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Mario Draghi outlines how the Single Market has benefited Europe over the past 20 years

John Hunter looks at the future of the Isle of Man's banking sector

Technology is being left out as modern matchmakers continue to gain in the business of love

THE GLOBAL TRADE PLATFORM

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Europe and the euro 20 years on

We should consider the gains made as a result of having one market with one money, says Mario Draghi, outlining how the Single Market has benefited the people of Europe over the past 20 years

In January 2019 we celebrate the 20th anniversary of the launch of the euro. The two decades in which the euro has existed have perhaps been exceptional. The first was the culmination of a 30-year upswing in the global financial cycle, while the second saw the worst economic and financial crisis since the 1930s. But, exceptional as they were, these two periods can teach us some useful lessons about what still needs to be done.

Monetary Union has succeeded in many ways, but it has not delivered the gains that were expected in all countries. This is partly the result of domestic policy choices and partly the result of Monetary Union being incomplete, which led to insufficient stabilisation during the crisis.

The way ahead, therefore, is to identify the changes that are necessary to make our Monetary Union work for the benefit of all member countries. We need to make these changes as soon as possible, but we also need to explain why they are important to the people of Europe.

The rationale for one market, one money

The Single Market is often seen simply as an expression of the globalisation process, which over time has even eliminated exchange rate flexibility. But the Single Market and globalisation are not the same thing.

Globalisation has led to higher overall welfare for all economies, and for emerging markets in particular. But it is now clear that the rules that accompanied this process were not sufficient to prevent it from causing severe distortions. Open markets have heightened economic insecurity for people exposed to intensified competition, and added to their sense of being 'left behind' in a world where the great wealth created has been concentrated in a few hands.

From the outset, however, the Single Market was designed to reap the benefits of openness while also tempering its costs for the most vulnerable; to promote growth while protecting the people of Europe from the injustices of untrammelled free markets. This was undoubtedly also the vision of Jacques Delors, the architect of the Single Market.

[The] European project is even more important today. It is only by continuing to make progress, freeing up individual energies but also fostering social equity, that we will save it through our democracies, with a unity of purpose

The Single Market was conceived during a period of weakness in the European economy. Annual growth had averaged just 2.2% from 1973 until 1985 in the 12 countries that would go on to form the euro area[1], down from 5.3% between 1960 and 1973. Growth potential had also fallen from about 5% per year at the beginning of the 1970s to around 2% per year by the beginning of the following decade.

The typical response of governments to low growth was to increase fiscal deficits. From 1973 to 1985, public deficits in the euro area 12 averaged 3.5% of GDP, while in Italy the average was 9% of GDP. Unemployment rose from 2.6% in 1973 to 9.2% in 1985 for the euro area 12. In Italy, it climbed from 5.9% to 8.2% over the same period.

But the EU had a powerful tool at its disposal to raise growth: the common market.

One reason that growth potential had decelerated was that intra-EU trade growth had stalled in the early 1970s, because the common market covered mainly intermediate goods where growth was already saturated. Trade in sectors with high R&D and skill content was restricted by non-tariff barriers, preventing productivity spillovers[2].

The Single Market offered a way to remove these barriers, reverse the decline in economic potential, and bring more people back into work. Yet the Single Market was never just about this. It also aimed to protect people from some of the costs of the changes that would inevitably arise. This, in turn, would create a more favourable political environment for advancing the process of European integration, following the setbacks of the 1970s.

Unlike the wider process of globalisation, the Single Market allowed Europe to impose its values on economic integration – to build a market that, to the extent possible, was free but just. Product rules could be used to protect consumers from lax standards in other countries, and protect producers from unfair competition. And production rules could be used to protect workers by putting a floor on 'social dumping' and upholding labour standards.

This is why the launch of the Single Market agenda in the mid-1980s went hand in hand with a strengthening of common rule-making in the EU and of powers of judicial review. The opening of markets was accompanied by the creation of a strong European authority to safeguard fair competition; product standards became tighter, with the introduction of the geographical indication protections for specific foods, for example. And safeguards central to the European social model were progressively embedded in EU law, in areas where the EU had the power to act.

The Charter of Fundamental Rights has prevented a 'race to the bottom' in terms of workers' rights. Legislation was adopted to curtail unfair labour practices, such as the revision of the Posted Workers Directive this year. EU legislation also protects those in less secure employment.

One example is the Directive on part-time work in 1997, which sought equal treatment for part-time and fixed-term employees. Last year the EU institutions endorsed the European Pillar of Social Rights to support equal opportunities and access to the labour market, fair working conditions, social protection and inclusion.

EU legislation has not led to a complete harmonisation of labour protections across Europe. But it has meant that the gap in labour standards across countries has gradually narrowed, even as lower-income countries have joined the EU. Research finds a process of upward convergence in significant areas of social expenditure in the EU since 1980, although this has tailed off in recent years[3]. The same cannot be said at the international level.

But the Single Market required greater exchange rate stability than a free trade area, and this resulted in significant trade-offs for economic policy. These were well-articulated by Tommaso Padoa-Schioppa in his famous *"inconsistent quartet"*[4]. If European countries wanted to have the benefits of managed open trade, they could not simultaneously have capital mobility, independent monetary policy and fixed exchange rates.

Governments initially responded to this conundrum by maintaining fixed exchange rates and introducing capital controls on short-term flows, which allowed a degree of monetary policy autonomy. But as financial integration deepened and capital controls were progressively eliminated during the 1980s, fixed exchange rates became unsustainable.

Due to the international financial storms raging at the time, the countries that had pegged their currencies to the Deutsche Mark (DM) within the European Monetary System (EMS) had to periodically decide either to maintain an independent monetary policy and devalue, or to maintain parity with the DM and lose any sovereignty over their monetary policy.

Given the frequency with which policymakers had to make these decisions, some countries lost both the benefits of exchange-rate stability and their monetary policy independence. The social costs were high. This process came to an end with the ERM crisis in 1992-3, when it ceased to be credible for countries entering a recession to follow German interest rate rises. At the same time, devaluing repeatedly was becoming incompatible with the deep Single Market that countries were trying to build.

Indeed, the prevailing view on devaluations was captured well by Nobel laureate Robert Mundell, who developed his theory of optimal currency areas in the belief that, *"I could not see why countries that were in the process of forming a common market should saddle themselves with a new barrier to trade in the form of uncertainty about exchange rates"*[5]. Exchange rate flexibility would have undermined the Single Market in two ways.

First, it would have weakened incentives for firms to raise productivity, because they could have lifted competitiveness – if only temporarily – by devaluing rather than increasing output per head[6]. Yet Europe had witnessed time and again that such actions did not lead to lasting welfare gains.

From the launch of the EMS in 1979 to the ERM crisis in 1992, the Italian lira was devalued seven times against the DM, losing around half of its value cumulatively vis-à-vis the German currency. Yet average annual productivity growth[7] in Italy was lower than in the euro area 12 over this period, Italy's GDP growth rate was roughly the same as that of its European peers, and its unemployment rate went up by 1.3 percentage points. At the same time, consumer prices in Italy grew cumulatively by 223%, compared with 103% in the euro area 12[8].

Second, support for the Single Market would be undermined in the long run if firms that did invest in raising productivity could be deprived of some of the benefits by 'beggar-thy-neighbour' behaviour through competitive devaluations in other countries. Open markets would not have lasted.

Europe had experienced the problems created by exchange rate flexibility in the 1960s with the common agricultural market. Absent a single currency, the common agricultural policy was based on prices quoted in units of account. But successive currency crises, in particular a revaluation of the DM and a devaluation of the French franc in 1969, jeopardised trust in the market, as the farmers affected demanded compensation for their losses.

The issue was smoothed over by introducing monetary compensatory amounts to mitigate sudden changes in farm prices caused by abrupt adjustments in exchange rates. But the system proved difficult to implement and sustain as it was virtually impossible to avoid distortions of production and trade, which poisoned intra-Community relations[9].

So, faced with an 'inconsistent quartet' of policy choices, a single currency provided, at least in principle, a way to resolve them. It would allow countries to maintain stable exchange rates and therefore benefit from openness within the Single Market, while managing as far as possible its costs.

Not all countries that had joined the Single Market also joined the euro, of course. Some countries, such as Denmark, pegged their exchange rates to the euro. For other countries, the Single Market represented the gateway to the euro. Five additional countries[10] joined the euro in its first decade and three more in its second, but other smaller economies have stayed out so far.

Finally, there is the United Kingdom, the only large economy inside the Single Market that chose to stay out of the euro area. The United Kingdom is a particular case, not only for political reasons but also for structural reasons, such as the relatively low exchange rate pass-through it had in the past[11].

The benefits of one market, one money today

We should consider what gains have been made as a result of having one market with one money. With the euro protecting the Single Market, trade growth has increased, with intra-EU exports rising from 13% of EU GDP in 1992 to 20% today.

Intra-euro area trade has risen both in absolute terms and as a share of total trade with advanced economies[12], even as emerging market economies have entered the global market. Foreign direct investment (FDI) flows within Europe have also grown[13], with inflows from the rest of the EU to Italy increasing by 36% from 1992 to 2010[14].

Behind the growth of intra-EU trade lies perhaps an even more important development, which is the much closer intertwining of European economies through the deepening of value chains.

Since the start of the 2000s, supply chain linkages between countries within the EU have intensified at a faster pace and were more resilient during the crisis, compared with their supply chain linkages with countries outside the Single Market[15].

The removal of customs barriers as part of the Single Market agenda has facilitated multiple border crossings during the production process. Europe-wide standards have boosted intra-EU value chains by providing more certainty for firms about the quality of production in other countries and encouraging the fragmentation of the production process that is typical of value chains[16].

And the single currency has further enhanced the process by eliminating the costs of foreign exchange payments and settlements and of hedging exchange rate risk.

Participation in these value chains has brought gains for all countries, especially in terms of productivity spillovers. The imported inputs used in value chains generate a tangible boost to productivity[17].

