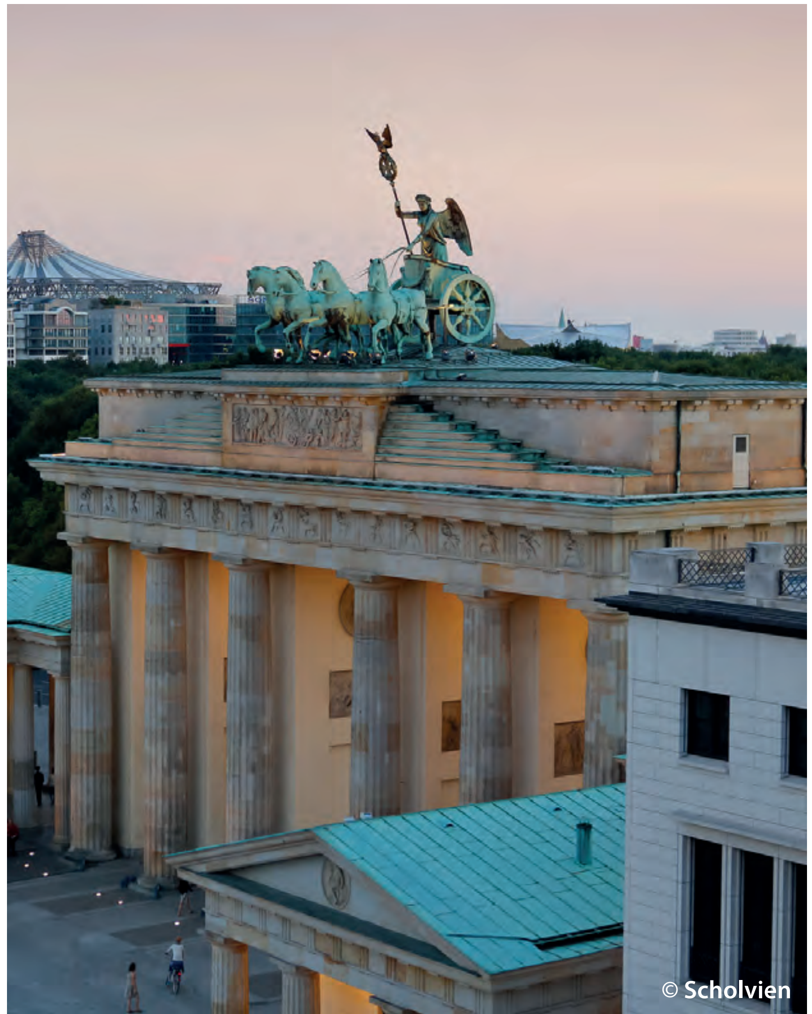
This year, the 6th World Health Summit will be held at the Federal Foreign Office in Berlin from 19 to 22 October 2014. The summit brings the international medical elite from all over the world to Berlin: some 1,500 medical experts from more than 90 nations are expected to attend the large-scale conference. The event features speakers from academia, politics, civil society, and the private sector who will address global health issues. The central topics of this year's summit will be 'Climate Change and Health,' 'Healthy Ageing,' and 'Physical Activity for Health.'

From 26 to 29 November 2014, the CityCube Berlin will be hosting the DGPPN Kongress of the Deutsche Gesellschaft für Psychiatrie und Psychotherapie, Psychosomatik und Nervenheilkunde.

10,000 people are expected to participate in this year's congress which focuses on the connection between mental illnesses and the demographic change.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visitBerlin Berlin Convention Office

The Berlin Convention Office (BCO) of *visitBerlin* is the engine that drives Berlin's meetings and conventions sector. Last year, the BCO represented the city of Berlin at 72 trade fairs and workshops around the world. It also supported 202 convention applications and provided services to 81 events in the city. Collaboration with international trade associations in the meetings industry have made it possible to position the capital as a well-rounded convention destination, to keep up with trends in the industry, and apply this knowledge for Berlin's benefit.

Established in 2001, the BCO offers comprehensive support for the organisation of conventions, meetings and incentives in Germany's capital. Customers benefit from the experienced team, free-of-charge agency and reservation services for hotel allocations as well as a vast network of national and international contacts. As a continuous presence in the target markets is significant, the BCO works in close collaboration with agencies in the United Kingdom, USA and Brazil. In consultation with the convention bureau, these agencies support the active marketing of Berlin in the target countries. ■

For more general information about the congress destination Berlin go to convention.visitBerlin.com.

**Source: 2013 convention statistics from the independent market research company ghh consult GmbH on behalf of visitBerlin.*

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The euro and European geopolitics

Daniel Dăianu is Professor of Economics at the National School of Political and Administrative Studies, Bucharest, and former Finance Minister of Romania, former MEP and a CASE fellow

The Ukrainian crisis and Russia's annexation of Crimea have produced a reality check in Europe. These events highlight the political dimension of the single currency area as well as its geopolitical relevance. The European order is being questioned almost a quarter of century since the fall of the Berlin Wall.

The introduction of the common currency (the euro) is part and parcel of the unfolding of European integration. The single currency has a well defined political dimension. As a matter of fact, it is not surprising that profound roots of the eurozone crisis are related to top politicians' overlooking, years ago, of the need to provide the single currency with solid institutional and political underpinnings - among which a fiscal component (fiscal integration) was paramount.

It pays to remember that studies made for the European Commission, more than three decades ago, highlighted the need for a eurozone budget, which should go over 5% of the cumulated GDP of the member states (the MacDougall report). There is talk nowadays, too, about the need to create a eurozone budget (see, inter alia, the Glienicker group report in Germany and the Eiffel group report in France). Even the President of the European Council, Herman van Rompuy, aired the idea of a 'fiscal capacity', which would allow the eurozone to deal with asymmetric shocks.

The eurozone reveals major economic discrepancies and the single currency operates as an undervalued currency for the highly performing German economy and as an overvalued currency for the less competitive member states. It is fair to mention that domestic devaluation, via massive income cuts, have reduced external imbalances considerably in Greece, Portugal, Spain, etc, but such measures cannot guarantee economic recovery. In addition, they do not mend bank balance sheets automatically.

The Banking Union is seen by many as a conduit for getting the eurozone out of the current mess. It does advance under very difficult conditions, with market fragmentation taking place in the single currency area. The vicious nexus between sovereign debt and bank balance-sheets is to be broken via the Single Supervisor Mechanism (SSM) and a common resolution mechanism (SRM). In ten years time, the latter would benefit on €55 billion as its resources. But its envisaged size is quite small. And there is hardly any talk about a collective deposit insurance scheme, which would make sense in a monetary union. National budgets will essentially be the main financial backstops in case of emergencies, although the ECB will hover as the ultimate lender of last resort in case of dire need.

Since member states' financial fortunes are very different inferences are not hard to make. The bailing-in procedures are likely to increase funding costs, in the short term at least. One can conclude that there is still a long way to go before the eurozone recovers. Such a thought should consider the nefarious influence of an oversized financial sector, which makes much of its profits through trading (speculation) and which operates as an inbuilt destabilizer for the rest of economy. The obsession of decision-makers, currently, to come up and implement macro-prudential measures stems from this stark reality.

"... the Ukraine crisis and Russia's annexation of Crimea have produced a reality check. These dramatic events highlight both the political dimension of belonging to the single currency area as well as a geopolitical aspect"

The eurozone crisis and the financial crisis have entailed rising cautiousness as to a rapid accession into the single currency area among New Member States (NMS). During 2010-2011, not a few analysts anticipated a reconfiguration of the single currency area, with severe economic and political consequences. The NMSs (who joined the Union starting from 2004) have become quite ambivalent about a fast accession. Because the eurozone crisis shows that an uncompetitive economy easily gets suffocated inside a single currency area where essential adjustment tools are missing, that real convergence is badly needed as a precondition of accession.

However, the Ukraine crisis and Russia's annexation of Crimea have produced a reality check. These dramatic events highlight both the political dimension of belonging to the single currency area as well as a geopolitical aspect. We are living an historical moment in Europe when spheres of influence seem to be redefined, when the European order is being questioned at almost a quarter of century since the fall of the Berlin Wall. Top officials of the Baltic countries have never refrained from linking their joining of the eurozone to a more organic, stronger embeddedness in the common fate of democratic Europe.

This means, that apart from the logic of turning a monetary council regime (which links a local currency to the euro at a fixed rate) into membership of the single currency area, national security motives and strategic policy choices that go deeply into European geopolitics are taken into account. Other new member states may also consider a faster joining of the eurozone (which would involve close linkages with the Banking Union) with a geopolitical rationale taking centre stage.

The recent dramatic geopolitical events test EU member states' resolve to develop the European project under conditions of geopolitical duress. In this respect, much hinges on how Germany, as the most powerful member state, politically and economically of the Union, will structure its relationship with Moscow. Here, the energy dossier may provide some clues to figuring out possible scenarios (The German minister of economy and energy's recent declaration, that there is hardly an alternative to gas supply from Russia, is to be taken into account in this regard). It is also Germany that holds the key role in completing the mechanism for a well functioning Banking Union (eurozone), for reforming finance in Europe (including its regulation and supervision) and, not least, for adopting measures that should support overall economic activity in the single currency area. And so many things have yet to be done to these ends.

To conclude, the geopolitical relevance of the eurozone depends on its consolidation. Likewise, unless European integration strides forward resolutely the European Union will get weaker in global geopolitics. ■

The ECB's new policy package: A step in the right direction for intra-eurozone rebalancing

Domenico Lombardi is Director of the Global Economy Program at the Centre for International Governance Innovation (CIGI), where Samantha St Amand is a Research Associate

In 2002, Robert J Barro identified a major policy development that would affect the next few decades, *"At some point, monetary policy may have to shift from a concern with inflation to the avoidance of the kind of deflation that prevails in Japan"*[1]. After hitting the zero-lower bound on interest rates in 2008, the Federal Reserve acted quickly and aggressively to further support the financial system and to stimulate economic activity. The Fed's expansionary monetary policy throughout the crisis and beyond is one of the reasons that the IMF is now projecting that the United States will return to its 2 percent inflation target by 2017.

In the eurozone, the European Central Bank (ECB) has responded more cautiously to the crisis: it was only this month that the Governing Council introduced further monetary stimulus after over half a year of low inflation. Despite emphasizing the symmetry of the ECB's price stability goal[2], it still appears as though the ECB has a deflationary bias, on balance, remaining more concerned with inflation rather than the avoidance of deflation. The ECB's more hesitant monetary policy during the crisis and its previously dovish views on the persistence of low inflation are part of the reason why the IMF currently projects that inflation in the eurozone will remain below the ECB's target five years from now.

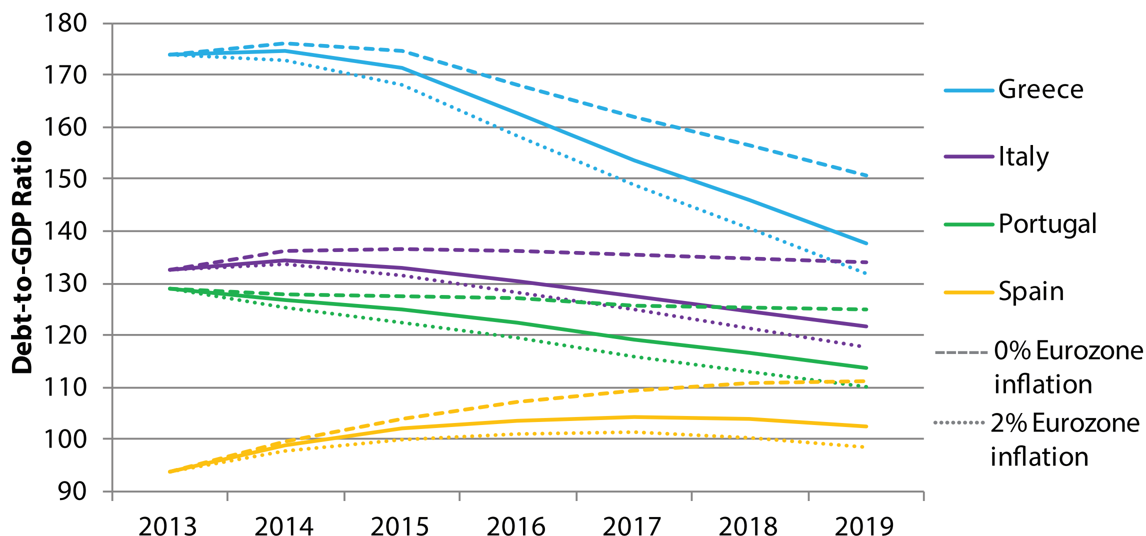
The Governing Council's new policy package, which includes negative deposit rates, the extension of fixed-rate full allotment tender procedures, the introduction of targeted long-term refinancing operations (TLTROs), and a plan to conduct outright purchases of asset-backed securities, is a step in the right direction. Despite the ECB's efforts, low inflation is likely to persist in the eurozone over the medium term. Low inflation is harmful to the economic recovery in the eurozone because it delays much needed intra-eurozone sovereign debt and competitiveness adjustments.

This article analyzes the impact of low inflation on debt dynamics and the adjustment of real unit labour costs (ULC) in the eurozone countries under stress (Greece, Italy, Portugal, and Spain). It concludes with a brief discussion of the role of the ECB and EU and domestic policymakers in addressing low inflation.

Implications of low inflation on debt dynamics

The debt-to-GDP ratio is an important indicator of the sustainability of sovereign debt, and has a paramount role in credit ratings decisions and the pricing of sovereign bonds. Through these channel, the debt ratio affects domestic banks' balance sheets and the credit flow throughout the economy. Debt dynamics are important for the recovery in the eurozone

Figure 1. Debt dynamics in the eurozone countries under stress contingent on different inflation scenarios



Source: Authors' elaboration on IMF (2014).

because of their implications for the financial system and governments' abilities to use expansionary fiscal policy. With all else being equal, a positive rate of inflation decreases the debt-to-GDP ratio by increasing nominal GDP.

The debt-to-GDP ratio in Italy and Greece is currently expected to peak in 2014 at 135 and 175 percent, respectively. It is expected to have peaked in Portugal in 2013 at 129 percent, and peak in Spain in 2017 at 104 percent. The IMF projects that by 2019 the debt ratios in Greece, Italy, Portugal and Spain will fall anywhere from 2 to 37 percent from their peaks (Figure 1, solid lines).