And higher productivity in turn leads to higher wages. Integration within value chains is associated with an increase in hourly compensation for all skill groups[18].

Moreover, integrating into value chains has improved risk-sharing among European countries, since it has allowed the gains (and losses) of trade with the rest of the world to be more evenly spread. Within the EU, close to 20% of export-supported jobs are located in a country other than the one that exports the final product[19].

Around half a million Italian workers are involved in the production processes of companies located in other EU countries that export to the rest of the world[20]. Italian firms themselves participate strongly in global value chains and this is positively associated with labour productivity[21].

It is often this link to value chains that allows in particular the SMEs that are so typical of Italy's manufacturing sector to survive and grow. In a world that is increasingly dominated by scale, this permits Italy to retain one of its fundamental characteristics. Italy, through the Single Market and the single currency, is deeply integrated into the European production process.

The closer intertwining of European economies has had two significant effects on exchange rate relationships for euro area countries. First, the cost of not being able to devalue within Monetary Union has fallen.

ECB analysis finds that misalignments of real effective exchange rates are smaller – albeit more persistent – for euro area countries than those between advanced economies or countries linked by pegged exchange rates, and these misalignments have actually become smaller in the second decade of EMU relative to the first decade[22].

At the same time, value chains have blunted the short-run benefits of competitive devaluations[23]. Since exports contain a greater share of imports, any boost to external demand associated with a hypothetical devaluation is now offset by higher input costs from imported intermediates. As a result, participation in value chains has been found to reduce the responsiveness of export volumes to movements in the exchange rate[24].

So, any country hypothetically looking to devalue to regain competitiveness would have to do so to a much larger extent than was necessary in previous decades. And devaluations of such size would not only threaten the existence of the Single Market. They would also result in a substantial loss of welfare within the country carrying out the devaluation owing to the greater negative impact it would have via higher import prices.

And studies on non-EU countries suggest that the welfare loss would be greatest for the poorest in society, since poorer households tend to spend a larger share of their income on tradeable goods than richer households[25]. This is also typically the case in euro area countries.

But does being outside the euro provide additional benefits in terms of monetary policy sovereignty? This is not so obvious. First, the single currency has actually allowed countries to regain monetary sovereignty compared with the fixed exchange rate regimes of the past.

Decision-making over monetary policy, which effectively belonged to Germany under the EMS, is now shared among all euro area countries. And the size of euro financial markets has made the euro area less vulnerable to US spillovers, even as global financial integration has accelerated.

Second, it is worth noting that the supposed advantages of monetary sovereignty – such as the ability to engage in monetary financing of government spending – do not appear to be valued highly by countries that are members of the Single Market but not the euro.

Such countries have a weighted average public debt of 68% of GDP (44% of GDP if the United Kingdom is excluded), compared with 89% for countries that use the single currency.

In any case, as the history of Italy has shown, monetary financing of government debt did not lead to real long-term benefits[26]. In periods where debt monetisation was more common in Italy, such as in the 1970s, maintaining a growth rate similar to its European peers required repeated devaluations. Inflation reached unsustainable levels and hit the most vulnerable in society.

Convergence and divergence in the euro area

But if it is true that the supposed advantages associated with the freedom of being outside Monetary Union belong to a memory that has been obscured by time and the dramas of the recent crisis, it is also true that in some countries various benefits that were expected from EMU have not yet materialised.

It was not mistaken, and nor is it today, to expect higher growth and employment to emerge from the 'culture of stability' that Monetary Union would bring about. But it was inconceivable that joining Monetary Union alone would be sufficient to achieve this. We needed and continue to need much more.

To the founders of EMU, it was clear that establishing a well-functioning monetary union would be a long and gradual process. Historical experience suggested that opening markets could lead to differentiated gains, with some regions profiting more than others. This had been the experience of both Italy and Germany after unification in the 19th century[27].

Several euro area countries have achieved significant convergence, particularly the Baltic countries, Slovakia and, to a lesser extent, Malta and Slovenia. In these countries, the gap between real GDP per capita and the euro area mean has been reduced by around one-third since 1999[28].

Others that also started far from the euro area average – such as Portugal and Greece – have on balance been unable to close the gap considerably.

But such divergences are not exclusive to the euro area. GDP per capita in the richest state in the United States is around twice that of the poorest state, which is roughly the same gap as in the euro area[29]. And the dispersion of growth rates across euro area countries has fallen considerably over time and, since 2014, has been comparable to the dispersion across US states.

So what has driven the different convergence trajectory of countries, and how much is it related to membership of the euro? Convergence can be thought of in two ways. The first is convergence of real GDP per capita levels. This is a long-term process which is driven by factors such as rates of FDI, productivity growth and institutional quality. Such factors can be fostered by sharing a single currency, but they are not determined by it. Domestic policies, structural and institutional reforms, and contributions from EU structural funds are what play a crucial role here.

The second concept of convergence relates to *growth rates*, ie. how much business cycles across countries are synchronised, especially when major shocks hit. This is determined more by monetary union membership, since the design of a monetary union affects the capacity of countries to adjust and stabilise demand during recessions.

In the case of Italy, we see both long-term and cyclical factors at play. Between 1990 and 1999 – that is, before the introduction of the euro – Italy already had the lowest cumulative per capita GDP growth of the original euro area members. From 1999 to 2008, it again had the lowest per capita GDP growth of all euro area members.

From 2008 to 2017, it recorded the second lowest cumulative growth, behind Greece. And, if we look further back, the growth we saw in the 1980s was borrowed from the future, having been based on debt that was left for future generations to bear.

So, low growth in Italy is a phenomenon that dates back a very long time before the euro. This is a supply-side problem, which is clear if one looks at regional performance. There is a correlation between GDP per capita in different Italian regions and some structural indicators, such as – just to take an example – the ease of doing business index compiled by the World Bank: the values for the poorer regions are generally lower than those of richer regions.

At the same time, the fact that Italy – and other countries – diverged further from the euro area average during the crisis highlights two important points. First, that structurally weaker countries are more vulnerable to economic slowdowns than others; and second, that our Monetary Union remains incomplete in some key respects.

There is a fair amount of evidence that countries that implemented decisive structural policies recovered faster from the crisis than others. In countries that made such changes, the labour market is now more responsive to growth[30], and the improved economic conditions have led to gains in employment[31]. But alongside structural policies, different layers of protection are necessary to ensure that countries can stabilise their economies during crises.

Without appropriate backstops at the euro area level, individual countries in a monetary union can be exposed to self-fulfilling dynamics in sovereign debt markets. Such overshooting can aggravate adverse debt dynamics in downturns, inducing procyclicality in national fiscal policies, as we saw in 2011-12.

Typically, sovereign borrowing costs should fall in a recession, but at that time economies representing one-third of euro area GDP saw their borrowing costs become positively correlated with risk aversion[32]. The result was a lack of stabilisation that harmed both growth and fiscal sustainability.

So it is the structurally weaker countries that most need EMU to have instruments to diversify the risk of crises and counteract their effect on the economy. I have talked before about how countries like Italy, which had been weakened by decades of low growth and had no fiscal space when the crisis began, saw a crisis of confidence in government debt turn into a credit crisis with major repercussions for employment and growth[33].

Deepening private risk-sharing through financial markets is one key element in preventing such events from recurring. In the United States, around 70% of shocks are mitigated and shared across the individual states through integrated financial markets, whereas in the euro area the share is only 25%[34]. It is therefore also in the interest of the weaker countries in the euro area to complete banking union and to proceed with the construction of a genuine capital market.

But national budgets will never lose their function as the main stabilisation tool during crises. In the euro area, around 50% of an unemployment shock is absorbed through the automatic stabilisers in national public budgets, significantly more than in the United States[35]. The use of automatic stabilisers, however, depends on countries not being constrained by their debt level. So the necessary fiscal space will have to be created again so that budget interventions can be made in the event of a crisis.

Yet national fiscal policies also need a complement at the European level. We need an institutional architecture that gives all countries the necessary support to ensure that their economies are not exposed to procyclical market behaviour during downturns. This will only be possible if the support is temporary and does not constitute a permanent transfer between countries, which would result in a failure to put in place the necessary fiscal consolidation, let alone the fundamental structural reforms needed for a return to growth.

Conclusion

It is not a technocratic desire to see convergence across countries and the smooth functioning of Monetary Union that has led me to frequently mention the importance of structural reforms in recent years. Each country has its own reform agenda, but such reforms are the only way to create the conditions for sustainable growth in wages, productivity and employment and to underpin our welfare state.

In large part these measures have to be undertaken at the national level, but they can be supported at the European level by the recent decisions to launch an instrument for convergence and competitiveness.

However, to tackle future cyclical crises, the two layers of protection against shocks – the diversification of risk through the private financial system on the one hand, and public countercyclical support through national budgets and the fiscal capacity of the EU budget on the other – need to interact in a complete and efficient manner.

The more progress we make in completing the banking union and capital markets union, the less urgent – although still necessary – it becomes to construct a fiscal capacity, which could at times serve to complement national stabilisers. Inaction on both fronts heightens the fragility of Monetary Union in times of great crisis and the divergence between countries increases.

It is clear that completing Monetary Union is the best way to prepare the transition to a form of union that is more complete. Monetary Union, a necessary consequence of the Single Market, has become an integral and defining aspect – with its symbols and its constraints – of the political project whose central aim is a Europe that is united in freedom, peace, democracy and prosperity.

It was an exceptional response – or to paraphrase Robert Kagan[36] an anti-historical response – to a century that had seen dictatorships, war and misery, and in that respect was not dissimilar to previous centuries. A unified Europe was part of that world order, itself the result of exceptional circumstances, which followed the Second World War.

The intervening years have confirmed the rationality of the choices made at the European and the global level. The challenges that have arisen have become ever more global in nature and need to be tackled together, not alone. And this is even more true for Europeans, both at the level of their individual nations and for the continent as a whole: rich but relatively small; strategically exposed, militarily weak.

Yet today, for many, the memories that inspired those choices seem distant and irrelevant, and the rationale behind them has been undermined by the misery created by the great financial crisis of the past decade. It does not matter that we are emerging from the crisis. Elsewhere in the world, the fascination with illiberal prescriptions and regimes is spreading; we are seeing little steps back in history.

And this is why our European project is even more important today. It is only by continuing to make progress, freeing up individual energies but also fostering social equity, that we will save it through our democracies, with a unity of purpose. ■

Mario Draghi is President of the European Central Bank

Endnotes

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5. Mundell, R, "Optimum Currency Areas", luncheon speech at Tel Aviv University, 5 December 1997.

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7. Real GDP per hour worked.

8. Reference period is 1979-1991, excluding Italy.

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11. See, for example, Campa, JM and Goldberg, LS (2002), "Exchange Rate Pass-Through into Import Prices: A Macro or Micro Phenomenon?", NBER Working Paper, No. 8934.

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17. See, for example, Halpern, L, Koren, M and Szeidl, A (2015), "Imported Inputs and Productivity", American Economic Review, 105(12), pp. 3660-3703.

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33. See Draghi, M (2018), "Risk-reducing and risk-sharing in our Monetary Union", speech at the European University Institute, Florence, 11 May.

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What 'EU sovereignty' are we talking about?

Emmanuel Macron has called for 'European sovereignty'. Daniel Dăianu discusses what this may mean for Europe and the transatlantic relationship

French President Emmanuel Macron produced quite a stir by asking for what he called *"European sovereignty"*. In April 2018 he reiterated this quest in the European Parliament. Arguably, this quest is to be embedded in a wide context by considering trends which have been getting steam during the past decade.

'European sovereignty' automatically leads to the idea that the EU needs more room of manoeuvre in world affairs, not least in economic terms. But how can one interpret such a goal in a world in which global supply chains have created powerful interdependencies? Does it mean that Europe strives to be less dependent, more self-reliant economically in this regard?

One could argue that such an objective is not devoid of common sense at a time when multilateralism is severely tested by, what an irony, the US. Or, that economic and security rationales lie behind an *inward-looking syndrome*[1], that shows up in the way Europeans tackle the challenges of immigration, protection of borders, fighting terrorism, dealing with cyber attacks, etc. All these challenges would suggest that however much one is enamoured of economic openness, of a borderless world, reality forces upon us tough choices and an inexorable motion toward a EU epitomized, eventually, by a sort of fortress.

Decades ago Richard Cooper wrote a book titled *The Economics of Interdependence* (Columbia University Press,1980). That was an interpretation of what underpins the transatlantic economic and political community. The Cold War was a period that reinforced the links between Europe (EU) and the US, in economic and military affairs. In spite of inevitable economic rivalries and Europeans' envy of Washington's *"exorbitant privilege"* (as Valery Giscard d'Estaing called the US leeway to fund its worldwide ventures by just printing US currency), ever deeper economic ties were a strong lynchpin for containing the Soviet Bloc and for expanding western democracies' interests worldwide.

But the world nowadays seems to have turned upside down. Whereas emerging economies have been traditional advocates of *fair trade*, currently some advanced economies, with the US in the lead, argue that global trade is not a level playing field, that unfair practices favour emerging powers – China in particular.

Moreover, multilateral arrangements, that were fostered by the US after the end of the WW2, are being seriously questioned; bilateralism and plurilateralism are proliferating. Again, China is seen across the Atlantic, as a huge geopolitical rival, whose ascendancy has to be slowed down, if not averted, by all means – including trade and investment restrictions. But Europeans, too, are screening Chinese investments and transfers of know-how that regard strategic sectors, more or less linked with security concerns.

Acquiring more 'policy space' is a commendable aim for EU policy-makers, but this has to be defined in realistic terms

Europe also resents tactics and methods used by Washington, with the latter flexing its diplomatic and military muscles in unconventional ways, which do not leave friends unscathed. What some view as bullying is used frequently and *real politik* is much more muscular during the Trump Administration. Does it work?

Sometimes it seems that it does, for bilateral deals are taking concrete shape. By the way, the EU also tries to get into bilateral trade arrangements. Sanctions, too, are used in a more forceful and unhidden ways by Washington. This major change in the way American diplomacy is articulated and pursued, and diverging strategic stances between the US and the EU (take the case of Iran), brings about a quest in Europe for more room of manoeuver; one could call it 'policy sovereignty', or policy space.

But does Europe (the EU) have, or can it have, the policy space the US has? Nota bene: this question is not an implicit defence line of the new policy thrusts and forms across the Atlantic; instead, it does consider how security concerns may influence policy-makers when it comes to judging trade-offs between unimpeded markets and preserving competitive edges in key domains.

It may be that Europe (EU) is heavily disadvantaged in this regard, for:

- It is not a federal state, and its decision-making mechanisms are much more complicated, cumbersome;

- The euro is not a genuine rival for the USD in critical respects, and this is illustrated by the share of the American currency in world reserves and in world payments. More on this issue: could the EU create a rival payment system in view of the US dollar dominance in financial markets? In addition, as long as the euro area will continue to be crippled by a weak design and inadequate policy arrangements, is it hard to think that the euro can be a genuine rival to the USD

- Europe is the largest trading bloc in the world, but it is also fraught with currents of fragmentation and a growing divide between the North and South in the euro area, between West and East on issues such as immigration, the 'rule of law', how close the ties with the US should be.

Acquiring more 'policy space' is a commendable aim for EU policy-makers, but this has to be defined in realistic terms. Arguably, more policy space should not cause more confrontation areas with the US. Europe is too fragmented and weak internally to afford itself to fuel tense relations with Washington.

When it comes to defence, Europe (and this is felt in the eastern EU members states in particular) needs the US. The White House is playing its own cards, better or worse, but the US means more than the current administration. Take the issue of climate change to realize that this is the case. The bottom line is that for Europe to have more voice, power, and allies in a 'G-Zero' world (to use Ian Bremmer's formulation), it needs to deal with:

- A real reform of the euro area, with an adequate combination of risk-reduction and risk-sharing arrangements (including a euro area budget)

- But mutualisation of risks in the euro area leads to a huge political conundrum. Here one meets Dani Rodrik's trilemma, namely that there can be no integration (globalisation via a 'single market') in cohabitation with an autonomous economic policy and democratic accountability at national level; something must give up in this triumvirate[2].

  It is fair to argue that this trilemma simplifies things and that compromises can be found. And yet, it raises a formidable challenge to the euro area functioning unless financial integration is accompanied by policy arrangements and mechanisms that combat growing divergence between member states. For increasing divergence eats into the social fabric and fuels extremism, populism, euroscepticism.

- Reform the functioning the Single Market, which should make the European social model more inclusive (remember the *Monti Report* of 2010 and the *Sapir Report* of 2004)

- Foster a change in the way international financial institutions function, so that these do not lose their lustre due to newly formed (Asian, Chinese-backed) arrangements

- Accept that regional arrangements are probably inevitable in a polycentric world

- Europe's weight in the global economy diminishes inexorably for demographic and other reasons. For the soft power and the EU's voice in the world to be preserved, reforms are needed to strengthen it;

- Spend more to support new technologies projects; in artificial intelligence endeavours, Europe lags badly behind the US and China;

- There is need for a robust EU budget to fund EU public goods (security, defence of borders, fighting climate change, etc); it implies more resources including a rising share of own resources, as the HLGOR (High-Level Group on Own Resources) advocates.

- An effective immigration policy that should reconcile humanitarian concerns with the reality that Europe cannot become a shelter for all those who are fleeing ravaged countries. If this is not done in a balanced way the rise of extreme right parties will continue.

Having Europe (the EU) move forward along lines such as those mentioned above would help it get a larger 'policy space', more 'sovereignty'. Sovereignty is about a common purpose, unity, common projects, social cohesion and economic strength, inter alia.

When it comes to military, defence purposes, history shows that, when it comes to heavy lifting, the American friends (and their British cousins) are irreplaceable – at least for the foreseeable future. And I would remind what Robert Gates said years ago, that Europe should not bet on an everlasting American *"umbrella"* unless it is pays more for its defence needs. ■

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Endnotes

1. See also my piece "The new protectionism", World Commerce Review Volume 11, Issue 1, January 2017

2. Rodrik, D, "The inescapable trilemma of the world economy", personal blog, 27 June 2007.

A new vision for trade

The Foundation for European Progressive Studies present a vision that can form the core of a new, forward-looking progressive model for trade and investment

Over the last decades international trade has played an important role in promoting economic growth, job creation and better living standards at the global level. At the same time, international trade has been linked to a form of unregulated globalisation, causing uneven and unjust results for significant parts of our societies.

A key objective going forward must be forging a new consensus on trade and investment contingent on the principles of employment, broad-based prosperity, equality, transparency and sustainability. What follows presents a vision that can form the core of a new, forward-looking progressive model for trade and investment.

Changing nature of trade agreements

The focus of trade agreements has moved away from trade liberalisation to covering a range of trade-related issues, like investment liberalisation and protection, and intellectual property rights, with important social, economic and environmental repercussions.

We need to acknowledge and tackle the issues arising under these new types of economic agreements, in particular in relation to unregulated capital flows and investments. We also need to redress the often opaque manner, in which these comprehensive trade and investment agreements have been negotiated, often designed to advance the interests of those in the top income brackets.

Europe as a leader for a progressive agenda

To address these challenges, we believe that the EU must use its economic weight to advance a progressive trade and investment policy at the multilateral and the bilateral level. To achieve this goal, we propose an agenda that reinforces the multilateral trading system while improving its fairness for the poorest and enhancing Europe's contribution to trade and development.

Further, we propose to better integrate trade with labour and environment, and rethink investment and capital flows to advance sustainable development, as well as develop rules to govern the digital revolution and ensure the fairness of the intellectual property regime. To complement these elements of a new progressive vision of international trade governance, we propose the establishment of a new European fund to address the negative consequences of globalisation.