Using the IMF's most recent projections, we estimated the debt trajectories in the eurozone countries under stress contingent on different inflation scenarios. If eurozone inflation were to fall to zero percent and remain at that level over the medium-term, the debt-to-GDP ratios in Italy, Portugal, and Greece would make little progress over the medium term, resting at 134, 125, and 151 percent by 2019 (Figure 1, dashed lines). In Spain, the debt ratio would continue to rise over the medium term reaching 111 percent by 2019.

The higher the level of debt, the more sensitive the ratio is to fluctuations in the inflation rates. In fact, for every one percentage point that inflation falls below the IMF's current projections in a given year, the debt-to-GDP ratio would rise by over one percentage point in Italy, Portugal and Greece. In Spain, it would rise by approximately 0.9 percentage points because of the current lower level of debt. If, however, inflation in the eurozone were to remain stable at the ECB's target of 2 percent over the medium-term, the eurozone countries would shave an average of 4 percent off of their debt-to-GDP ratios by 2019 (Figure 1, dotted lines).

Implications of low inflation for real ULC adjustment

Real ULC is a widely used indicator of relative competitiveness that measures the cost of labour per unit of output. There are two components of ULC: labour productivity and labour compensation. If growth in real labour productivity is higher than growth in real labour compensation then real ULC will fall, increasing domestic firms' labour cost competitiveness; and vice versa.

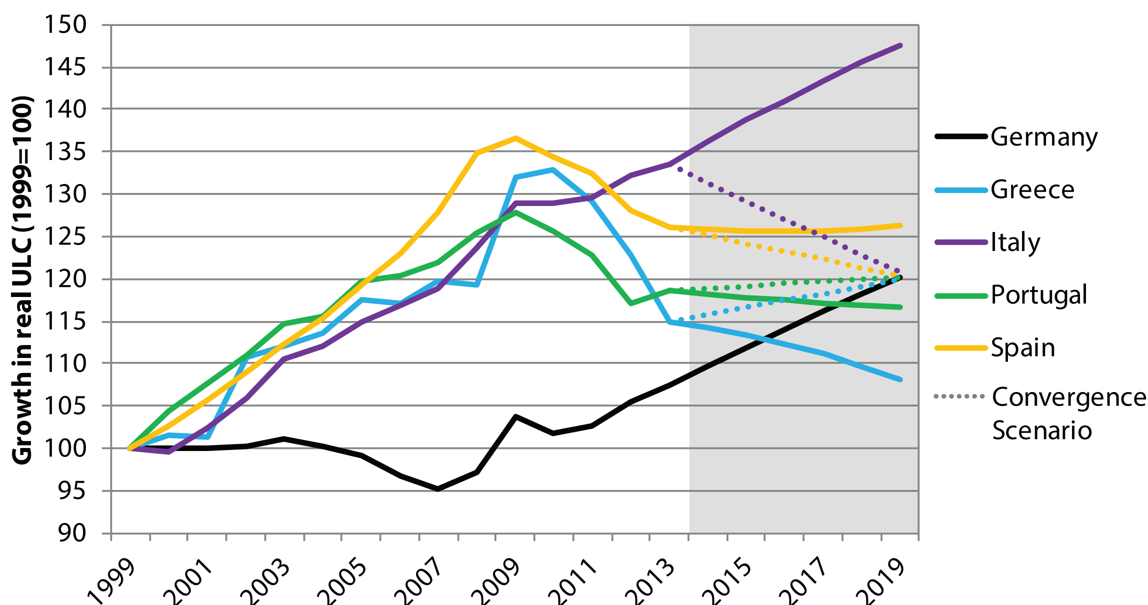
"The additional monetary stimulus introduced by the governing council is a step in the right direction"

We will use this intuition to explain the trends in real ULC growth in the eurozone countries under stress relative to that of Germany and to reveal the adjustments necessary to catch-up to German competitiveness levels over the next five years. This will be followed by a discussion of the implications of low inflation for adjustment.

A large gap between ULC in Germany and the eurozone countries under stress developed from the creation of the euro in 1999 to the start of the Great Recession in 2008 (Figure 2). Throughout the crisis most of these countries have been working towards closing this gap, with the notable exception of Italy. Spain and Portugal have decreased their real ULC throughout the crisis by sustaining higher growth in real labour productivity than in real labour compensation. Greece has also decreased its real ULC; however, it has done so by decreasing real labour compensation while its real labour productivity has been falling.

Germany has accommodated the relative adjustment by maintaining relatively high growth in real labour compensation coupled with low growth in real labour productivity. Italy is a real outlier: its relatively high growth in real labour compensation coupled with near zero growth in real labour productivity has prevented any improvement in its relative competitiveness. These trends explain why Italy's labour cost competitiveness

Figure 2. Real ULC Trend Projections and Convergence Scenario



Source: Authors' elaboration on OECD (2014).

"If the crisis has taught us anything, it is that ... concerns over high rates of inflation have, for most central banks in the major advanced economies, been overshadowed by concerns over persistently low rates of inflation"

has deviated from the other eurozone countries under stress during the crisis.

If current trends in the two components of real ULC continued over the medium term, Greece and Portugal would catch-up to German competitiveness levels by 2018 and 2017, respectively (Figure 2). Spain would maintain relatively flat ULC levels, but would continue to approach German competitiveness because of the dynamics in Germany. At the same time, Italy would continue to diverge from the competitiveness levels of the other eurozone countries under stress while maintaining the gap between Germany.

Given current trends in real labour productivity, we estimated the adjustments in real labour compensation necessary to catch-up to German competitiveness levels by 2019 (Figure 2, dotted lines). Greece, Portugal and Spain would be able to maintain positive growth in real labour compensation over the next five years as long as Germany continues to maintain relatively high growth in real labour compensation. Italy, however, would need to decrease real labour compensation to catch-up with Germany by 2019. Even worse, it would have to decrease nominal labour compensation because the required reduction in real compensation is higher than the projected inflation rate.

Low inflation makes adjustment to real labour compensation more difficult or practically infeasible. Workers may unwittingly accept cuts to real wages as long as their nominal wages continue to rise, or at the very least remain the same. Decreasing nominal wages, however, could create social unrest and potentially prolong the recovery. There may also be legal barriers that restrict the flexibility of labour compensation; particularly in countries with a higher trade union density – the percentage of workers that are union members. Italy, the country that requires the largest adjustment, has a higher trade union density than any other country in our sample at 36 percent. The union densities of Germany, Greece, Portugal and Spain are significantly lower at around 18, 19, 25 and 16 percent, respectively.[3]

Adjusting real ULC is important for the recovery because it facilitates price adjustment and internal rebalancing within the eurozone. Adjusting ULC by cutting compensation, however, may prolong the recovery by increasing unemployment, poverty and inequality. A more satisfactory and effective way to adjust relative competitiveness is to improve productivity by implementing growth-enhancing structural reforms.

The role of the ECB and other policymakers

Mario Draghi, the President of the ECB, has acknowledged the importance of inflation for debt dynamics and competiveness adjustment but indicates that it is not the correct tool for the eurozone because *"monetary policy is geared to the euro area as a whole… there will always be some jurisdictions where inflation falls substantially below the euro area-wide objective, while inflation rates will naturally have to exceed the objective elsewhere."* But no eurozone country currently has a 12 month rate of inflation above or even equal to the ECB's target, while four countries are experiencing deflation.[4] We don't need to inflate away the debt, but sustaining stable inflation around the ECB's target would aid internal adjustments and decrease uncertainty within the eurozone.

If the crisis has taught us anything, it is that Barro's prophecy was correct: concerns over high rates of inflation have, for most central banks in the major advanced economies, been overshadowed by concerns over persistently low rates of inflation. Only recently has the Governing Council's concern over persistently low inflation overshadowed its nightmares about unanchoring medium-term inflation expectations.

Monetary policy is by no means a panacea and cannot solve the underlying structural problems within the eurozone. The additional monetary stimulus introduced by the governing council, however, is a step in the right direction. It will support price stability and facilitate intra-eurozone adjustments while the EU and domestic policy makers continue the ongoing efforts to strengthen the financial sector and implement structural reforms. ■

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3. OECD, "Trade Union Density" OECD.StatExtracts. Most recent reported values for each country are 2011 for Germany, Greece and Italy, and 2010 for Portugal and Spain.
4. April 2014 Harmonised Indices of Consumer Prices (HICP) data retrieved from Eurostat on June 5, 2014.

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The OTC derivatives markets after financial reforms

Cosmina Amariei is an ECMI Research Assistant and Diego Valiante is a Research Fellow and Head of Capital Markets Research at the Centre for European Policy Studies (CEPS)

Over the past five years, over-the-counter (OTC) derivatives markets have received heightened regulatory attention, due to their opaqueness, size and interconnectedness, with a view to improving the robustness, safety and resilience of this market segment. There has been continued progress in the follow-up to the G-20 commitments, with the EU (EMIR, MIFID II, CRD/CRR IV, MAD) and the US (Swap Execution Facility or SEF, Title VII of Dodd-Frank Act, Basel III) leading in the implementation timelines and capturing approximately 80-90% of the overall market.

Based on the data compiled for the yearly ECMI Statistical Package, this commentary provides a snapshot of the current status of the global OTC derivatives markets by: i) identifying general trends over the past decade, ii) looking at the changes in the market structure (instruments and participants), iii) estimating the uncollateralised derivatives exposure and iv) examining the relationship between OTC derivatives and exchange-traded derivatives.

Recent market developments

Trends in OTC (over-the-counter) derivatives markets can be identified by tracking in parallel upward/downward movements in the gross notional value of outstanding contracts and the gross market value. Over the past seven years, however, the notional amount outstanding has been altered by the increasing uptake of central clearing and the growing use of portfolio compression services or other risk-mitigation procedures.

Central clearing increases the reported notional amounts outstanding due to double-counting. When bilateral counterparties, A and B, centrally clear a contract, this is replaced by an equivalent contract between A and a CCP (central counterparty) and another equivalent contract between B and the same CCP. Multilateral netting performed by the CCPs is assumed to be four times more effective than bilateral netting. This, in turn, is expected to reduce the margins to be posted. Compression of both bilateral and cleared trades, on the other hand, reduces the notional outstanding as economically redundant transactions can be 'torn up' and replaced with a smaller set of trades. Despite these distortions on notional values, three main trends (Figure 1) emerged from reaction to market events: 1) the financial crisis or the European sovereign debt crisis (phase 'a' and 'c'), 2) endogenous market structure adjustments (phase 'b' and 'd'), and 3) potential structural effects caused by more exogenous factors (phase 'e').

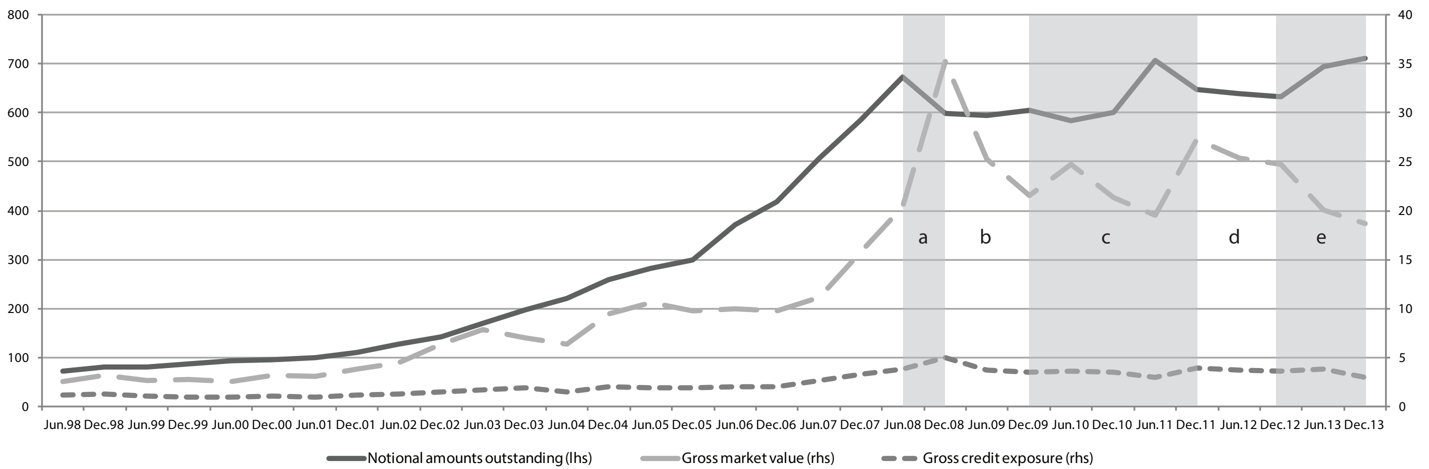
In the last decade, the OTC derivatives market showed an impressive rate of growth, reaching its peak at end-2013 with more than $710 trillion in notional amounts outstanding. Although the OTC derivatives market did not trigger the financial crisis, cases such as the collapse of AIG and Lehman Brothers took centre stage and brought to the fore the systemic importance of derivatives for the overall financial system.[1] From June to December 2008, the notional value of all types of OTC contracts (market activity) went down by 11.06% while the market value soared by 73.46% to $35 trillion. The gross credit exposure hit a record high of $5 trillion, with only limited collateralised exposure.

Uncertainty about counterparty risk increased the fear of another bankruptcy like Lehman Brothers, thereby driving up the risk of systemic losses derived from knock-on effects (also called 'cascade' effects) and a chain of banks bankruptcies. As widespread government intervention alleviated market pressures, by the end of December 2009, market activity recovered modestly by 1%, whereas the gross market value dropped by 43.14%. The latter indicator signalled better underlying market conditions with a decline in market volatility and stabilising interest rate levels and credit spreads.

Although the worst part of the crisis was over, the underlying market stability did not last for long. As the European sovereign debt crisis started in the first half of 2010, market activity continued to rise, surpassing pre-crisis levels in June 2011 ($706 trillion), while the market value of exposures constantly decreased but with more volatility due to uncertainty in the sovereign bond markets in particular. Between June and December 2011, in particular, the markets went through another round of turbulence due to fears of a euro-area break-up. The issuance of new instruments decreased and the market value of exposures sharply sloped upwards, with a remarkable increase of 40% – the highest level recorded since end-2008. This largely happened in the interest rate derivatives segment with volatility returning to the high peaks of October 2008. After December 2011, a massive intervention by the ECB to cool down funding costs for eurozone banks improved market conditions, reflected once again in lower market activity and lower gross market value of exposure (contracting by 10%).