... the EU must use its economic weight to advance a progressive trade and investment policy at the multilateral and the bilateral level

Multilateralism

We see the multilateral trading system as the preferred option for building international rules on trade. Multilateralism is fairer with a wide diversity of strong and weak, big and small economies. It is more efficient in providing a stable and predictable environment to a maximum number of operators. For these reasons we believe states should conclude the negotiations on the Doha Development Agenda.

They should rebalance the specific trade disciplines that govern the agricultural sector that is currently tilted in favour of developed countries. They should also strengthen WTO disciplines in areas such as subsidisation, conduct a review of the 'special and differential treatment' principle in order to adapt to present realities, and modernise the WTO framework in areas of growing importance.

The EU's role on trade and development

The EU has an important role to play in its bilateral economic relationships, especially with developing countries. As part of the post-Cotonou negotiations, the EU must expand unilateral trade preferences and preferential treatment to all low-and lower middle-income countries in Sub-Saharan Africa, in order to support the region prioritising its own regional integration.

This would allow for the creation of jobs, increased incomes, and ultimately, to reduce poverty and aid dependency. To achieve SDG 2 on ending hunger, we need to *"correct and prevent trade restrictions and distortions in world agriculture markets."* Accordingly, further reform of the EU Common Agricultural Policy (CAP) will help achieve SDG 2. Finally, the EU must live up its commitments regarding Official Development Aid (ODA) in accordance with SDG 17.2.

Labour

All areas covered by trade and investment agreements impact employment and labour conditions. Trade policy must therefore play a vital role in encouraging and helping trade partners to implement ILO core labour standards. Parties must firmly commit to implementing core labour standards. Implementation and enforcement of core labour standards must be adapted to the partner country's level of development, and coupled with support.

Further, the comprehensive and effective involvement of social partners and civil society is essential for the successful execution of labour provisions in trade agreements. A progressive labour chapter should also provide a suitable framework for continuous and guided cooperation aimed at progressively advancing labour protection.

Finally, labour provisions should be complemented with traditional state-to-state dispute settlement as well as an innovative collective complaint procedure.

Environment

Trade and investment rules should not pose barriers to solving environmental challenges, such as climate change, biodiversity loss, and water scarcity. In the area of climate change, to avoid any potential regulatory chilling effect, states should clarify that strong, potentially disruptive, non-protectionist climate action is needed and is not prohibited under international trade and investment rules.

At the same time, trade rules should help discipline certain types of measures, such as fossil fuel subsidies. The design of climate measures with trade impacts, whether border carbon adjustments or other measures, must apply differential treatment and exemptions to exports from poor and middle-income countries whose CO_2 emissions per capita are low. Policy space for green industrial policies and green subsidies should be permitted, and agreements should be designed or adapted accordingly.

Investment

Most comprehensive trade agreements today include chapters and provisions on investment. These chapters have focused on investment protection, investment liberalisation, and investor-state disputes settlement. The focus of these treaties should be reoriented to promoting quality investment that advances SDGs.

First, the treaties should guarantee the policy space needed to regulate incoming and operating investments. The EU should accordingly re-examine and adapt its approach to pre-establishment and market access rules and the prohibition of performance requirements.

Second, EU treaties should ensure that investment protection provisions do not limit the state's legitimate right to regulate. Moreover, they should also be rebalanced to include not only investment protection but also responsibilities for investors, including with respect to responsible global value chains.

The EU should continue leading on reforming investment-related dispute settlement and explore alternatives to investor-state dispute settlement. EU member states should proceed with terminating and redesigning the over 1000 outdated investment treaties of EU member states.

Capital flows

In light of the increasing evidence in favour of regulating excessive capital flows to respond to concerns about macro-economic instability and major economic costs that external capital flows and ensuing currency crises may create, countries should use capital flow management measures alongside other macroeconomic policies. Many trade and investment agreements prohibit such capital account regulations or lack the appropriate safeguards on capital account management. This erosion of policy space to implement such policies must be avoided.

In future, neither the WTO, nor investment treaties and chapters in free trade agreements should contain provisions that limit an individual country's ability to freely manage its capital accounts and regulate capital flows.

If there are commitments to capital account liberalisation, appropriate and sufficient safeguards must be in place to allow countries to implement capital account regulations for prudential or balance of payments reasons, ideally on a permanent basis. Existing treaties should be promptly amended accordingly.

Digitalisation

Technological innovation is deeply interwoven in our globalised world. Fuelling cultural and economic exchanges, tech advancements spawned a global community, reaching the most remote regions of the world. Few economic or cultural realms lie outside the reach of technological innovation and some, like employment, grapple to reconcile old and new structures of social organisation.

Specific policies regarding digital trade, data flows, intellectual property rights, and net neutrality must embody and uphold democratic principles and a strong commitment to achieving the Sustainable Development Goals. This implies revising policies on data provisions, data localisation, research and development, national tax systems, the digital single market, and a reconsideration of investment screening mechanisms.

European Transformation Fund (ETF)

Ten years ago, the European Globalisation Adjustment Fund (EGF) was established to support victims of industrial transformation in Europe because of global economic changes. The EGF remains too modest in size and too narrow in focus given current needs. It must be redesigned both in terms of budget and scope.

For the EGF to be effective, the EU must conduct sound and transparent impact assessments before concluding new trade and investment agreements. This analysis should be as accurate as possible and identify the consequences and changes on different economic sectors and on European regions.

The new Globalization Adjustment Fund, to be renamed as the 'European Transformation Fund' (ETF), must be designed to support the restoration of an ambitious industrial policy, one based on permanent, prospective analysis of economic and technological changes, including the effects of trade, allowing for the necessary strategic investments to prevent negative consequences of trade and investment treaties in Europe.

To conclude, the traditional approach, which argues that 'trade is good, but we need to work on the side effects,' is outdated. In today's changing world, 'business as usual' does not work. We believe that in such a new context between the faithful and unconditional promoters of free trade and the populist critiques defending protectionist and nationalist visions of the world, there is a critical political space for progressive forces to defend a regulated vision of globalisation, a vision which guarantees that global trade and investment benefit the many and not the few. ■

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The Foundation for European Progressive Studies, (FEPS) is the only progressive think tank at European level

The future of the WTO: cooperation or confrontation

There is a danger of further escalation in the tariff war. André Wolf considers protectionism and the future of the World Trade Organization

The world in 2018 has witnessed a gradually intensifying trade conflict. It started with a series of threats and counter threats and ended in the imposition of retaliatory tariffs by the US on their trading partners (and vice versa). The worsened climate in international trade relations evokes the danger of a further escalation of the tariff war. In a world characterized by global supply chains, such an escalation could have highly disruptive effects on the structure of all major economies.

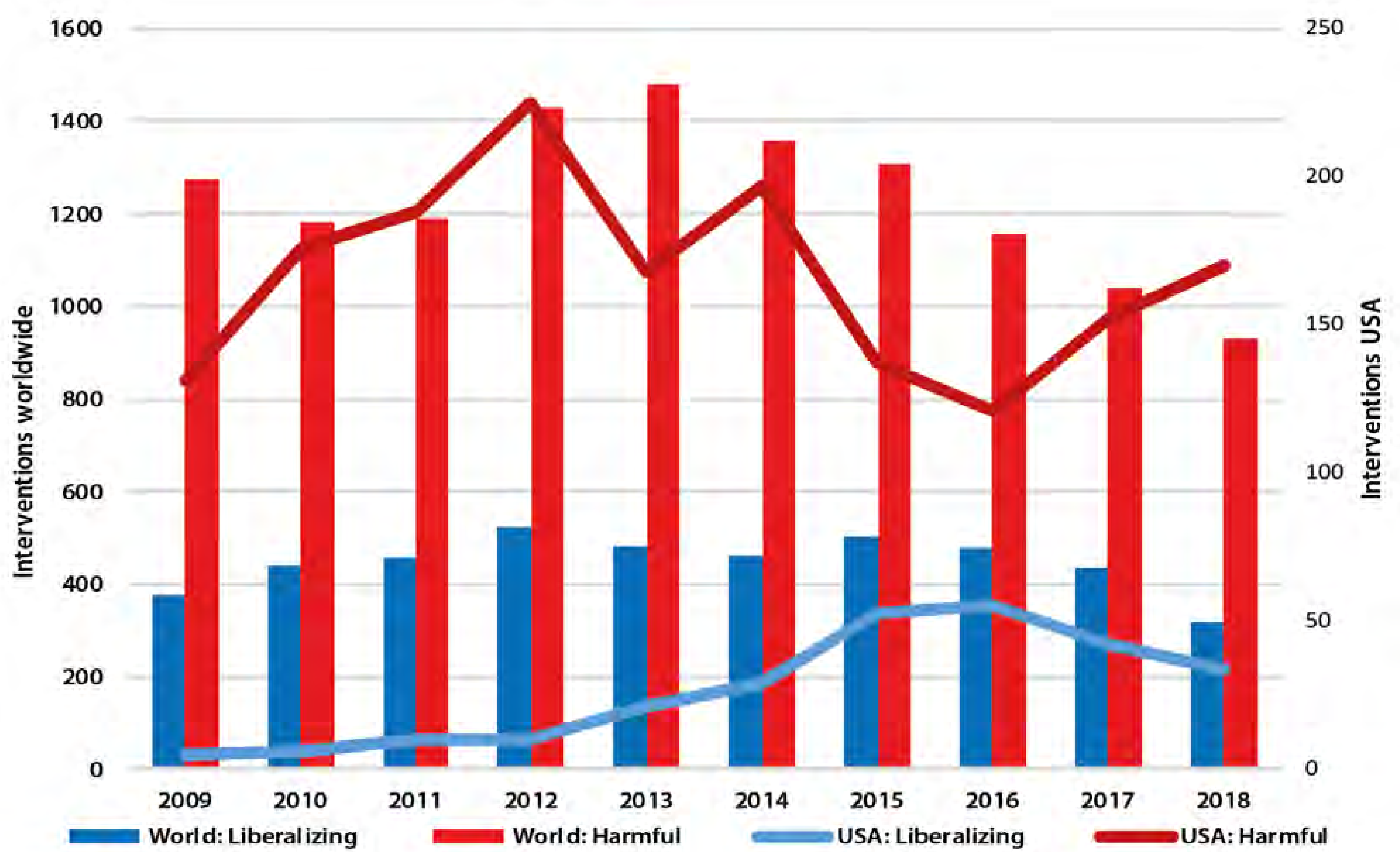
In addition to this visible threat, there are also more subtle factors indicating that protectionism is on the rise. The Global Trade Alert Initiative (GTAI) records the total amount of (tariff-based and non-tariff-based) policy interventions of a country designed either to liberalize or to inhibit cross-border trade.

At the global level, harmful interventions have clearly dominated over the past years, as can be seen in Figure 1. This also holds for the US during the years of the Obama Administration, putting the perceived change in the policy stance from Obama to Trump a bit into perspective.

Among the most popular harmful instruments were not tariffs, but subsidies and technical regulations favouring domestic firms, which indicates that governments increasingly turn to more hidden ways of shielding domestic markets from foreign competition.

At the same time, and in parts also as a reaction to protectionist tendencies in the major economies, the number of regional trade agreements has continued to rise in recent years. The scope of these agreements has widened further. They not only eliminate tariffs in intra-regional trade, but also liberalize trade in services and include far-reaching cooperation in regulatory issues.

Figure 1. Number of policy interventions



Source: GTAI (2018)

The share of international trade taking place under such deep agreements has risen significantly (UNCTAD, 2018). Regional agreements, however, are no substitute for trade liberalization at the global level, as the emergence of regional trade blocs has a distortionary impact on trade outside the integration area. Therefore, a multilateral answer to the current conflicts has to be given, asking for initiatives within the realm of the World Trade Organization (WTO).

It is now the prime responsibility of the leading economies to use this window of opportunity to enter into serious negotiations on the future of the WTO

Unfortunately, in this delicate situation, the WTO faces its biggest crisis yet. In general, the WTO performs three main functions for the global trade system: it provides a platform for multilateral trade talks, it monitors compliance with existing trade agreements and it offers member states the opportunity for dispute settlement.

By now, all three functions are subject to serious criticism. The ability of the WTO to promote far-reaching liberalization agreements seems to have declined continuously after the beginning of the Doha Development Round in 2001. A major reason for the lack of significant results is the irreconcilable confrontation between developed and developing member states on trade in agricultural and industrial goods.

While developed countries are reluctant to open their highly-subsidized domestic agriculture to foreign competition, developing countries are not willing to grant market access for industrial products from the developed world, insisting on their right to grow within a protected market environment.

Furthermore, many developing countries refuse to engage in talks about issues related to trade in services and the protection of intellectual property. Concerning the monitoring function, a lack of transparency with respect to non-tariff measures is bemoaned. Member states are obligated to notify the WTO Secretariat of any national laws and regulations that could represent obstacles to cross-border trade.

However, compliance is unsatisfactory, especially for measures with indirect influence on trade flows like subsidies to domestic firms. As these kinds of measures can potentially exert very distortionary impacts on trade flows, the current state of insufficient knowledge invites countries to undermine the global trade regime, thereby endangering the general willingness to engage in multilateral agreements.

Another point of contention in the heated debate concerns the role of the dispute settlement body. The appellate body, the body that hears appeals from the reports produced by dispute settlement panels, has melted down from its regular number of seven to just three judges. A blocking of the appointment of new judges by the US Administration has led to this situation.

The US view this as an act of protest against what they perceive as an over-stepping of authority on the part of the judges. They are accused of having interfered with national trade law on several occasions and of unnecessarily revisiting factual findings of previous panels, contributing to a prolongation of proceedings.

Moreover, the US put the general need for an appellate body in dispute settlement into question, arguing that it renders the whole process inefficient. They even threaten to ignore any rulings that haven't been issued within the formally required time span of 90 days.

Finally, one general source of discontent is the increasing imbalance caused by the high share of member states with 'developing country' status. About two thirds of the WTO's 164 member states currently claim this status.

It is associated with a range of privileges, above all an exemption from the principle of reciprocity, ie. developing countries which are granted better market access by developed countries are not obliged to make equivalent concessions. Other forms of preferential treatment include additional time to fulfill certain commitments and the provision of legal assistance in WTO disputes by the WTO Secretariat. A major issue is that this status is not granted based on any transparent set of indicators, but on self-assessment of a country.

Therefore, these otherwise reasonable provisions increasingly undermine the coherence of the trading system, by creating incentives to circumvent its basic principles. Particular controversy surrounds the maintenance of the developing country status of China. The justification expressed by Chinese officials is that despite persistently high rates of economic growth, the country is in many of its regions still characterized by a lack of modern infrastructure and innovation capacities.

By contrast, the US Administration simply regards this state as a means to protect China's unfair trade practices. Threatening countries to withdraw their status, however, is likely to destroy further confidence in the fairness of WTO rule in the developing world.

Dissatisfaction with the current system has risen to an extent that the US government not only takes unilateral actions that more or less openly violate existing agreements. President Trump even contemplates about officially leaving the WTO, if no structural reforms are carried out soon.

In this situation, the European Union (EU) has decided to put the American willingness to cooperate to a test by coming forward with an own reform agenda for the WTO, picking up many issues addressed by the US. On September 18th the European Commission issued a corresponding concept paper. It contains a list of concrete reform proposals. In order to increase transparency, incentives for member states to deliver all the necessary information on policy measures shall be improved.

For instance, a new measure showing features of a subsidy could be automatically treated as a subsidy under WTO terms, leaving the responsibility to prove the opposite to the government. Moreover, the scope of trade policies covered is proposed to be extended to areas like digital services and ecommerce as well as to the conflictual topic of forced technology transfer.

To bring back dynamics to multilateral negotiations, the role of the WTO Secretariat is suggested to be strengthened, allowing it to seize the initiative in preparing future talks.

Finally, the commission stresses the need for plurilateral initiatives, ie. agreements between subgroups of WTO members under the umbrella of the general WTO framework, to set the pace for a deepening of trade relations (EU, 2018). As opposed to regional free trade agreements negotiated outside the WTO, these initiatives remain open for all WTO members to join, thereby preventing the formation of trade blocs.

In case of open initiatives like the International Technology Agreement (ITA), the benefits are even extended to non-signatories. The hope is that these initiatives can act as laboratories to test new forms of cooperation among WTO members, providing a boost to multilateralism by inducing more and more countries to join successful initiatives.

At a ministerial meeting held in Ottawa on October 23rd and 24th, a broad alliance to back the EU proposals seems to have emerged. It consists apart from the European Union of 12 WTO member states, including big economies like Japan and Brazil. In the Joint Communiqué, they stress their belief in the necessity of a rules-based multilateral trading system, a statement directed against the unilateral approach of the US.

In this, they regard the dispute settlement system as a central pillar, asking US representatives to stop their blockage of a reappointment of judges. At the same time, they call for a revitalization of the negotiating function of the WTO in order to overcome the current stalemate in the Doha Round (WTO, 2018).

However, under the current regime, any general reform of the system requires unanimous consent of WTO members. This makes it particularly difficult to implement changes to the status quo. Nevertheless, if there is one good thing about the recent tensions, then it is the fact that they finally made the urgent need for structural reform obvious to everyone.

It is now the prime responsibility of the leading economies to use this window of opportunity to enter into serious negotiations on the future of the WTO. The proposals made by the EU Commission can serve as a reasonable basis for this. The success of this venture will crucially depend on whether both the US and the large group of developing countries will be brought on board.

This is the more likely, the less exclusive opportunities for intensified cooperation within a new framework will appear to be. Higher transparency of negotiation processes as well as a stronger involvement of societal pressure groups are equally necessary to achieve some form of consensus on the future organization of global trade. ■

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First digital debates on world trade reform begin on Global Dialogue on Trade platform

ICC, supported by the WTO, OECD and regional development banks, has launched a digital dialogue on the multilateral trading system

The International Chamber of Commerce, supported by the World Trade Organization (WTO), the Organisation for Economic Co-operation and Development (OECD) and regional development banks has launched the first digitally-enabled dialogue on the future of the multilateral trading system, allowing companies, multilateral institutions, think tanks and academics to join the ongoing debate on world trade reform.

The initiative – digitally enabled and managed by ICC – convenes open dialogue among multilateral institutions, think tanks and businesses from around the world.

Launched by Roberto Azevêdo, Director General of the World Trade Organization (WTO) and John WH Denton AO, Secretary General of the International Chamber of Commerce at the World Bank and International Monetary Fund annual meetings in Bali, Indonesia on 10 October 2018, the new Global Dialogue on Trade platform will provide concrete support to the on-going intergovernmental approach to improving the multilateral rules-based trade system.

ICC Secretary General John WH Denton AO said:

> *"The business community is at the forefront of international commerce and should contribute to shaping the rules that govern cross-border trade. The Global Dialogue on Trade, enables business to be a constructive partner to the on-going intergovernmental negotiations through actionable recommendations on reform.*

The digital platform provides an unprecedented opportunity for users of the multilateral rules-based trading system to drive positive change and ensure that solutions proposed to make the system fit-for-purpose are heard."

Following its launch, over 75 suggested themes for debate were submitted to the Global Dialogue on Trade platform. Discussions officially started on 22 November, kicking off the first-ever digital debate on world trade reform.

The submitted themes were whittled down into three initial debate questions that now form the structure of the Global Dialogue:

(1) How to deal with trade distorting practices?

(2) How to take account of the growing importance of e-commerce to global trade? And

(3) Flexible multilateralism: what role for plurilaterals and other negotiating tools?

Since the Global Dialogue on Trade was announced, momentum has been building around the future of the rules-based multilateral trading system. Government leaders have met regularly in past months to set a roadmap for world trade reform, and several WTO members have already put forward proposals for change.