Finally, and most interestingly, from December 2012 to the present, a decoupling of investment trends in derivatives from underlying market conditions can be observed. While the notional amounts outstanding increased steadily, indicating higher market activity – driven perhaps by uncertainty about the future outlook, the gross market value continues to decline,

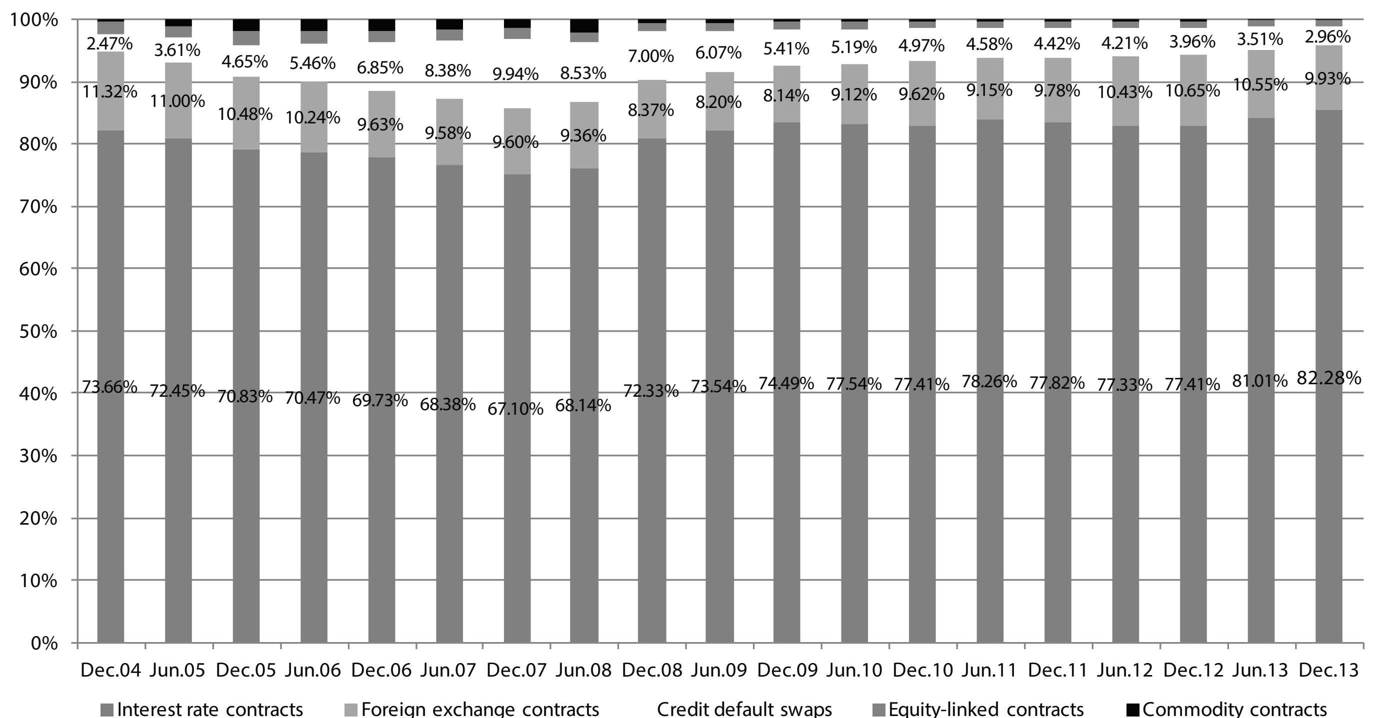
Figure 1. Notional amounts outstanding, gross market value, gross credit exposure of OTC derivatives ($ trillion)*



** The notional amount outstanding represents a market size indicator and is defined as the gross nominal or notional value of all deals concluded and not yet settled on the reporting date. However, this amount is generally not entirely exposed to risk. The amount at risk in derivatives contracts is a function of the price level and/or volatility of the underlying asset/market variable used in the determination of contract payments, the maturity and liquidity of contracts and the creditworthiness of counterparties. In addition, they also depend on whether an exchange of principal actually takes place between counterparties. The gross market value represents the cost of replacing all outstanding contracts at current market prices. Finally, gross credit exposure looks at the gross market values after legally enforceable bilateral netting but before collateral is taken out. These two last measures might be better measures of risk.*

Source: BIS (2014)

Figure 2. Distribution of OTC derivatives by asset class (% of notional amounts outstanding)



Source: BIS (2014)

"Over the past five years, the OTC derivatives market showed an impressive resilience in levels of market activity, which are now above pre-crisis levels in outstanding notional value"

as reflected in improved market conditions. More data on trade counts collected by ISDA[2] confirms a structural upward trend in market activity in the last two years and most recently a drop caused by the increasingly widespread use of compression services.

Evolution of market structure: instruments and participants

The distribution of derivatives transactions amongst the different instruments has remained relatively constant over the past decade (as shown in Figure 2).

Interest rate derivatives (IRD) are the largest segment with an average market share of 73%, followed by the foreign exchange derivatives (FX) category that account for 13%. Credit default swaps (CDS), equity-linked and commodities derivatives represent together approximately 7% of the overall market.

Prior research suggests[3] that the OTC derivatives market is concentrated, with a highly interconnected set of 'core' participants dominating a less interconnected 'periphery' representing the non-financial entities.

Figure 3 confirms that over 85%-90% of notional is being handled by reporting dealers and other financial institutions.

A change within the category of financial institutions, however, can be observed. In the past five years, some dealers exited the derivatives markets or reduced their involvement in OTC derivatives market-making due to a refocusing of their business models, capital shortages or deleveraging, while other financial institutions entered the market for business or risk-management purposes. The latter group includes central counterparties, banks, funds and non-bank financial institutions, which may be considered as financial end users (eg. mutual funds, pension funds, hedge funds, insurance companies and others). In addition, the portion represented by the non-financial entities has slightly declined from the levels prior to the financial crisis. Most notably, at the end of 2013 the non-financial institutions accounted only for 4.12% of the market activity. This may be the result of a reduction in hedging activities due to either sluggish economic activity/uncertain business prospects or anticipated rise in the total cost of OTC derivatives use.[4]

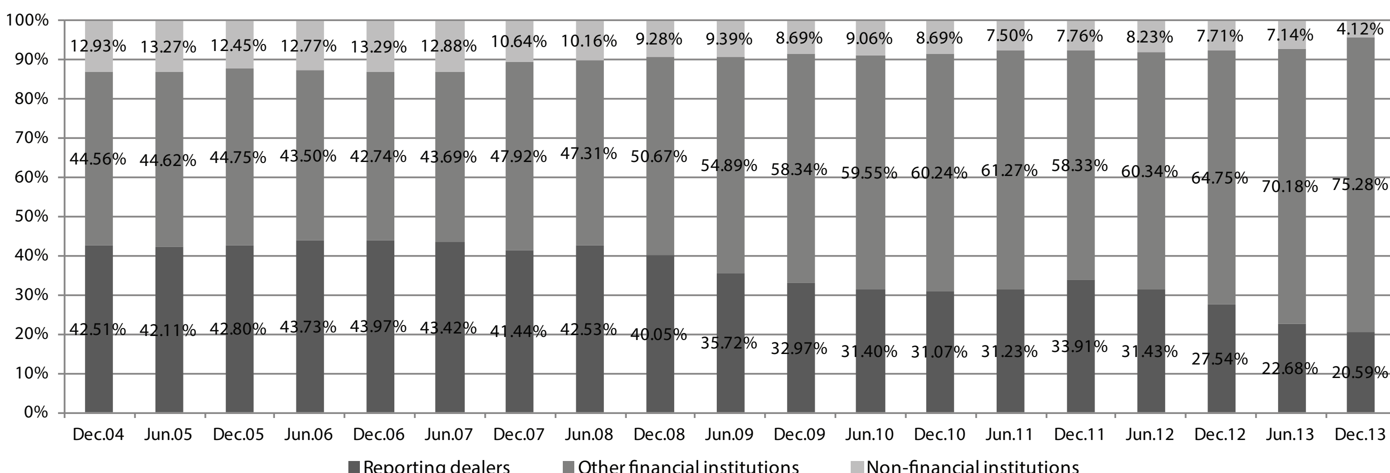
An update on central clearing

According to FSB (April 2014),[5] central clearing of OTC derivatives remains most well established for interest rate and credit derivatives, while limited progress has been made in other asset classes. At the end of February 2014, the cleared segment of IRD measured approximately $191 trillion on a single-count basis. This represented around 59% of the transactions that could be cleared on CCPs' current platforms ($325 trillion, ie. single-currency interest rate swaps, forward rate agreements, basis swaps and overnight indexed swaps) and 46% of G15 dealers' notional amounts outstanding ($413 trillion) reported to the DTCC.[6] Roughly $80 trillion of IRD cannot be cleared by current CCPs platforms (swaptions, cross currency swaps, options, inflation swaps widely used by corporates, pension funds and insurance companies), plus approximately $10 trillion in clearable IRD in non-clearable currencies and $35-55 trillion in IRD with non-financials.

For credit derivatives, the gross notional outstanding amount across all market participants (not just large dealers, and adjusted for multiple-counting) was $18 trillion at end-February 2014. Around $8.2 trillion (47%) of this total amount outstanding could be centrally cleared given, existing credit derivatives clearing offerings of CCPs, while $3.3 trillion (19%) of the total amount outstanding had in fact been centrally cleared.

In line with recent market developments, IMF (2010) analysis suggests that a substantial fraction of the derivatives market will

Figure 3. Distribution of OTC derivatives by counterparty (% of notional amounts outstanding)



Source: BIS (2014)

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remain uncleared.[7] One-quarter of interest rate swaps, one-third of credit default swaps and two-thirds of other OTC derivatives will not be sufficiently standardised, liquid, or complex to be cleared. With regard to compression, market participants have eliminated $239 trillion in notional IRD since 2009, according to the post-trade infrastructure provider TriOptima. The amount compressed includes $185.5 trillion of cleared and $53.9 trillion of non-cleared IRD. According to ISDA (2013), a cumulative amount of $85 trillion of CDS has been compressed since 2007, including $20.3 trillion in the past three years.

Estimating the uncollateralised OTC derivatives exposure

Reducing the counterparty risk is an important part of reforming OTC derivatives markets. This is expected to follow from better collateralisation of OTC derivatives exposures, either through bilateral credit support agreements or central clearing. At the end of 2013, according to ISDA (2014a), over 90% of bilateral OTC transactions were subject to collateral agreements with cash and government securities accounting for roughly 90% of the $3.2 trillion estimated amount of collateral in circulation. The reported collateral received and delivered against $407 trillion in notional amounts outstanding of centrally cleared OTC derivative transactions totalled roughly $295 trillion.[8]

At the end of 2013, the estimated uncollateralised exposure amounted to $1.45 trillion (see Figure 4), representing 47.72% of the gross credit exposure.

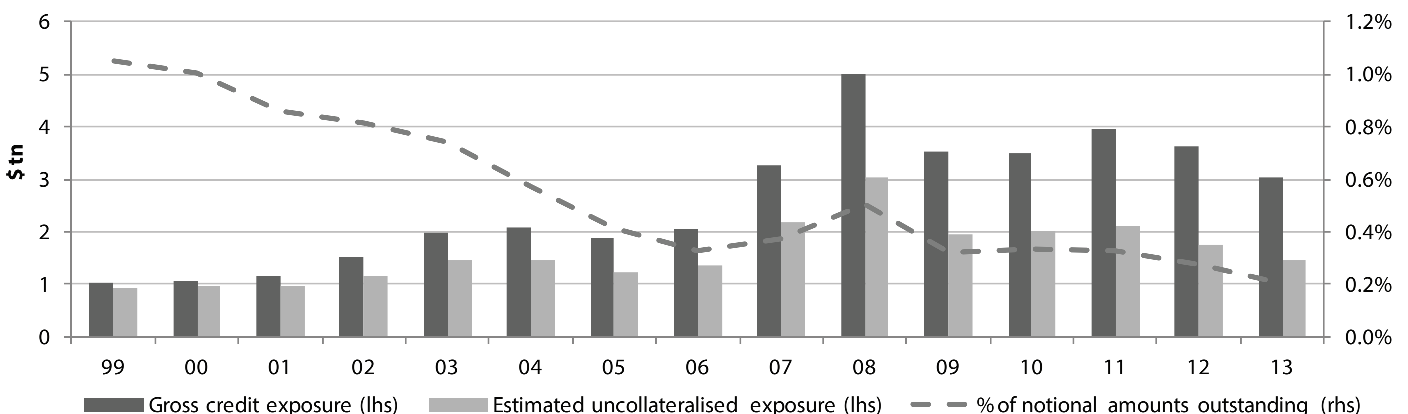
As a result of current reforms and technological developments, the uncollateralised exposure has been constantly going down as the market developed, even before the crisis and despite the growth of volumes in the market. After the initial spike in uncollateralised exposure during the worst moment of the financial crisis, the combination of risk aversion, between end of 2008 and 2009, and market reforms, in the last couple of years, have pushed additional collateralisation into the system. These results are in line with a number of studies that looked at the expected increase in collateralisation as part of the envisaged OTC derivatives markets reforms. According to a report prepared by the Macroeconomic Assessment Group on Derivatives (MAGD, September 2013), these reforms will result in the total amount of collateral used to back trades rising to between €1.1 trillion and €1.8 trillion, with a central estimate of €1.3 trillion.

As a side note, it is essential to optimise the use of collateral and to make collateral pools more fungible by promoting interoperating CCPs (mainly through cross-margining agreements) in order for the benefits promised by central clearing to be effectively delivered. However, while CCPs have a valuable function in reducing counterparty risk compared to the regime of bilateral exposure, they are not a panacea for eliminating it. CCPs face a wide range of risks, such as legal, credit, liquidity, investment and operational risks and may become a new source of systemic risk for financial markets if not properly managed. It is therefore of the utmost importance for CCPs to establish adequate levels of capital, a risk-based effective margining system, a robust default management waterfall structure as well as clear governance and conduct requirements for all members in order to prevent that e global OTC derivatives reforms from simply substituting one group of 'too big to fail' (TBTF) entities for another.[9] At this stage, the issue of setting up viable arrangements for providing central bank liquidity to CCPs as a last line of defence remains very complicated.