Recognising the fundamental role that rules-based trade has played in delivering global economic gains for decades, the Global Dialogue on Trade was designed to open up these discussions to a full range of stakeholders, particularly business—the users of the rules-based multilateral trading system.

Following the debates on the platform, recommendations for reform will channel into the on-going intergovernmental processes and will be made publicly available on the platform at:

www.globaldialogueontrade.org

Follow the Global Dialogue on Trade on Twitter at @DialogueOnTrade

Geotechnology meets geopolitics

Stephen Nagy examines China's geotechnology strategy and its relationship to the Sino-US artificial intelligence rivalry

The geopolitical rivalry between the US and China has expanded into the geotechnological realm. The race for AI dominance and digital economic sovereignty, including the development of ultrafast 5G mobile systems and automation has the potential to dramatically reshape the global balance of power.

The winner will be able to write the protocols for a new internet (intranet), laying the foundations for the next technological revolution and subsequent digital economic era. It will also have a determining role on reconfiguring the security architecture and dominance by the US in East Asia.

China views AI dominance at four levels: 1) national development strategy; 2) domestic stability; 3) political longevity and sustainability; and 4) international security. To accomplish these four objectives, China is developing a closed intranet system that enables the government to monitor all aspects of digital behaviour through metadata gathering, expansive CCTV monitoring and merging that data with AI's capacity to map out trends, behaviour patterns and to identify people through facial recognition technologies.

This article examines China's geotechnology strategy and its relationship to the Sino-US artificial intelligence (AI) rivalry. Through highlighting the central role AI plays in China's national development strategy, this article hopes to shed light on the implications of Sino-US AI competition for the region and global order. It concludes that AI rivalry between the US and China has the potential to result into two independent digital economies, a Chinese-based, closed intranet system and a non-Chinese-based, open internet system.

The implications are clear, the bifurcation of the global economy into two digital economies will result in the duplication of production networks. This will increase the costs for businesses with global reach.

AI and national development strategy

With access to the metadata of at least one billion digital citizens engaging in uncountable daily digit activities, China has and is accumulating vast amounts of metadata to develop, refine and deploy its AI systems to achieve its strategic objectives. Examining first how AI dominance is related to national development strategies, based on China's *Made in China 2025*/ 中国制造 *2025/Zhōngguó zhìzào 2025*[1] strategy, China aims to become the world's leading manufacturer of telecommunication, railway and electrical power equipment by 2025 (State Council, 2018).

Much will depend on the outcome of the current trade war and whether China will accept US demands to open its market, stop IPR theft, forced technology transfer and reform of state-owned enterprises

The Center for Strategic and International Studies' (CSIS) Scott Kennedy suggests that the 2025 *Made in China* strategy also includes a focus *"on the entire manufacturing process and not just innovation, the promotion of the development of not only advanced industries, but traditional industries and modern services while maintaining a focus on state involvement with market mechanisms are more prominent than in SEI"* (CSIS, 2015).

He also argues that *"there are clear and specific measures for innovation, quality, intelligent manufacturing, and green production, with benchmarks identified for 2013 and 2015 and goals set for 2020 and 2025"* (Ibid).

Successfully achieving first mover status in the AI-based digital economy through the *Made in China 2025* initiative[2], China may be able to transitions its economy away from heavy manufacturing towards high technology, services and robotics enabling it to shift away from complete the transition away from its current economic growth model. As of November 2018, China's total GDP is approximately 40% of the GDP being generated by the manufacturing sector and 51.6% of GDP being generated by the services sector.

Comparing to countries within the region, this figure is less than South Korea at 60%, Japan at 70% and other East Asian economies in the service sector. It should be noted that both in terms of quality and scale of service sector jobs being created, there are concerns that neither meets the trajectory needed to escape the middle-income trap (Cai, 2012).

With that in mind, policy makers in Zhongnanhai are cognizant of the role of being the first mover an AI-based digital economy would be in transitioning the Chinese economy towards sustainable high quality technological-based growth. Succinctly, it would allow China to leapfrog its economic development allowing the CCP leadership to achieve twin goals of realizing *"socialist modernization"* by 2035 and to *"have built a modern socialist country that is strong, prosperous, democratic, culturally advanced, and harmonious"* by 2049.

AI and domestic stability

Following the removal of term limits at the 19th Party Congress in October 2017, President Xi Jinping and the CCP have stepped up efforts to deploy AI-based technologies to foster social cohesion based on a social credit system (Brehm, Stefan, and Loubere. 2018).

To elaborate, AI-based technology working synergistically with ubiquitous CCTV cameras and the WeChat or WeChat-related applications allows the central government to monitor, track and reward or penalize public and private behaviour that the authorities of the CCP consider incompatible with CCP's *China Dream* and socialism with Chinese characteristics objectives, as formulated in Xi Jinping's *Thought on Socialism with Chinese Characteristics for a New Era*.

This kind of Orwellian monitoring has serious implications for those contemplating action against the authorities. First, the pervasive social monitoring through AI-based technologies means that the CCP can assign digital and non-digital citizens a fluid social credit score that fluctuates depending on whether the citizen in questions is in obedience with rules and regulations stipulated by the CCP. Those that are in line with rules and regulations receive higher social credit scores and subsequently preferred access to various social welfare privileges issued by the Central government (Cheung and Chen, 2018). Conversely, those that consistently engage in behaviour that the CPP designates as not sociably desirable have lower social credit scores.

The consequences can be severe for those with low social credit. For example, low social credit citizens may not be able to get a loan, buy train or airplane tickets or access other social welfare benefits provided by the state. As of 2018, scholars researching AI and social credit in China find that it is *"complicated system that focuses primarily on financial and commercial activities rather than political ones"* (Liang, Das, Kostyuk, and Hussain, 2018).

In short, AI-based technology consolidates domestic stability by forcing citizens to behave in ways that the state deems in accordance with China's national objectives and priorities.

AI and political longevity and sustainability

Leaders in China have reflected on the Chinese civilization's history and critical junctures that have led to dynastic transitions in the past that resulted in civil war, warlordism, institutional decay and most recently the so-called *"century of humiliation"* under foreign powers. Their take home message from this historical reflection is that when was China strong, prosperous and stable it had a strong central governing institution.

With the above lessons of history in mind, the leaders of Zhongnanhai understand AI-based social surveillance and social credit system as a tool to preserve a strong centralized governing body, while at the same time securing the CCP's own position as the sole and central governing body of China. AI technology allows the CCP to increase its role in all aspects of Chinese society and thereby consolidate its position as the singular organizing body in modern China.

By virtue of being in all aspects of Chinese society, the CCP has realized the French philosopher Michel Foucault's panopticon written about in his monograph *Discipline and Punish* in which the political, social and economic behaviour of Chinese citizens is being modified to fit the desired mold of those in power, the CCP.

In the Chinese case, AI and surveillance technologies ensure that no countervailing political currents take root in the Chinese political context, nor does information that the CCP deems counter to its national narrative have a conduit for transmission to is citizens. Technological dominance ensures that the CPP controls how citizens think about politics and governance through censorship, through selective access to history, news narratives and to existing disunity in China regarding governance and the optimal form of governance for China.

Illustrative examples of this distorting effect on historical and news narratives are plentiful. For example, following the Umbrella Movement in Hong Kong that was attempting to secure the one-country, two-systems model and to ensure that Hong Kong citizens could choose their own political leaders as agreed upon in the Joint Declaration when Hong Kong was reunified with Mainland China.

The narrative in Mainland China about the movement was one that focused on a separatism movement. While a very small minority did advocate independence, the Umbrella Movement and the post-movement sentiment in Hong Kong was neither about independence or separatism, it continued to focus on maintaining the robust one-country, two systems agreement.

The same can be said about shaping how Chinese citizens view democracy, interventionism and human rights. Domestic portrayals of US politics focus on the mercurial leadership of President Trump, how split government and partisanship make for ineffective government, etc.

Foucault's panopticon with Chinese characteristics will no doubt strengthen social control and reduce political descent in Mainland China, consolidating politico-social control ensuring that the CCP's rule is as sustainable as it is long lived.

AI and international security

While much of China's focus on AI is domestically oriented, there is an important international dimension that focuses on the economy and military security in China's periphery and globally. Economy (2018), Deutch (2018) and Li (2018) view China's AI push through the lens of 'China's new revolution', 'China's New Great Leap Forward', or as 'Industry 4.0' respectively. Each stress that China views AI domination as critical to China's economic stability, autonomy and sustainability.

Importantly, China's quest for AI dominance in the digital economic arena has the end goal of ensuring the Chinese economy is 'open' to outside investors based on China's understanding of cyber-sovereignty (Segal, 2018). This means investors and businesses wishing to enter the Chinese market will have to accept the conditions, protocols and regulations of a Chinese closed digital economy. This may include a closed digital platform that does not protect privacy, IPR or it may demand that all digital information be localized making its use by a non-Chinese firm invasive and risky. Future prospects of securing these guarantees are low as the CCP increases its role in all aspects of Chinese society.

Another important consequence for businesses and the global production network of this closed digital system is its impact on supply chains, transaction costs and businesses and allies being forced to choose between a China-based closed digital platform and a non-Chinese (US) led open platform.

It is conceivable as the Sino-US rivalry deepens that the US may demand allies and its own businesses to eschew doing business with China as part of a broader strategy to constrain China's economic growth and technological edge through first mover digital hegemony.

In the security realm, digital hegemony has consequential advantages for securing China's core interests that were outlined in the whitepaper *China's Peaceful Development 2011* which stress 1) state sovereignty; 2) national security;

3) territorial integrity; 4) national reunification; 5) China's political system established by the Constitution and overall social stability; 6) basic safeguards for ensuring sustainable economic and social development.

If China is the first mover in the AI revolution it will be able to furbish its existing anti-access/anti-denial missile systems (A2/AD) with AI technologies that will enhance their ability to evade US naval and other capabilities in China's periphery. This would erode many of the US security assets within the region, weaken the US extended deterrence and raison d'être of the existing alliances in the region.

At the same time, AI equipped A2/AD systems would significantly increase the costs (Johnson and Johnson, 2018) of a conflict with China and compel the US to locate its naval assets far beyond the first island chain. The consequences on for the US security guarantees and ability to freely navigate the ECS and SCS would be immediate and likely usher in a Chinese version of the Monroe Doctrine with China having exclusive control over both the ECS and SCS.

Sino-US geotechnology rivalry: from competition to cooperation?

The race for AI hegemony and dominance of the emerging digital economy is currently characterized by competition and a zero-sum outcome. The question remains is China and the US can move this race away from a zero-sum equation to a win-win equation characterized by cooperation? If they cannot, the outcome of the competition will be extremely disruptive on the regional and global economy as well as the US guaranteed East Asian security architecture.

Much will depend on the outcome of the current trade war and whether China will accept US demands to open its market, stop IPR theft, forced technology transfer and reform of state-owned enterprises (SoEs).

As this article stresses throughout, first mover status in the AI domain is not just about economic development but also social stability and cementing the CCP's position as the central and permanent governing organization in China. As a result, we should not expect China to back down in the trade war or its quest for AI hegemony. ■

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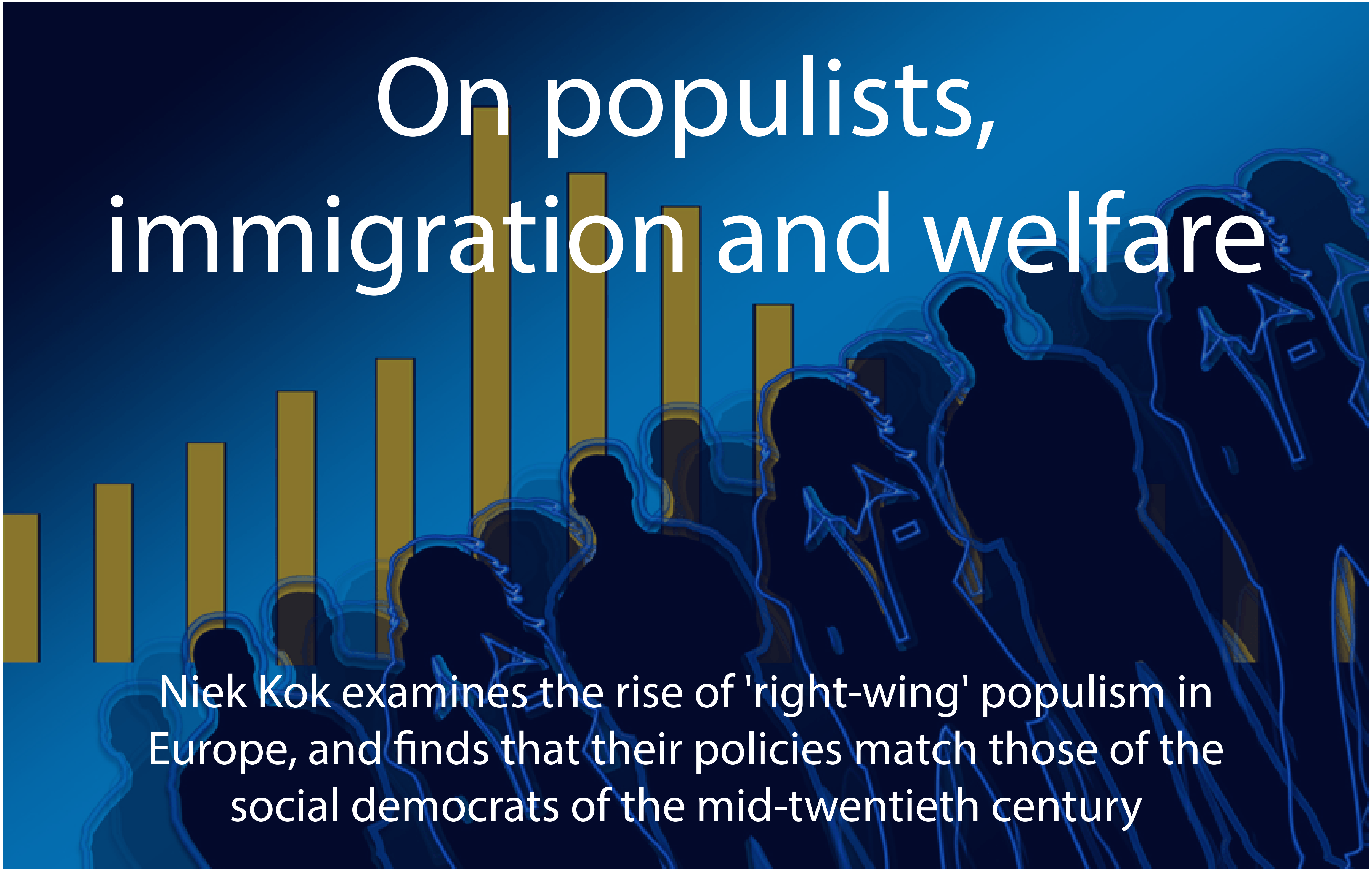

On populists, immigration and welfare

Niek Kok examines the rise of 'right-wing' populism in Europe, and finds that their policies match those of the social democrats of the mid-twentieth century

In her book *For a Left Populism* (2018), the political philosopher Chantal Mouffe argued for a 'left-wing populism' to counter the rising support for right-wing populists. Mouffe has observed that what makes most current European populist parties right-wing is their xenophobic character.

She refers to parties such as the Danish People's Party (DPP), the Sweden Democrats (SD), the Dutch Party for Freedom (PVV) and the Freedom Party of Austria (FPÖ). These parties present immigrants as a threat to the identity of what they claim to be 'the people'.

Indeed, most European populists (admittedly, an analytically often ill-defined category) share a preference for restrictionist immigration policies. But most of them also start to make political arguments in line with welfare statism and, though to a lesser extent, trade protectionism. All of these policy preferences were a part of traditional social democratic thought from the 1930s to the 1970s onwards.

Undoubtedly, the populist emphasis is on anti-immigration whereas traditional social democracy puts the accent on the welfare state. Still, comparing the views on the welfare state and immigration of the 'right-wing' populist of today with the traditional social democrat yields interesting parallels.

I argue that this begs the question if it makes sense at all to label the aforementioned political parties *right-wing* – and if they are, in a sense, not simply best compared to traditional working class parties that advocated welfare statism and, as a result, welfare protectionism.

What the populist says

Populists have been said to distinguish an 'us, the pure people' from a 'them, the corrupt elites'. They present themselves as leaders embodying 'the people's true interests'. Political analysts find that this discursive strategy is used by most European populists such as the Dutchman Geert Wilders or the Swede Jimmie Åkesson – as well as by President Donald Trump, who is sometimes deemed a populist as well.

Interestingly, these three politicians share similar views on immigration, but also adopt similar welfare chauvinistic views. Åkesson, for instance, presents politics as a dichotomous choice between mass immigration and welfare. In his view, you cannot have both. Trump repeatedly called for renegotiated trade deals and a reduction in immigration as a way to promote working-class economic security. And Wilders reportedly opposed attempts by

Chantal Mouffe has called for a left-wing populism. But in a way, the supposedly right-wing populists are already quite leftish the Dutch government to slash funding for health care and other welfare state programs after *"his criticism of Islam and immigration turned out to do very well with less educated voters"*.

Many contemporary populists lament the idea of immigrants coming to the 'fully laid table' of the welfare state and grieve that *"people who have not contributed throughout a lifetime with their labour, taxes and socially useful activities are allowed to enjoy common benefits as free riders"*.

It remains unclear whether populist parties adopt a protectionist approach to welfare to attract working class voters or whether they adopted this approach only after attracting the vote of the working class. What is clear, however, is that populist parties are increasingly attracting support from voters who, speaking for European politics at least, traditionally supported social democratic politics.

As Mouffe has argued, so called populists like Åkesson, Trump and Wilders are deemed right-wing because they favour strict immigration policies. I would argue that this is a rather limited view. Contemporary anti-immigration parties are using the welfare state as an argument *for* restrictionism.

The traditional European left also favoured anti-immigration policies to protect the welfare state. This is because of a conceptual congruence between the welfare state, a strict immigration policy and even trade protectionism. The history of social democratic ideas shows that these policies are likely to go hand-in-hand.

Traditional social democrats and the anti-immigration cause

Looking at the history of welfare statist ideas in Europe, we find very strong *ideological congruence* between support for the welfare state and restrictionist immigration policies. The reason for this is that a restrictionist immigration policy conceptually follows from the idea of the welfare state.

In a much-cited article, the political scientist Gary Freeman noted that national welfare states *"are compelled by their logic to be closed systems that seek to insulate themselves from external pressures and that restrict rights and benefits to members"*. The welfare state presupposes a bounded group of people that distribute welfare amongst themselves – and not with outsiders.

This 'logic of the welfare state' stems from the idea that only those individuals who have contributed to its system may temporarily fall back on its benefits in times of unemployment or, for instance, for old age pensions. William Beveridge (1879-1963), a British economist and member of the Liberal Party, best known for his report *Social Insurance and Allied Services* (1942) which outlined the contours for the British welfare state, wrote that there is no absolute right to welfare benefits.

Citizens only have a right to welfare benefits in virtue of the contributions they have made to the welfare state. In other words, the solidarity of welfare programs exist for those who have contributed. Foreigners, as well as anyone who does not contribute, can thus not be said to have a right to welfare benefits – they can acquire it only until after they have made contributions.

Beveridge already foresaw that exclusive rights to welfare benefits in one country would be problematic in a world in which people could freely move from one country to another. What would happen to acquired, individual social rights as soon as individuals would move to another country?

Beveridge proposed that, in due time, different countries should arrange possibilities for transfers of individual rights to welfare from one country to the other, *"enabling men on migration to avoid forfeiting security and allowing them to carry with them some of the rights that they have acquired in their former country,"* Beveridge wrote.