In the EU, EMIR provides the regulatory and supervisory framework for CCPs. These are subject to organisational, conduct of business and prudential requirements defined in the ESMA's Regulatory Technical Standards (No. 152/2013 and 153/2013) covering points such as capital requirements, margining, default fund, liquidity risk controls, segregation and portability of positions and collateral, investment policy and stress testing. On 5 October 2012, the Commission launched a consultation on a possible framework for the recovery and resolution of financial institutions other than banks, including CCPs, CSDs, and proposals are expected in Q4 2014.

In the US, the FSOC (Financial Stability Oversight Council) is authorised under Title VIII, section 131, of the Dodd-Frank Act to designate a Financial Market Utility (FMU) as 'systemically important' in cases where a failure or a disruption to the functioning of an FMU could create, or increase, the risk of significant liquidity or credit problems spreading among

Figure 4. Estimation of the uncollateralised exposure *



** Collateralisation further reduces gross credit exposure. In order estimate the level of under-collateralisation, 50% of the collateral in circulation (as estimated in the ISDA Margin Surveys) is subtracted from the gross credit exposure (as reported in the BIS semi-annual surveys).*

Source: Authors' own calculations based on BIS and ISDA data.

financial institutions or markets and thereby threaten the stability of the US financial system. Currently designated FMUs, including five clearing entities supervised by the Board, the CFTC or the SEC, are subject to heightened prudential and supervisory provisions aimed at promoting robust risk management, safety, and soundness.

With regard to international standards and/or guidance for FMIs, including CCPs, the consultation periods for both the CPSS and IOSCO consultation report on recovery of FMIs and the FSB implementation guidance on FMI resolution have now closed, and both final reports are expected to be published in Q3 2014.[10]

Trade execution requirements

It is useful to look at the evolution of the OTC derivatives and ETD notional amounts outstanding and their market shares relative to the overall trading activity to identify if business has shifted from the OTC space to exchange-based trading. There is little evidence (Figure 5) that the market share of the (electronic) trading platforms has gathered steam.

On the contrary, the ratio of exchange-traded derivatives to overall derivatives trading seems to have decreased slightly after 2009, from approximately 11% to 8.85% at the end of 2013, with a corresponding opposite trend in the OTC derivatives market share.

These findings have to be interpreted in the context of mandatory trading obligations not being in force in many jurisdictions. In the US, the requirement to execute certain IRD and CDS on Swap Execution Facilities (SEFs) and Designated Contract markets (DCMs) took effect only on 15 February 2014 for market participants. While an initial regional market fragmentation in the Euro IRS emerged, caused by the obligation to trade with US person on US SEFs (ISDA, 2014b), it is early to make a final assessment on the impact of trading obligations. Effects will become clearer when the EU will complete its piece of financial reforms. In effect, the EU agreed on the MiFID 2 in Q2 2014 and is now working to finalise the technical details of the legislation. This legislation is likely to come into force at the end of 2016 at the earliest, formalising the already voluntary moves that EU participants have made towards a greater use of organised trading platforms (such as MTFs), already used under existing legislation for trading of some derivatives and fixed income.

Conclusions

Over the past five years, the OTC derivatives market showed an impressive resilience in levels of market activity, which are now above pre-crisis levels in outstanding notional value. This confirms its systemic importance. Current volatility of the gross market values and gross credit exposures can be attributed to the uncertain market conditions for the global economy.

Distribution of derivatives instruments has remained relatively constant over the past decade. Central clearing and portfolio compression is developing fast for interest rate and credit derivatives, while progress in other asset classes is fairly slow.

The OTC derivatives market is structured with a highly interconnected system of financial institutions. But composition is changing from a dealer-driven business to a more diversified environment, with other financial institutions (such as CCPs and investment funds) playing a greater role.

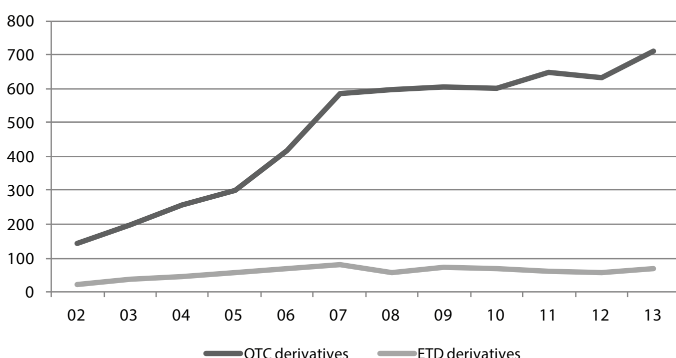
Uncollateralised exposure is estimated in constant decline as a result of better collateralization of OTC derivatives exposures, either through bilateral collateral agreements or the use of CCPs, and improvement of market conditions.

A structural shift of OTC derivatives to organised trading platforms is still not happening. Despite high volumes of on-exchange commodity derivatives and increasing volumes of interest rate derivatives traded on organized platforms, the market for OTC derivatives continues to be bigger than the exchange-traded side of the market, but the situation may rapidly change as the trading obligations gradually enter into force across key jurisdictions.

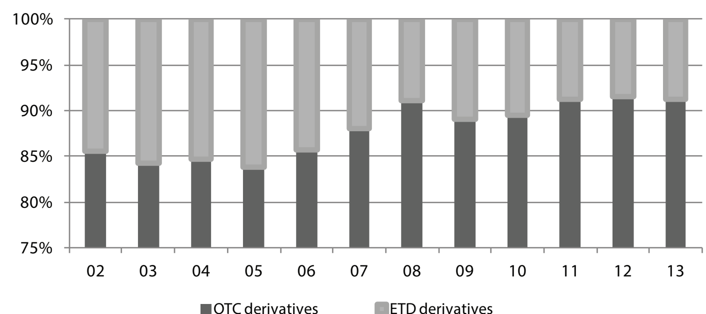
It is too early to conduct a comprehensive assessment of the effectiveness of the regulatory reforms in meeting the G-20's underlying objectives of increasing transparency, mitigating systemic risk and protecting against market abuse in the OTC derivatives market. The benefits and costs of the underway reforms will largely depend on how these will interact with derivatives portfolios and affect the structure of the derivatives

Figure 5. OTC versus ETD activity[11]

a) notional amounts outstanding ($ trillion)



b) market share (%)



Sources: Authors' own calculations from BIS and WFE data.

market more broadly. There are multiple factors that may influence the impact of OTC regulatory reforms, such as the netting efficiency, collateral availability, market liquidity, exposures fragmentation, margining pro-cyclicality and market volatility, safeguards for CCPs, changes in hedging practices and risk-taking behaviour and cross-border regulation. ■

1. In effect, the systemic risk in this market is connected to the volatility in the underlying markets, liquidity and counterparty risk.
2. Data available at www.swapsinfo.org.
3. See Craig and von Peter (2010), Valiante (2010, 2012), Markose (2012), Langfield, Liu and Ota (2013).
4. Both the Dodd-Frank Act and EMIR include clearing exemptions for sovereigns, supranationals and corporates (subject to thresholds in the EU) that use derivatives to hedge commercial risk. A three-year carve-out for European pension funds was also included in EMIR.
5. In the US, mandatory central clearing is in effect for specified classes of interest rate swaps (fixed-to-floating, basis, forward rates, overnight index swaps) and index credit default swaps for major swap participants and so-called active funds; for commodity pools, banks and private funds; and for accounts managed by third-party investment managers, pension plans and other entities. In the EU, the first mandatory clearing obligations are expected in Q4 2014 or early 2015.
6. DTCC data are used. Close to 99% of BIS data on the IRD and CDS notional amounts outstanding had been reported to DTCC GTR. The BIS semi-annual survey has reported amounts outstanding that range from 1% to 3% higher than the DTCC GTR for IRD. The main difference between the two reference sources is that the DTCC GTR is more granular and includes data based on the ISDA product taxonomy.
7. Higher initial and variation margin requirements for non-centrally cleared OTC derivatives to be phased in from December 15th to November 19th.
8. The ISDA Margin Surveys track the gross amount of collateral defined as the sum of all collateral delivered and all collateral received by survey respondents. It does not adjust for double-counting of collateral assets, which takes at least two forms. The first occurs when one survey respondent delivers collateral to or receives collateral from another respondent. The second source of double-counting is collateral re-use, sometimes called re-hypothecation, where collateral is delivered from one party to another and then delivered to a third party, and so on.
9. See Lannoo (2014).
10. See CPSS-IOSCO (2013, 2012), FSB (2013).
11. BIS data have been supplemented by World Federation of Exchanges (WFE) data on exchange-traded commodities derivatives. The amounts outstanding of commodities derivatives were estimated by discounting the total end-year notional turnover value of commodities options and futures by a 'decompressing factor' equal to 0.0338977. This methodology was used in D Valiante (2013), Commodities Price Formation: Financialisation and Beyond, CEPS-ECMI Task Force Report, pp. 32-33, Centre for European Policy Studies, Brussels.

Islamic finance in Europe: unfulfilled potential

Sohail Jaffer is Deputy CEO at FWU Global Takaful Solutions

In 2013, KPMG polled 800 Muslims living in Sweden about their attitudes towards Islamic banking[1]. The income of the survey's respondents was roughly in line with the average national monthly level of SEK23,000.

The results of the survey were telling. It found that there was a *"clear demand from private customers for shariah-compliant mortgage loans, other types of loans and services."* Specifically, KPMG found that 95% of Muslims would switch to an Islamic bank if the option existed. Perhaps even more striking, in light of the economic downturn across Europe, was that 83% of respondents indicated that they would be prepared to pay more for shariah-compliant products and services than for conventional banking.

Given that the Muslim community in Sweden is projected to reach about 1 million, or just under 10% of the population, by 2030, this suggests that there is plenty of potential for a vibrant and profitable Islamic banking industry in Sweden. According to KPMG's calculations, the total market for shariah-compliant financial services could be worth as much as SEK52 billion, with the mortgage market alone potentially valued at SEK26 billion.

In spite of this demonstrable potential, no local bank in Sweden yet offers products and services in accordance with Islamic principles, according to KPMG, which reports that banks have responded in a *"fragmented way to the Muslim community requests for shariah-compliant banking services."*

The main reasons explaining why banks appear to be hesitant to offer shariah-compliant financial services in Sweden is *"lack of clear international regulatory standards and exposure to reputational risk."* The KPMG analysis also found that the current tax regime is *"disadvantageous"* for Islamic banking.

The unfulfilled potential of Islamic banking in Sweden based on simple demographic extrapolations is mirrored throughout Europe. According to a study published in 2011 by the Pew Research Centre on Religion and Public Lifeii[2], the global Muslim population will increase by about 35% over the next two decades, rising from 1.6 million in 2010 to 2.2 billion in 2030. Over the same period, Europe's Muslim population is forecast to expand from 44.1 million to 58.2 million, an increase of 32%. More specifically, by 2030 Muslims are expected to account for 10.3% of the French population, for 10.2% of Belgium's and

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9.3% of Austria's.

It does not, of course, follow that all Muslims will demand or even be aware of shariah-compliant financial services, let alone be prepared to pay a premium for them. Aside from KPMG's Swedish analysis, research on this subject is dated, sketchy and inconclusive. A 2005 survey by Rabobank, for example, found that only 200,000 of the 1.2 million-strong Muslim population in the Netherlands expressed an interest in shariah-compliant mortgages[3]. A more recent, and altogether more positive survey, undertaken in the UK in February 2014, found that 81% of Muslims living in Britain either currently use or would consider using Islamic financial services[4].

More broadly, however, it is frequently argued that one of the reasons why retail banks in Europe have maintained a lukewarm attitude towards Islamic finance is because the demographics of local Muslim populations make the economics of shariah-compliant banking questionable. A recent presentation on the potential of Islamic finance in Belgium[5], for example, which has an estimated Muslim population of 900,000, remarked on the *"limited success of [shariah-compliant] investment products"* arising from the *"socio-economic status of the target group."*

Questionable viability for providers may explain why, even where the potential of Islamic finance has been recognised, and initiatives introduced to encourage its growth, it is notable that the emphasis has generally been on the development of opportunities in Islamic investment management and capital markets. Equally notable is that the development of these areas is aimed predominantly at building and diversifying financial centres in order to service the international market, rather than at satisfying the needs of local Muslim depositors, borrowers or entrepreneurs.

For a financial centre like Luxembourg, with its tiny domestic population, this is a wholly reasonable approach. As early as 1978, the Grand Duchy became the first country in Europe to host an Islamic financial institution. Since then, it has chalked up a series of other notable firsts for the Islamic financial services industry in Europe, with the Continent's first shariah-compliant life insurance company opening in Luxembourg in 1982. Another landmark was passed in 2002, when the Luxembourg Stock Exchange became the first bourse in Europe to list a sukuk.

Luxembourg's success in building its credentials as a hub for Islamic funds is immediately evident from the fact that the Grand Duchy is now the third largest domicile for shariah-compliant funds in the world, with 111 funds. Only Malaysia (263) and Saudi Arabia (163) have more[6]. In the sukuk market, meanwhile, there are now 16 instruments listed on the Luxembourg Stock Exchange with a combined value of $7.3 billion.

Europe's other leading centre for investment funds, Ireland, has also enjoyed considerable success in building its capacity as a centre for Islamic funds. Ireland has made no secret about its ambitions in the shariah-compliant market. In a speech in 2012, Deputy Prime Minister Eamon Gilmore explained that *"developing Ireland's involvement in Islamic finance has been identified as a priority government"*. He added that *"we have recognised the importance of the Islamic finance in the global financial system through adopting our tax system and financial regulatory system to ensure a level playing field between Islamic finance and conventional measures[7]."*

The result of Ireland's focus on the opportunities in Islamic finance was that by 2012 it was estimated that the country was already a location for 20% of Islamic funds domiciled outside the Middle East[8]. Ireland's success as a hub for Islamic investment funds, however, is in vivid contrast to what has been done to make basic shariah-compliant banking services accessible the country's 55,000 Muslims. The failure of the domestic banking sector to explore the potential of retail Islamic banking has

prompted the local Muslim community to *"appeal to the Irish banks to contact any of the banks worldwide providing shariah-compliant products and learn from their experience[9]."*

France is another striking example of a European economy that has focused more on building up the infrastructure for wholesale Islamic financial services than on extending shariah-compliant alternatives to Muslim savers and depositors. Paris Europlace set up its Islamic Financial Committee in 2008, and later the same year, France's Finance Minister at the time, Christine Lagarde, put her weight behind the promotion of France as a centre for shariah-compliant banking. In July 2008 she pledged that *"we will adapt our legal environment so that the innovation and stability of our financial sector can benefit...Islamic finance and make its activities as welcome in Paris as they are in London and other places[10]."* France has been true to its word, amending its tax regime to encourage the listing and trading of sukuk on Euronext in Paris and introducing a shariah-friendly legal and tax environment allowing for the efficient structuring of a range of funding instruments compliant with Islamic principles.

While retail banking services have been slow to take root in Continental Europe, an important landmark is due to be passed later this year with the establishment of the first fully-fledged Islamic bank headquartered in the eurozone. Backed by a consortium of private investors from the Gulf, the Luxembourg-based Eurisbank will have an initial capital of €60m and plans to offer a range of shariah-compliant retail, corporate and private banking services through a network of branches in key European centres such as Paris, Brussels and Frankfurt. A Deloitte feasibility survey has already indicated that Eurisbank, which is planning to begin operations in the last quarter of this year, will earn a high return on its investment[11].

While the Eurisbank initiative is an important step forward for Islamic banking in Europe, it is the UK, however, that has made the greatest strides in improving access to shariah-compliant alternatives for individual depositors and borrowers, corporates and investors alike. In 1982, Albaraka International Bank began offering Islamic mortgages in the UK, with the United Bank of Kuwait (UBK) following suit in 1996. It was not until the early 2000s, however, that shariah-compliant retail banking services were made more broadly available to the UK's fast-growing Muslim population. In 2003, HSBC became the first high street bank to offer Islamic mortgages and other shariah-compliant products through its Amanah subsidiary.

The following year saw the opening of the Islamic Bank of Britain (IBB), the first retail bank targeted exclusively at Muslims in the UK. By late 2013, IBB was offering a comprehensive range of shariah-compliant financial services to more than 50,000 personal, business and premier customers throughout the UK.

"While retail banking services have been slow to take root in Continental Europe, an important landmark is due to be passed later this year with the establishment of the first fully-fledged Islamic bank headquartered in the eurozone"

This growth dovetailed with a range of government initiatives, which began in 2001 when the Bank of England established the Islamic Finance Working Group. Chaired by the then BoE Governor, Eddie George, this was aimed at investigating obstacles facing the industry and paving the way for the development of a flourishing Islamic banking industry in the UK. One of the most notable of these obstacles was dismantled two years later with the passage of revisions to the Stamp Duty Land Tax (SDLT). This exempted individuals using alternative financing arrangements (including Islamic mortgages) from double charging on SDLT that might otherwise have applied when a financial institution buys a property for re-sale to an individual – which is one of the foundations upon which shariah-compliant home lending has developed. In 2005, the SDLT provisions were extended to equity-sharing arrangements, and a year later, companies were also made eligible for relief on the tax.

In February 2014, the government broadened the scope of Islamic mortgages when it announced that its Help to Buy scheme, designed to give prospective homebuyers access to taxpayer-backed funding, would be extended to HPPs.

The UK has also adopted a leadership position in supporting the development of the Islamic capital market. The UK Government announced in January 2014 that it had appointed HSBC and law firm Linklaters to advise on its planned debut issue of sukuk[12], which may be the first shariah-compliant bond issue from a non-Muslim sovereign borrower, although it faces competition from Luxembourg and Hong Kong, both of which are readying debut sukuk transactions.

The experience of the UK, twinned with the confidence of the Eurisbank investors and the findings of the KPMG Swedish survey all suggest that there is still plenty of under-explored potential for the expansion of Islamic retail banking across much of Europe. This also applies to Turkey, where Islamic or so-called 'participation' banking still accounted for only just over 6% of lending in 2013, even though about 99% of the population is officially Muslim. ■

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The benefits of a good international collections agency

Raymond van der Loos is a Director, Atradius Collections NV

In many businesses the sale is celebrated when the customer agrees to the terms and signs the contract. But if you think about, has the sale actually been completed? Sure you have the agreement of the buyer that they will accept your products or services, and that the amount that you should receive for them is acceptable to them. But they haven't paid you yet so the sale is not complete. Too often the excitement of the sale is crushed when the customer is late in paying or refuses to pay altogether.

When this occurs in your home market often you believe you can do something about it yourself or you can easily hire a local collections agency to pursue the debt on your behalf. But what if the customer is not local? What if the customer is located in a different part of the country or in another country altogether? Collecting the debt all of a sudden becomes a real challenge.

This doesn't have to be the case. A good international collections agency can turn a difficult situation with little chance of recovery into a seamless process with a much better potential outcome. In addition, many of the principles that apply to foreign debt collection also apply to domestic collections.

First of all, why engage a collections agency? For one thing, some buyers simply wait until they get contacted by a collections agency before they pay. It's almost as if they think the seller is not interested in getting paid unless they bring a collections company into the picture. As many businesses know, just because they are not good at paying on time does not mean they can't be a good long term customer. You may want to remain on good terms with the buyer to do future business with them. In these situations you want your collector to use a bit of tact in pursuing the debt. Atradius Collections, for instance, is adept at applying the right amount of pressure on the buyer to help you preserve your business relationship if that is what you desire.

An international agency may not be needed for local debts, but their reputation and resources can add an extra level of encouragement for a debtor to pay and if the debt is domestic

but not local they can relieve you of the burden of finding a local agency that you are confident with in the city of the debtor. Whether the debt is domestic or foreign, the international debt collection agency will typically have an extensive network of collectors with knowledge of the collections norms and requirements - most notably legal requirements - that can increase your chances of success.

In cases where there is a language barrier, the international collections agency generally will be able to communicate in the language of the debtor, both actually and figuratively. The collector's knowledge of the common payment and collection practices, laws, cultural values, his or her ability to speak the same language and having a similar background will likely increase understanding and the probability of collection success.

Partial or gradual payment is better than no payment at all. A good international collections agency will know the signs that the buyer wants to pay but is just not able to under the existing payment terms. They will be able to take these cues and negotiate a payment plan at the local level that the buyer is comfortable with and that results in a smaller loss or no loss at all.

In collecting overdue debts, time really is money. The longer you wait to pursue the debt, the lower your chances of recovery. Atradius conducts annual surveys of the payment practices and based on the 2013 feedback the chances of an overdue invoice being uncollectable climbs from about 5% in the first 15 days to more than 50% if still uncollected after 90 days. With improvements in global economies in 2013 and 2014, we anticipate these numbers will fall to about 4% and 35% respectively in the 2014 survey, but the exponential increase in the risk of a loss over time is consistent. About 1/3 of the value of invoices uncollected after 90 days past due are never paid. An international debt collection agency can help you mobilise faster, increasing your chance of recovery. Don't worry about losing track of the status of your collection cases. Larger international collections agencies have secure, integrated international IT platforms that enable you to submit, track and ask questions about your collections cases online, anytime.

"Bottom line, while one off payment defaults in your local market may be manageable with a local collections company or even kept in house, larger international agencies can save you time, money and increase success rates while at the same time keeping you informed about collection case progress every step of the way"

Bottom line, while one off payment defaults in your local market may be manageable with a local collections company or even kept in house, larger international agencies can save you time, money and increase success rates while at the same time keeping you informed about collection case progress every step of the way. ■

Rewriting of AMBA's constitution – supporting the global MBA strategy

The Association of MBAs (AMBA), the only MBA-specific accreditation organisation in the world, has recently rewritten its constitution in order to support the organisation's strong global expansion. The Chairman of AMBA's International Management Board, Chris Russell Balkwill, has been leading the change.

The Association of MBAs (AMBA) is best known internationally for its MBA programme accreditation service for global business schools. But we have our origins as a membership organisation for MBA graduates – in fact we are still the only global organisation to provide services especially for MBA graduates. AMBA was established in 1967 by a small group of business graduates who had just been subjected to the academic and personal rigours associated with completing a new-fangled course called the MBA. The fledgling organisation had the aim of raising the profile of business education and the MBA qualification. Now with graduate and business school members in 81 countries around the world, that is still our purpose.

Some 5,000 graduate members belong to AMBA – directly, or indirectly through group membership schemes administered by accredited Business Schools. For these members, AMBA is designed to serve as something of an exclusive club, offering a number of services including CPD activities, webinars, MBA refresher events and networking events, often in partnership with local business schools. There are also a number of other popular services, notably a Career Development Centre, offering MBA jobs and networking opportunities, intended to help MBA graduates exploit the competitive advantage which an MBA from an accredited school brings.

Chris Russell Balkwill with Andrew Main Wilson, AMBA's Chief Executive, at the AMBA International Conference for Deans and Directors in Paris, April 2014

In August 2013, AMBA appointed a new Chief Executive, Andrew Main Wilson, who had come from the London-based Institute of Directors. Whilst he is developing and expanding the Association's services for business schools and graduates, so too AMBA's board structure has been evolving, culminating in a special resolution earlier this year, when the membership of the organisation agreed some important changes to support the governance of the new organisation.

New Articles of Association

AMBA is registered in the UK as a not for profit charitable organisation. Its charitable objective is now described as 'for the public benefit, to advance business education throughout the world.' Our renewed global perspective, reflected through the addition of these words, was just one of a number of changes to the organisation's constitution – its Articles of Association – which the AMBA membership approved overwhelmingly at a General Meeting in February 2014.

Reading our old Articles document dating back to 1967 seemed sometimes a bit like a journey into a gentler world when communications were still made by letter and quill pen. We found that day-to-day as well as longer-term governance considerations were hampered by Articles which were no longer fit for purpose. It was clear that the organisation's governance needed to be thoroughly reviewed, because the organisation's Articles were no longer appropriate to the requirements of the online age.

There were some provisions that needed updating as a result of changes to the law, but more important was the issue of correct representation on the Board of AMBA's different stakeholder groups, and a more appropriate structure to support timely de-

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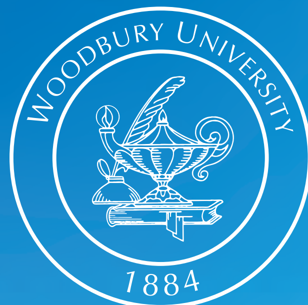

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"Reorganising the two principal governance boards at AMBA will... ensure AMBA's continued relevance and healthy development well into its second half-century"

cision-making in the organisation. In other words, it was a question of ensuring that AMBA's constitution properly reflected where the organisation's ambitions now lie, and the importance to the organisation of its relationship with the business schools themselves.

International Management Board (IMB)

As a result of the changes agreed in the spring of 2014, a total of 14 Trustee Directors can now serve on the IMB board, of whom six are elected by the graduate membership of the Association. Business schools are represented through the Chair of the IAAB and by four international business school deans who are co-opted onto the Board as Trustee Directors. Two deans are already serving on the IMB and two more are in the process of being recruited now and will reflect the global reach of the organisation. Professors Rob Dixon, Dean of Durham Business School (UK), Nick Binedell, Dean of Gordon Institute of Business Science (South Africa), and Andrew Lock, Dean Emeritus of Leeds Business School (UK) and Chair of the IAAB, together with Tim Instone, Trustee Director at AMBA, will be leading the search on behalf of the IMB.

Up to three other co-opted places are used to represent the MBA employer perspective. AMBA has recently recruited Sarah Laessig, formerly of Citigroup, and over the next few months, recruitment will take place to strengthen this all-important constituency.

Of course, all board members are required under company and charity law to act in the best interests of the Association. They may be drawn from a particular stakeholder group, but once appointed as Trustee Directors, they are obliged by law to abide by the joint decisions of the board. Keeping these perspectives aligned and productive is important, but in the end our board members understand that they work to promote a higher ideal, namely management education and the benefits, personal and organisational, that flow from the endeavours that individuals make to improve themselves.

International Accreditation Advisory Board (IAAB)

An important aspect of the new governance structure at AMBA is the representation of the International Accreditation Advisory Board at IMB level. The purpose of the IAAB is to set accreditation standards, approve the documentation of accreditation criteria, make decisions on the award and/or removal of accreditation, and to provide advice to the IMB on accreditation strategies, policies and processes.

AMBA's Board and senior management team discussing the organisation's global strategy

The new chair of International Accreditation Advisory Board (IAAB), Professor Andrew Lock

IAAB membership is global. The new Chair is Professor Andrew Lock who has been a member of IAAB for many years. Professor Lock was Dean of the Business School at the University of Leeds until 2008. He has now retired from the university and is engaged in a range of projects in the UK and overseas. He holds a Masters and PhD from London Business School. He graduated from Leeds in French, returning in 2000 (after 30 years) as Dean of the Business School, having previously been Pro-Vice-Chancellor and Dean of Faculty at Manchester Metropolitan University.

Moving to a multi-polar world

Reorganising the two principal governance boards at AMBA will allow it to respond to an important trend in business schools' external environment – the move away from a purely western-style model, reflecting the origins of Business School curricula – to one where the requirements and diversity of other business school regions can be properly heard and addressed. This will ensure AMBA's continued relevance and healthy development well into its second half-century. ■

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AACSB Accreditation

Where quality, not size, matters

With fewer than 500 undergraduate and graduate students, it has traditionally been a challenge for Woodbury University's School of Business to compete with business schools with prestigious brand names, far larger student bodies and endowments many multiples that of the entire university. Yet by focusing on its strengths – small class sizes, diverse faculty and a highly personal mentorship program among them – and pursuing AACSB accreditation, Woodbury (www.woodbury.edu) has moved to the head of the class for business students seeking an alternative to the more bureaucratic, impersonal programs offered on sprawling campuses across the country. With AACSB accreditation conferred on fewer than 5 percent of business schools worldwide, Woodbury's School of Business has joined an elite group indeed.

Like the train in the popular children's story *The Little Engine That Could*, Los Angeles-based Woodbury University's School of Business for decades faced an uphill climb when it came to competing with so-called 'prestige' schools – despite its status as one of the oldest institutions of higher education in Southern California.

As the premier accreditation body for institutions offering undergraduate, master's and doctorate degrees in business and accounting, AACSB International (Association to Advance Collegiate Schools of Business) offered Woodbury the opportunity to level the playing field by establishing that it's School of Business meets the same high standards as the leading lights among global business schools.

What the School of Business – and, indeed, the university itself – learned during the seven-year accreditation process has both altered and affirmed its vision, mission and core values, raised the value of its business degrees and prepared it to compete with far larger institutions around the world, according to André van Niekerk, dean of the School of Business, who directed the accreditation effort.

"AACSB accreditation is the hallmark of excellence in business education – the equivalent of 'Intel Inside,' or the 'Good Housekeeping Seal,'" said van Niekerk. *"It affirms that our School of Business, its faculty and programs meet a specific set of standards of excellence and certifies that our business students have access to a business education program that is among the best anywhere."*

"At Woodbury, our mission is to cultivate the distinctive talents of each student to prepare future leaders of business who communicate effectively, act ethically and think globally," said Woodbury University President Luis Ma. R. Calingo, Ph.D. *"The Woodbury model of values-based and ethically driven business education is based on building lifelong relationships and networks which will aid our students' future success and provide the tools to be an effective and valued member of society. The accreditation process played a significant role in helping us understand how to apply our mission to today's global business environment."*

Specifically, the accreditation process:

> Allowed for greater collaboration among the board of trustees, the administration and the dean of the business school around a common goal of quality and continuous improvement. *"The accreditation process created a ripple effect across the institution,"* said Calingo, who serves as a member of the Board of Examiners of the Malcolm Baldrige National Quality Award, the country's highest award for quality and performance excellence. *"By working through the process, quality and high standards have become an integral part of Woodbury's DNA."*
>
> Was responsive to the needs of the customer – that is, the student. The student experience - small class sizes,

one-on-one mentoring, opportunities for coursework in a variety of disciplines – is what sets the School of Business apart. Woodbury is strategically located near the heart of the entertainment industry and is proximate to a number of major employers. For students (graduate and undergraduate alike) the fact of accreditation will immediately find its way on to resumes and CVs, increasing both the value of the Woodbury business degree and the School's appeal to companies near and far. And AACSB accreditation will enable many more international students to list Woodbury's School of Business as an approved option with the accompanied financial support from their home country.

Encouraged the School of Business to rethink and refine its curriculum. *"The accreditation process forced us to be more customer-focused in terms of what we offer, in both content and delivery,"* said van Niekerk. *"It meant upping the ante on curriculum by introducing new courses and refining and refocusing our offerings, which extends to requiring the GMAT and GRE. This process of improvement will be continuous, since we will go through accreditation reviews every five years. We're now operating at a whole new level."*

Enabled the faculty to redefine the focus of their own professional endeavours. *"Before AACSB, Woodbury was purely a teaching institution,"* said Assistant Dean of the School of Business Joan Marques, Ph.D. *"AACSB helped us to strike that very important balance between excellence in teaching and meaningful intellectual contributions. Woodbury had to transition from a teaching-focused institution to a teaching and research-oriented institution. That meant we had to re-educate our faculty and adopt a new culture."*

Caused the School of Business to assess the effectiveness of its curriculum. *"Assessment of learning is very, very important. How do you prove that the students are learning?"* asks Associate Dean Satinder Dhiman, Ph.D. *"When you put all the syllabi from all the faculty together to create a program, how do you assess that you are really effective? That is the key to any institution's success. Through three cycles, our faculty members developed rubrics for each of their courses and then measured the students' learning against those rubrics, and each time we took what we had learned and made changes to our teaching, to our curriculum and to our program."*

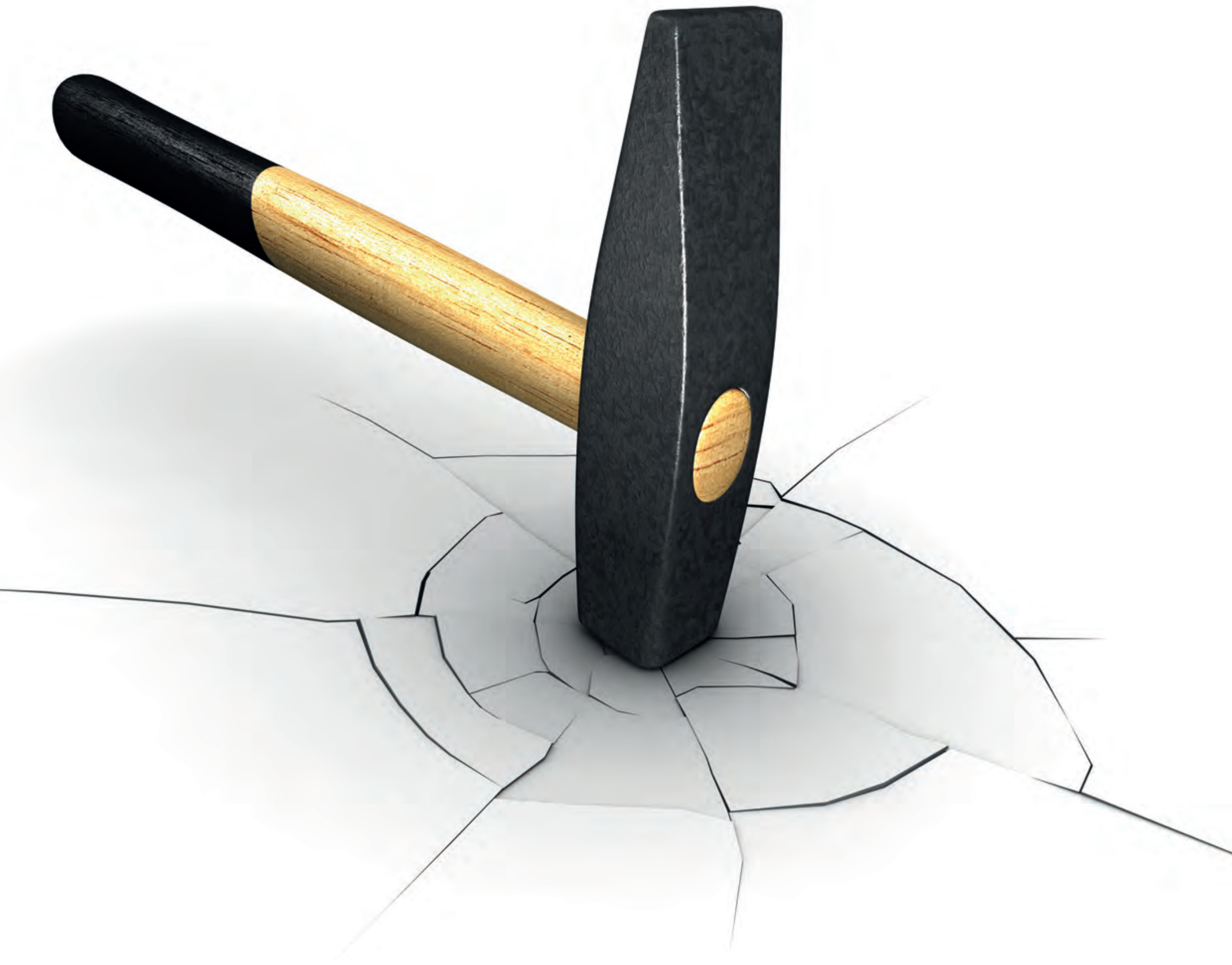
"As business education goes global, one key differentiator will be small programs that have the highest level of quality but deliver a unique level of mentorship and guidance"

Encouraged the School of Business to build stronger connections with the community. *"AACSB wants to see how you are connected to the community,"* van Niekerk said. *"Six years ago, I started a board of advisers for the School of Business. We now have 26 active members, all of them business leaders in our community. We can take ideas, test them with these community leaders and have them provide input. They help us refine our thinking. We can share success stories and develop spokespeople for our school out in the community. Because of AACSB, we may be able to enlarge our network and increase financial support of both the School and the university."*

As business education goes global, one key differentiator will be small programs that have the highest level of quality but deliver a unique level of mentorship and guidance, according to van Niekerk. *"Quality trumps everything, so long as it is founded on a clear vision with ethical leadership and decision-making. That's a powerful formula – one we are striving to achieve every day."* ■

Executive development

A CRY FOR IMMEDIATE BENEFIT



Jørgen Thorsell and Justin Bridge explore new perspectives on achieving immediate impact from executive development

Executive development is no longer simply about offering learning that leads to new insights and changed behaviour. Today it is about creating immediate impact in support of change. The challenge is how executive development can keep up with the demands for successful leadership in times of rapid change

Executive development has come a long way over the past few decades. The toolbox has grown to include a rich assortment of different approaches. But how effective are those tools when it comes to preparing executives to meet the demands for radical changes? Are these tools right for what we need today? And how well are they meeting the needs for achieving immediate impact on job performance?

This article argues that tools are a hierarchy of effectiveness in terms of their potential for delivering immediate impact. This hierarchy is determined by how effective a tool or method is in offering learning that is truly relevant to the actual challenges an executive is facing at that moment. The higher the relevance, the more likely the method is to deliver immediate and sustained impact on job performance.

Figure 1 shows such a hierarchy, which is discussed in detail in the rest of the article.

The challenges of teaching business theory

Well-documented theory should be the basis of effective executive learning whatever the choice of method. When best practices are studied carefully and academically 'processed', theory is what all business development should be solidly grounded in.

The challenge is how to make theory useful precisely when it is needed in real life. Business schools have long taught theory in MBA classrooms and, generally speaking, 'teaching theory' has been the preferred methodology for preparing students for a successful executive career. Even so, following graduation most students have felt a big gap between theoretical knowledge and becoming a successful executive.

Simply teaching theory as a one-way approach has been viewed by learning and development practitioners as the least effective way of preparing executives for success. That way of learning has consistently been rated lowest in attractiveness when we have studied successful executive development in recent years (Mannaz: Innovation in leadership development 2007, Mannaz: Global leadership development 2011, Mannaz: Preparing Chinese leaders for the global business world 2013).

Of all face-to-face learning methods, teaching theory has the lowest relevance to the reality of an executive's life and thus the lowest impact on job performance. Today there are learning methods that are much more effective at securing the transfer of theory into new effective practice than raw lecturing.

The case method

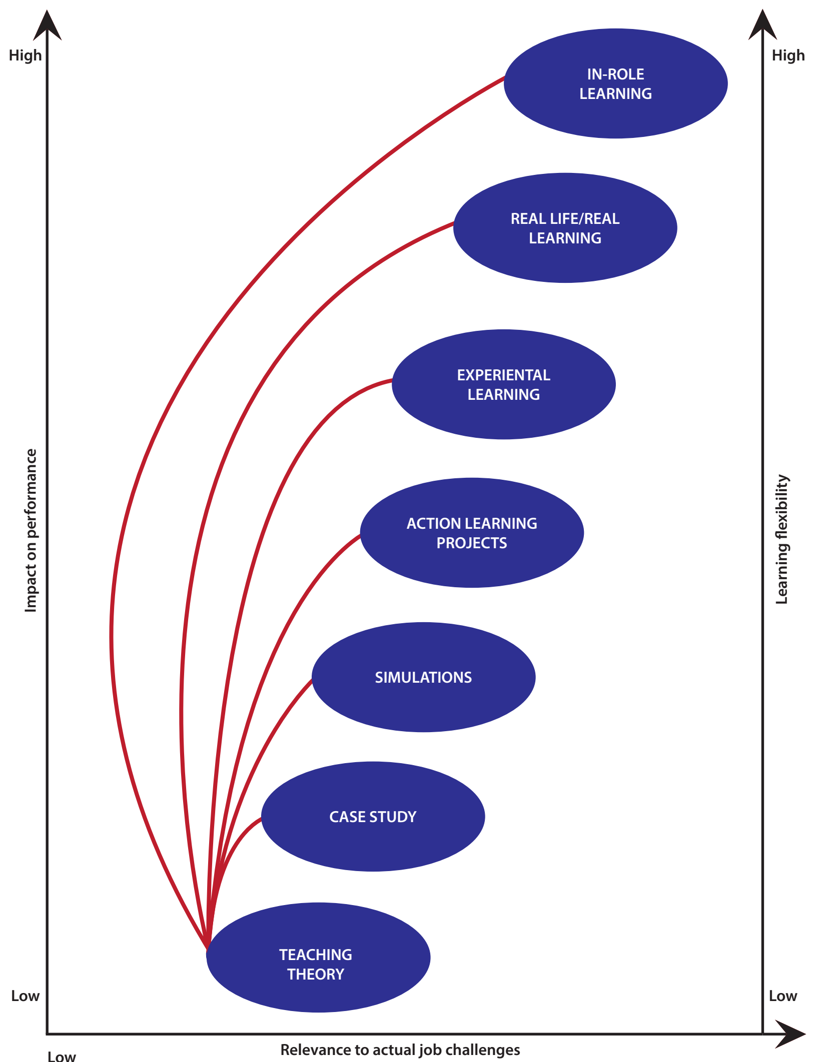
Harvard Business School pioneered the case method in the 1920s to address the deficits of theory-centred teaching. The case method involves debating interesting successful, or even less successful, business cases to extract learning in a challenging dialogue between the professor and the student.

The method was well received due to its much higher appeal than one-way lecturing and its emphasis on diagnosing for decision making. Thanks to the higher degree of relevance to the real business world and its engaging interactivity the case method has enjoyed long-lived success.

Although the case method was and still is more appealing to students than raw 'teaching of theory', it is challenged by the fact that in real life no single case will repeat itself. It hones analytical skills and may well influence shifts in executives' business mindsets but it lacks immediate applicability.

Advanced corporate universities have made up for that deficit by using tailored cases that address relevant real-life business situations in order to achieve a higher level of relevance and applicability.

Figure 1: The Impact Matrix



"Simply teaching theory as a one-way approach has been viewed by learning and development practitioners as the least effective way of preparing executives for success"

In other words, in most instances the relevance of case studies is still too distant from students' own situations and thus does not really cater for most of the real-life situations executives will be experiencing in their own jobs. Thus the case method has relatively low immediate impact on everyday executive performance.

Business simulations

'Learning by doing' is the foundation of business simulations, which became popular quite early in executive learning. Now computer-based simulations in particular offer a dynamic and intense learning experience. Simulations tend to excel in areas where facts and numbers play a significant role such as manufacturing and finance. Many students have learned much from the competitive landscape of simulations ranging from the basics of accounting to the more complex worlds of business development and change.

Simulations tend to favour 'doers' in a competitive environment. They typically offer less space for reflection and theory sharing. As such, simulations are ideal for acquiring skills rather than being truly effective at creating learning that is relevant to an individual executive's actual challenges.

As a simulation usually has little relevance to executives' on-the-job challenges, the likelihood of immediate application and thus immediate impact is small.

Action learning

The Chinese philosopher Confucius says: *"I hear and I forget. I see and I remember. I do and I understand"*.

In corporate life the inefficiency of 'teaching theory' left room for new and more 'doing' – orientated learning methods. Action learning is a significant example. Actual corporate projects are most often used for action learning and thus create a high degree of meaning for those involved.

However, action learning is often difficult to separate from everyday business projects. Thus, the 'learning' in action learning frequently does not receive proper attention and the method becomes quite inefficient from a learning perspective despite all the 'action'.

Lack of room for reflections and theory is still the Achilles heel of this approach to executive learning. In addition, chosen projects tend not to be of real relevance to the learner and lack true wholehearted sponsorship. That has fostered frustrations in using action learning.

Action learning can only be highly effective as an executive learning approach when it is truly relevant to the learner's situation and when it is fully backed by a committed sponsor. It is important for the effectiveness of action learning that highly qualified facilitators who can master sharing relevant theory and extracting meaningful learning supervise the actions. Only then does action learning get close to delivering immediate impact.

Experiential learning

While action learning places its focus on action, with only limited room for reflection, experiential learning is grounded in learning through reflection upon doing. Where action learning favours skills training, experiential learning is best when emotions and feelings are most important for the learning.

In executive development, experiential learning is often based on experiments, for example role playing and group exercises where learners interact with

the deliberate intention of living through a near real-life situation. Reflections and feedback from fellow peers and facilitators anchor the learning.

Experiential learning may still be at arm's length to the executive's own real world, however. Thus it is seen to lack full relevance for the learner's everyday job challenges. From our studies of best practices in executive development, it appears that experiential learning has gained increased popularity over recent years.

This is likely to be caused by its particular emphasis on developing leadership skills, which become important in times of change. That calls for methods that are particularly strong in fostering behavioural change.

Although being at arm's length from the learner's own job situation, experiential learning demonstrates greater relevance for the learner than other methods described so far.

Facilitators using this method often hear how a session has been considered life changing. Experiential learning is quite powerful when it comes to affecting one's insight into oneself and impacting others' behaviour. That makes it among the potentially stronger methods for achieving immediate impact.

Real-life real-time learning

Where experiential learning does not necessarily address the actual job challenges that keep the learner awake at night, real-life real-time learning offers learning centred around exactly the issues most pertinent to the learner here and now.

Rather than offering 'role plays' this method applies what might be called 'real plays'. That means it is the learner's own real-time job situation that is central to the learning process.

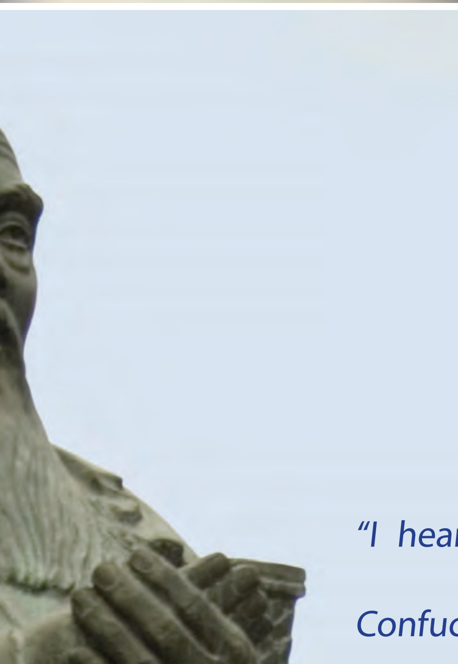
It is a method that requires good control of the facilitation process and places significant demands on the facilitator. The processes are typically systemic in nature, which means that the total ecosystem of the executive is the actual base for the learning. In other words, the process takes all aspects, personal as well as professional, into the process.

The challenge of real-life real-time learning is its reliance on highly skilled facilitators who must master the unforeseeable context and be able to share appropriate theory when needed. In contrast to standardised skills training, where programmes are carefully detailed to guide the trainer minute by minute, facilitators in real-life real-time learning processes have little guidance except for the overall development process since content relies on the specific situations.

According to our studies of best leadership development practices, the real-life real-time learning method has become extremely popular lately due to its strength of being highly relevant for each individual learner. The method has proved to be powerful in creating immediate impact when both the executive and the executive's team engage in the development processes.

In-role learning

From our practice of leadership development and studies of best practices, we have noticed a significant new trend towards in-role learning, which brings learning into the workplace.



"I hear and I forget. I see and I remember. I do and I understand"

Confucius

"Many students have learned much from the competitive landscape of simulations ranging from the basics of accounting to the more complex worlds of business development and change"

We see, for example, executive coaching getting much attention globally. Like real-time learning, executive coaching excels by being learner centric, real-life real-time based and thus focused strictly on relevant current issues. However, coaching is mostly focused on the individual executive and does not bring direct reports or the boss effectively into the learning process. This makes coaching something of a black-box learning experience, at least for the stakeholders around the coachee.

What we also see more of is a willingness to trigger deliberate learning on the job, which often involves key people around the executive. Intact team learning is an effective way of including various stakeholders in the on-the-job learning, which is often practised as various sorts of facilitated group coaching.

If the in-role learning is not facilitated, we have experienced difficulty in motivating the executives and creating space for learning in a hectic job situation. Executives can feel great frustration at not having been able to meet on-the-job learning assignments and in these cases in-role learning loses its effectiveness.

In short, in-role learning is still in the early stages of development but it leaves us with hopes for an effective approach that is relevant to all stakeholders and is powerful in bringing immediate results.

A cry for immediate impact

Fast change requires fast learning and executives nowadays operate in a hectic environment with an overload of new challenges. This demanding and complex reality calls for learning at a different pace and with much higher and immediate relevance to each executive. That has placed executive development in a situation that is more challenging than ever. Most of the classic tools, as we have seen above, do not meet those needs and new ways such as real-time learning and in-role learning are still in their infancy.

Our conclusion is that this cry for immediate impact and instant relevance seems to turn executive learning upside down.

In the past executive education was professor centred; today it is executive centred. In the past it was theory focused; today it is job-challenge orientated. In the past it was classroom teaching; today it is much more about facilitated, workplace- based learning. In the past learning was about theory learned by heart; today, executive learning is about instant relevance to the executive's own current challenges.

In the past executives were developed in isolation away from their team; today, the entire ecosystem of the executives is involved and has become an important part of a shared approach to leadership development. In the past the mindset was long-term career orientated; today, executive development is an important search for how to satisfy the need for immediate impact with instant relevance to increasing performance. ■

ABOUT THE AUTHORS

Jørgen Thorsell is CEO of Mannaz, and Justin Bridge is Managing Director of Mannaz Asia

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"Fast change requires fast learning and executives nowadays operate in a hectic environment with an overload of new challenges"

INCEIF - The Global University of Islamic Finance, is set up by Bank Negara Malaysia (Central Bank of Malaysia) to develop human capital for the global Islamic finance industry.

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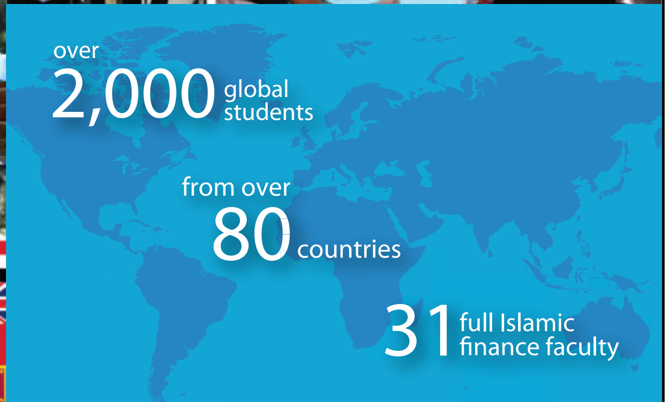

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A catalyst for success

In a Q&A with World Commerce Review, Kai Peters, Chief Executive of Ashridge, one of the world's leading and largest providers of executive education, outlines the ambition to be a catalyst for success for individuals and their organisations

What is the history of the School?

Ashridge Management College, now known as Ashridge Business School, was founded in 1959. Its home is Ashridge House, a neo-Gothic mansion built 200 years ago, which nestles within historic gardens adjoining Ashridge Forest, near Berkhamsted in Hertfordshire. It has been a seat of learning since 700 years ago when it was founded as a monastery. Later in the 16th century it was requisitioned by King Henry VIII and became home to young royal prince and princesses Edward, Mary and Elizabeth. It was sold by Queen Elizabeth I and subsequently demolished in the early 19th century to make way for the current house which became a magnificent family home.

Then in the 1920s it began a new life as a training centre for the Conservative Party. During World War II it was an emergency hospital, treating survivors from Dunkirk and providing a hospital service for people seeking a safe haven away from the London blitz. After the end of the war, the Conservative Party had no further need of Ashridge and it was used as a Ladies Finishing School before Ashridge Management College was founded. It has since developed into one of the world's leading business schools, providing modern teaching facilities whilst still retaining the character of its historic charm.

What is the School's prime function?

To help people and organisations to be the best by providing executive education programmes for both organisations and individuals. Activities include open and executive education programmes, MBA, MSc and postgraduate certificate qualifications, organisation consulting, coaching, applied research and online learning. Its work is underpinned by specialist research centres that undertake research into coaching, learning, strategic management, leadership and sustainability within a business context.

What type of accreditations has Ashridge received?

Ashridge is in the 1% of business schools globally to be accredited by AMBA, EQUIS and AACSB; the UK, European and American accreditation bodies.

What links to corporations and institutions does Ashridge have?

Ashridge works extensively within the corporate environment, helping organisations to address strategic business challenges and improve leadership and capability. In addition, Ashridge also accredits qualifications awarded by certain international institutions. These include: Lorange Institute of Business, Switzerland, Pearson and Management Development Institute, Singapore.

Other institutions where Ashridge has links are:

- Babson College, USA
- Case Western Reserve University, USA
- Cheung Kong Business School, China
- Danish Centre for Leadership
- HM Partners Czech Republic
- Indian Institute of Management, Calcutta (IIMC)
- Management Centre, Turkey
- Management Institute of Finland
- Melbourne University, Australia
- Mt Eliza Business School, Australia
- Stellenbosch University, South Africa
- Tsinghua University, China

What would you say makes the School unique?

The approach is to support and facilitate the development of new skills and build self-awareness among managers and senior executives. Ashridge aims to introduce different thinking, to challenge the current ways of working and to create situations where colleagues can work together to make a real difference to their organisation. By developing their knowledge, skills, behaviours and practices, Ashridge seeks to contribute to their personal success, that of their organisations and of wider society. This mission sets out to ensure that individual participants, management teams or global teams of managers are successful in their area of business whether it is in the private or public sector.

Ashridge Business School is a catalyst, a place where people come together, where plans are infused with passion and where futures are launched. Ashridge engages with middle and senior managers from around the globe and offers a combination of learning, consulting, facilitation, coaching and research that is directly applied to the realities and challenges being faced by organisations.

With its historic buildings combined with modern teaching rooms and facilities, Ashridge has a very special environment set amongst its beautiful gardens; it offers an atmosphere

With executive education, we are globalising and building faculty and partnerships around the world in order to be able to offer our clients a 'one-stop shop' for their learning and development and organisation development needs

where tradition meets innovation. Ashridge is not a place for the run-of-the-mill nor for transient management fads; new thinking and ideas abound that are explored and validated for the benefit of clients.

Who participates in Ashridge qualifications and other programmes?

Individuals and organisations from around the world to build management capability and address individual and organisation development challenges. Clients span the private, public and not-for-profit sectors.

What role do business schools play in the overall economy?

Business schools play a number of roles in the economy through their two key areas in teaching and research. In teaching, they prepare younger people - through undergraduate and Master's degrees for the workforce. For more experienced managers, part-time Masters degrees and executive education help individuals and organisations tackle their 'in the moment' strategic challenges - whether they are the need for additional knowledge, or help in strategy implementation and change management. Research from business schools helps inform economic actors on the best ways forward.

Please describe the School's international reach

Ashridge delivers custom and open programmes and has undertaken consulting work on five continents. It has representatives in offices across Europe and throughout the world. It works across over 50 countries with over 100 organisations and 9,000 managers every year. Over 60% of its clients are headquartered outside the UK.

How do you see the School going forward?

At Ashridge, we continue to develop the international footprint of our activities. In the Masters portfolio, we are working with partners to offer our programmes in other geographies. With executive education, we are globalising and building faculty and partnerships around the world in order to be able to offer our clients a 'one-stop shop' for their learning and development and organisation development needs. Additionally, we are investing heavily in our online capacity in order to provide the best possible combination of blended learning. ■

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A beacon of academic excellence

Serving as a bridge between civilisations is a maxim that has been proved to be immensely meritorious for Paris-Sorbonne University Abu Dhabi. With more than 600 graduates now successfully employed across the region in prominent positions, Sorbonne Abu Dhabi has bolstered its academic credentials as well as effectively contributed in the creation of a knowledge-based economy in Abu Dhabi.

Distinguished legacy

Paris-Sorbonne University Abu Dhabi is pluri-disciplinary and offers an extensive profile of undergraduate and postgraduate programmes across a spectrum of disciplines. The curriculum follows the European Credit Transfer System (ECTS), it is accredited by the UAE Ministry of Higher Education and Research and the French Ministry for Higher Education and Research, hence worldwide recognised.

Established in 2006 at the invitation of the Abu Dhabi government to help transform the academic landscape, Sorbonne Abu Dhabi is affiliated with the Abu Dhabi Education Council (ADEC) and offers an immersive educational experience. Sustained by an illustrious legacy of three globally-renowned French Universities, Paris Sorbonne, Paris Descartes University, and Pierre and Marie Curie University, Sorbonne Abu Dhabi ensures a multi-faceted academic experience with exclusive 11 Bachelor courses taught in French (except for the Science bachelor in Physics) and 15 Master courses taught in English.

Functioning as an extension of its Paris campus, Sorbonne Abu Dhabi offers distinctive yet identical education to Sorbonne Paris with similar teaching methodology, the same courses and faculty and all diplomas issued in Paris. Located on Al Reem Island, the University features a state-of-the-art campus which includes a library with over 100,000 titles, outstanding sports facilities, and contemporary and separate accommodation facilities.

Backed by its unique teaching methodology and a culture for innovation, Sorbonne Abu Dhabi deploys world-class French education by promoting international exchanges and inspiring its students to excel. Today Sorbonne Abu Dhabi has enrolled more than 700 students from over 75 nationalities, with 30% Emiratis, creating a truly multicultural environment.

The portfolio of compelling degree programmes have been created based on a long-term vision that corresponds to the city's ambitions. The undergraduate courses include the following programmes:

- French and Comparative Literature
- Applied Foreign Languages (LEA)
- Philosophy and Sociology
- Sociology, Social Sciences
- Geography and Planning
- History
- Archaeology and History of Art
- Law
- Economics and Management
- Physics
- Information and Communication

The postgraduate courses at Paris-Sorbonne University Abu Dhabi include:

- Performing Arts Management
- International Law, International Relations, and Diplomacy
- International Business Law
- Sustainable Development Law
- Banking and Finance
- Marketing, Management, Communication and Media
- International Business and Languages
- History of Art and Museum Studies
- Teaching French as a Foreign Language
- Publishing, Information and Multimedia
- Urban and Regional Planning
- Environment: Dynamics of Territories and Societies
- Muslim and Arab World Studies
- Social Research: Consulting, Survey and Evaluation
- Transport, Logistics, Territories and Environment

Going beyond academics

As part of its efforts in promoting Abu Dhabi as a significant

cultural hub in the region, Sorbonne Abu Dhabi organises numerous cultural events in English, French and Arabic every semester for its students and the community. Through valuable collaborations with local universities and cultural entities, the university holds events like opera and musical concerts, theatre and poetry evenings, art and photography exhibitions, and sports tournaments. This cultural dimension enables students to explore their creative aptitude, refine their talents and simultaneously strengthen community bonds.

Prof Eric Fouache, Vice-Chancellor of Paris-Sorbonne University Abu Dhabi said, *"We are proud of our accomplishments and of our students and faculty who together strive to flourish and create an indelible impression in their fields. Through scholarly exploration and intellectual stimulation, our students receive a solid grounding across several disciplines that enhance their analytic and critical thinking skills. From course delivery to lively extracurricular activities, interaction with business leaders, a vibrant environment and beyond, studying at Paris Sorbonne University Abu Dhabi ensures a new generation of progressive leaders resolute about having a positive impact in the world."*

The leading edge

Innovation and globalisation have transformed the social fabric of the region which is evident in a cosmopolitan city like Abu Dhabi. A remarkable facet of Sorbonne Abu Dhabi is its steadfast agility of adapting to fast-paced local and regional developments. The University's enduring vision and commitment to staying on top of emerging trends ensures it continues to challenge students to become dynamic and engaged global citizens.

Sorbonne Abu Dhabi is part of strong bilateral relations between France and the UAE and the university serves as a cornerstone of Abu Dhabi's emerging higher education strategy aligned to Vision 2030. By collaborating with government entities to constantly assess current and prospective job market scenarios, Sorbonne Abu Dhabi designs courses to effectively meet the region's future demand. The launch of four new Master degrees planned to start in October 2014 is symbolic of the university's resolve to align to the country's ambitions and focuses on fields that are expected to gain prominence in the next few decades.

The University has sealed a reputation for attracting passionate and ambitious students intent on creating strides and making exceptional contributions to the community

These new Masters have been carefully developed in consultation with various government institutions and ideally reflect both, the city's tremendous pace of progress and national aspirations. These programmes include Master of Transport, Logistics, Territories and Environment; Master of Social Research: Consulting, Survey and Evaluation; Master of Geodynamics of Current and Past Spaces, and Master of Muslim and Arab World Studies. In particular, the last Master is a research degree that, in addition to analysis and study, enables students to produce academic knowledge for fellow researchers and students.

Pursuit of excellence

In less than a decade, Sorbonne Abu Dhabi has swiftly emerged as a paragon of excellence gaining acclaim for its efforts in promoting humanistic disciplines and nurturing a culture of excellence. The University has sealed a reputation for attracting passionate and ambitious students intent on creating strides and making exceptional contributions to the community.

Last year, Paris Sorbonne University Abu Dhabi won the prestigious MENA Education Provider of the Year 2013 award by *The European Magazine* in recognition of its efforts to develop and advance the regional economy. This accolade represents a momentous milestone in recognising an unparalleled academic experience by readers beyond the region.

Paris-Sorbonne University Abu Dhabi's future initiatives will ensure studying in Abu Dhabi continues to appeal to more students determined to emerge as extraordinary leaders and determined go-getters. ■

Coaching is for everyone

Within many organizations, coaching is perceived as a 'perk' - a service that's available only to individuals within the upper echelons of leadership. What the best leaders are discovering, however, is that coaching - defined by the International Coach Federation (ICF) as partnering with clients in a thought-provoking and creative process that inspires them to maximize their personal and professional potential - is that, regardless of an employee's role in the organization or age, coaching can yield significant benefits. It's no wonder that, in the last four years, global awareness of and participation in professional coaching have increased despite tough economic times. The reason for this is simple: when it comes to enhancing performance and effectively responding to challenges, coaching works!

An intervention for all levels

According to the *2013 ICF Organizational Coaching Study*, coaching takes hold in many organizations thanks to a trickle-down effect, whereby a high-ranking individual within an organization participates in a coaching relationship, experiences a high return on expectations and/or investment, and proceeds to champion the use of coaching throughout his or her organization. Again and again, successful organizational coaching initiatives have demonstrated that this top-down approach gets results.

However, this is not the only model for successful organizational coaching. Indeed, a growing number of organizations are implementing coaching programs to support the goals and enhance the performance of front-line leaders - many of whom are in the first leadership role of their career. This is how the foundation for coaching was laid at CareSource, a Dayton, Ohio, USA-based non-profit managed-health care firm. When CareSource added a coaching component to its already-vibrant training program for new leaders, the result was increased engagement and retention of high-potential leaders, increased adaptability in a fast-changing business landscape, a cost savings of more than $600,000 and an ROI of 231 percent. What's more, CareSource saw the popularity of coaching grow from the middle, up, with C-suite executives inspired by the program making the decision to partner with a coach as well.

Value for all ages

Just as individuals at any level of an organization can reap the proven positive impacts of coaching, you are never too old or too young to benefit from professional coaching. Just ask the teachers, staff, students and parents affiliated with Turkey's Isikkent Schools.

Established in 1998 within a non-profit foundation, Isikkent Schools provide a unique learning environment that brings students ranging from preschool through grade 12 together on one campus - an organizational model seen infrequently in Turkey. Isikkent is also set apart by its mission: in a nation where most students are taught to measure their success and learning by their exam scores, Isikkent's teachers and administrators pride themselves on educating young people holistically. With a creative, inquiry-based approach to teaching; a high premium on global citizenship; and a commitment to ethical speech and behaviour, Isikkent Schools strive to develop young people into highly motivated, self-aware and thoughtful adults passionate about lifelong learning. Given the desire of Isikkent's leaders to innovate in service of student development, it's no surprise that the school joined Turkey's coaching movement in 2008, at its very onset.

Isikkent's program was rooted in a high level of buy-in by top administrators, who allocated 24 percent of the school's professional development budget for coach training for teachers. In 2009, school leaders contracted an ICF Credential-holder and an ICF-accredited training program to provide training and Mentor Coaching. All teachers participated in a two-day-long induction course that introduced them to the ICF Code of Ethics and Core Competencies and addressed several coaching skills applicable to their work in the classroom. At the conclusion of the induction course, interested teachers were given the opportunity to enrol in a full coach-training program. More than 40 teachers initially took advantage of this professional-development opportunity.

Coaching is available to anyone in the school community who requests it - even the three- and four-year-olds in Isikkent's pre-kindergarten program. The program is closely aligned with Isikkent's guidance services, and with a parent's permission, students are encouraged to schedule sessions with coach-teachers. Topics covered during coaching engagements have included goal-setting, planning for the future, interpersonal communication and conflict resolution. The coach-teachers also coach Isikkent teachers and parents on a voluntary basis.

Additionally, six coach-teachers are trained to administer Parent Effectiveness Training with an eye toward developing 'coach-like parents' who are skilful at giving feedback, listening actively and asking powerful questions.

In recognition of Isikkent's exceptional use of coaching, the International Coach Federation (ICF) awarded the school the 2013 ICF International Prism Award. The Prism Award honours organizations that have achieved the highest standard of excellence in the implementation of coaching programs fulfilling rigorous professional standards, addressing key strategic goals, shaping organizational culture, and yielding discernible and measureable positive impacts. (Learn more about the award and find out how to nominate an existing organizational coaching program for the 2014 International Prism Award at Coachfederation.org/prism.)

Although your organization probably won't be using coaching for the five-and-under set, recently released consumer research from ICF does show that adult consumers of all ages are looking to coaching as a means to achieve their professional and personal goals. According to the *2014 ICF Global Consumer Awareness Study*, commissioned by ICF and conducted by the International Survey Unit of PricewaterhouseCoopers LLP, the No. 1 reason consumers ages 25 and up cite for participating in a coaching relationship is optimizing individual/team work

performance (42 percent), followed by expanding professional career opportunities (33 percent), increasing self-esteem/self-confidence (31 percent), improving business management strategies (29 percent) and managing work/life balance (27 percent).

Because coaching is a highly individualized intervention, it can be a boon for organizations with workforces that span multiple generations by offering personalized support apropos to each coachee's stage in his or her life and career. Indeed, you may find it interesting to know that, according to the *2014 Global Consumer Awareness Study*, adults who have received coaching are likely to describe the experience somewhat differently depending on their age. When offered five phrases that they would use to describe coaching to someone else ('purpose-driven,' 'action-oriented,' 'forward-thinking,' 'structured work plan' and 'focused concentration'), all age groups included in the survey were in agreement on the statement most frequently selected to best describe coaching ('forward-thinking,' selected by 29 percent of respondents).

Beyond that, the age groups diverged, with respondents aged 55-plus more likely to describe focused work plans and focused concentration, while younger age groups (25-54) were more likely to describe coaching as purpose-driven or action-oriented. In other words, while coaching consumers aged 55-plus emphasize a process-oriented view of coaching, younger age groups take a somewhat more outcome-oriented perspective. A skilful coach will be able to tailor his or her approach to meet coachees where they are, helping them embrace the process and begin the journey toward desirable outcomes.

A worthy investment

Whether you're considering coaching for yourself or your organization, you already know that it is a significant investment of time and money. Before you begin the purchasing process, you may find it helpful to educate yourself about what coaching is and what it entails in greater depth. ICF's Research Portal (housed at Coachfederation.org/portal) is an excellent starting point for your research process, as it hosts dozens of scholarly articles and case studies that offer powerful insights into how coaching can be used in service of achieving strategic objectives.

"... regardless of an employee's role in the organization or age, coaching can yield significant benefits"

Before you begin the process of hiring a coach, pause to reflect on your goals and objectives for coaching. Being clear on this during the hiring process enables you to find the coach best-suited to help you reach individual or organizational goals. Because coaching is a partnership, you should also consider how much value you and your organization place on collaboration, other viewpoints and new perspectives are valued. Because coaching is a client-driven process, your buy-in is essential to ensure maximum results.

ICF recommends that you interview three coaches before you make a hiring decision. Ask each about his or her qualifications, experience and skills, and be sure to request at least two client references.

Ask the following questions of each 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 (enrolled in 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? And, at what levels (executives, upper management, middle management, etc.)?
- What is your philosophy about coaching?
- What types of assessments are you certified to deliver?
- What are some of your coaching success stories (specific examples of individuals who have succeeded as a result of coaching)?

Turkey's Isikkent Schools

Isikkent Schools' comprehensive coaching program is designed to impact every member of the learning community. All of Isikkent's teachers and support staff have completed several hours of coach-specific training in order to better understand and support the school's coaching culture.

The ICF also encourages you to ask each prospective coach about his or her coaching credentials and memberships in professional organizations. ICF's Membership Eligibility Requirements make it very easy for you to make an informed decision. In addition to adhering to the stringent ICF Code of Ethics, ICF Members must commit to rigorous coach-specific training; as a result, consumers can have confidence that the 26,000-plus ICF Member coaches worldwide are well-trained and well-prepared to offer their services.

Possession of an ICF Credential is another clear sign of a coach's willingness to take his or her professional performance to the next level. Currently, more than 13,000 individuals hold one of three ICF Credentials distinguishing themselves as consummate professionals. Each ICF Credential-holder has fulfilled rigorous education and experience requirements and demonstrated a strong commitment to excellence in coaching. To be eligible for an ICF Credential, a coach must complete coach-specific training; achieve a designated number of coaching experience hours; partner with a Mentor Coach; and demonstrate the appropriate understanding and mastery of ICF's definition of coaching, Code of Ethics and Core Competencies. If you are partnering with an ICF-credentialed coach you can be sure you're working with the best in the industry.

You may also find it helpful to know that industry research shows a positive link between coaches' credentials and professional memberships, and their clients' overall satisfaction with the coaching experience. According to the *2014 Global Consumer Awareness Study*, 93 percent of consumers who recalled that their coach held a credential or certification reported being 'somewhat' or 'very' satisfied with the coaching experience. According to the same study, 93 percent of consumers who recalled that their coach was a member of a professional coaching organization reported satisfaction with the coaching engagement. ■

Begin your search for an ICF-credentialed coach with the free Coach Referral Service housed at Coachfederation.org/crs.

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