The receiving country could, or so seems to have been Beveridge's assumption, not be expected to provide welfare for newcomers who had never contributed. One could only have a right to as much as one had contributed at home.

At the end of the 1940s, several British Labour politicians already foresaw the problem mass immigration could pose to social and economic security. On the 22nd of June 1948, they wrote a letter to Prime Minister Attlee, suggesting "*that the British Government should, like foreign countries, the dominions and even some of the colonies, by legislation if necessary, control immigration in the political, social, economic and fiscal interests of our people*".

These politicians thus called for a restrictionist immigration policy to prevent mass immigration in the future. Back then, their argument was not all too controversial. But when in 2007 Labour minister Margaret Hodge had the very same insight and argued that giving council housing to newly arrived immigrants undermined Beveridge's idea that welfare should reward individuals who paid into the system, she was heavily criticized for using the language of the 'far-right'.

Hodge's argument was, however, an argument congruent with traditional social democratic ideas. Mid-twentieth century European social democrats realized that citizens would only *want to* contribute if there was solidarity amongst them. And solidarity is more easily achieved in a homogenous society: one in which citizens feel like they are all part of the same family.

Concerns about immigration by the traditional Swedish and Dutch left

The Swedish ideologist and economist Gunnar Myrdal (1898-1987) expressed this exact notion. He explicitly linked welfare rights with nationalism and the 'commonness' of the people. Myrdal was acutely aware that the welfare state in Western countries is, as he wrote, by necessity, *protectionist* and *nationalistic*.

"The peoples in those countries have achieved economic welfare at home – economic progress and a substantial increase in liberty and equality of opportunity for all within their boundaries – at the expense of indulging in nationalistic economic policies". Myrdal moreover attested that the supporters of the welfare state are naturally of *"the inclination to take defensive action against the repercussions of the international crises in order to preserve stability and welfare at home"*.

All in all, a welfare state flourishes through the people's homogeneity and economic stability. The successive Swedish social democratic prime ministers Per Albin Hansson (1936-1946) and Tage Erlander (1946-1969) based their welfare state ideology on these ideas (Myrdal served as minister for commerce between 1945 and 1947 under both prime ministers).

Hansson introduced the famous Swedish notion of *folkhemmet*, which expresses the welfare state as a home for the people. Welfare statism required the Swedes to view each other as a single, large family. Hansson argued that the basis of the Swedish welfare state was the commonality and mutuality of its people. The idea of *folkhemmet* led his government to adopt strict immigration policies and assimilatory integration policies, as ethnic differences collided with the social democratic interest in building up a welfare state.

Folkhemmet excluded non-Swedes on both biological and cultural grounds. Hansson's successor, Erlander, continued his policies. In 1965, he compared Sweden to the United States, observing that *"We Swedes live in an infinitely happier condition. The population of our country is homogenous, not only in regards to race but also in many other aspects".*

The same ideological congruence between welfare statism and restrictionist immigration policies can be said to have been part of the Dutch social democratic ideology in the 1950s. From 1948 until 1958, the social democrat

Willem Drees was the Dutch prime minister. In this role and as minister for Social Affairs, he became known for having laid the foundations for the Dutch welfare state.

Drees, too, was aware of the danger of mass immigration to Dutch social and economic security. At one point, he even advocated a proactive emigration policy, as in his eyes the Netherlands started to become too full. He held these views throughout his lifetime.

In 1977, when Drees had long left politics, the Dutch newspaper *De Telegraaf* reported that Drees had strongly criticized the immigration policies of the later social democratic cabinet of prime minister Den Uyl, which had allowed the free settlements of many Surinamese, Turkish and Moroccan immigrants in the Netherlands.

Recalling the image of Drees' leadership is rather fitting in the context of *folkhemmet* and populism: paralleling the populist idea of a leader representing the people's interests and the *folkhemmet* idea of the people as a family, Drees was nicknamed Father Drees. Deeming a political leader to be a fatherly figure attests to a rather deep bond between him and his supporters – and it fits neatly into the analytical framework of populism proposed by many present-day political scientists.

Conclusion

In the 1970s, traditional social democratic views on immigration started to shift. New social democratic leaders such as Olof Palme in Sweden and Joop den Uyl in the Netherlands started to approve of multiculturalist policies and allowed for more foreign influx in their respective countries. But the parallel of their predecessors with contemporary so-called populists remain – and on top of that, their predecessors and contemporary populists appear to have the same voting base.

"[S]ocial democratic parties have in most countries identified themselves more or less exclusively with the middle classes, and that they have stopped representing the interests of the popular sectors – whose demands are considered archaic or retrograde," Chantal Mouffe writes. Much of the support for the traditional left has shifted toward what is called the 'far right'.

But besides the ideological congruence between welfare statism and restrictionist immigration, the observation that many left-wing voters now vote for 'far-right' parties begs the question: why should we so explicitly associate populists like Jimmie Åkesson and Geert Wilders with the right-wing?

In many respects, these politicians advocate the same ideas as the social democrats of the mid-twentieth century – except for a more explicit anti-immigration emphasis. Chantal Mouffe has called for a left-wing populism. But in a way, the supposedly right-wing populists are already quite leftish. ■

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Why a new multilateralism now?

History suggests that an economic downturn lurks somewhere over the horizon. David Lipton believes that with ingenuity and international cooperation we can create a shared and sustained prosperity

Having just passed the 10th anniversary of the start of the Global Financial Crisis, and now looking forward, I'd like to address what I see as a key topic: the next financial crisis. History suggests that an economic downturn lurks somewhere over the horizon. Many are already speculating as to exactly when, where, and why it might arise. While we can't know all that, we ought to be focusing right now on how to forestall its arrival and how to limit it to a 'garden variety' recession when it arrives—meaning, how to avoid creating another systemic crisis.

Over the past two years, the IMF has called on governments to put in place policies aimed at just that goal—as we have put it, *"fix the roof while the sun shines."* But like many of you, I see storm clouds building, and fear the work on crisis prevention is incomplete.

Before asking what should be done, let's analyze whether the international community has the wherewithal to respond to the next crisis, should it occur. And here I mean both individual countries, and the international organizations tasked to act as first responders. Should we be confident that the resources, policy instruments, and regulatory frameworks at our disposal will prove potent enough to counter and contain the next recession? Consider the main policy options.

Policy options for the next recession

On monetary policy, much has been said about whether central banks will be able to respond to a deep or prolonged downturn. For example, past US recessions have been met with 500 basis points or more of easing by the Fed. With policy rates so low at present in so many places, that response will not be available. Central banks would likely end up exploring ever more unconventional measures. But with their effectiveness uncertain, we ought to be concerned about the potency of monetary policy.

We read every day that for fiscal policy, the room for manoeuvre has been narrowing in many countries. Public debt has risen and, in many countries, deficits remain too high to stabilize or reduce debt. Now to be fair, we can presume that if the next slowdown creates unemployment and slack, multipliers will grow larger, likely restoring some potency to fiscal policy, even at high debt levels. But we should not expect governments to end up with the ample space to respond to a downturn that they had ten years ago. Moreover, with high sovereign debt levels, decisions to adopt stimulus may be a hard sell politically.

Given the enduring public resentments borne by the Global Financial Crisis, a recession deep enough to endanger the finances of homeowners or small businesses would likely lead to a strong political call to help relieve debt burdens. That could further stress already stretched public finances.

Working together, we will be better able to prevent a damaging downturn in the coming years and a dystopian future in the coming decades

And if recession once again impairs banks, the recourse to bailouts is now limited in law, following financial regulatory reforms that call for bail-ins of owners and lenders. Those new systems for bail-ins remain underfunded and untested.

Finally, the impairment of key US capital markets during the global financial crisis, which might have produced crippling spillovers across the globe, was robustly contained by unorthodox Fed action supported by Treasury backstop funding. That capacity is also unlikely to be readily available again.

The point is that national policy options and public financial resources may be much more constrained than in the past. The right lesson to take from that possibility is for each country to be much more careful to sustain growth, to limit vulnerabilities, and to prepare for whatever may come.

But the reality is that many countries are not pursuing policies that will bolster their growth in a sustainable fashion. The expansion actually has become less balanced across regions over the past year, and we are witnessing a buildup of vulnerabilities: higher sovereign and corporate debt, tighter financial conditions, incomplete reform efforts, and rising geopolitical tensions.

Five key policy challenges

So, let me turn to five key challenges that could affect the next downturn—areas where governments face a choice to take proactive steps now, or not, and where inaction would probably make matters worse.

The first challenge is the simple and familiar admonition: *"First, do no harm."* This is worthy advice for doctors and economic policymakers. Let me mention some examples.

In the case of US fiscal policy over the past year, the combination of spending increases and tax cuts was intended to provide a shot of adrenalin to the US economy and improve investment incentives. However, coming at a time when advanced recovery meant little need for stimulus, this choice runs the three risks of increasing the potential need for Fed tightening; raising deficits and public debt; and spending resources that might better be put aside to combat the next downturn.

Another example is the recent escalation of tariffs and trade tensions. Fortunately, the US and China agreed in Buenos Aires to call a ceasefire. That was a positive development. There certainly are shortcomings in the global trading system, and countries experiencing disruption from trade have some legitimate concerns about a number of trade practices. But the only safe way to address these issues is through dialogue and cooperation.

The IMF has been advocating de-escalation and dialogue for some time. That is because the alternative is hard to contemplate. We estimate that if all of the tariffs that have been threatened are put in place, as much as three-quarters of a percent of global GDP would be lost by 2020. That would be a self-inflicted wound.

So it is vital that this ceasefire leads to a durable agreement that avoids an intensification or spread of tensions.

Now to the second challenge, which is closely tied to the trade issue: China's emergence as an economic powerhouse. In many ways, this is one of the success stories of our era, showing that global integration can lead to rapid growth, poverty elimination, and new global supply chains lifting up other countries.

But as Winston Churchill once said of the US during World War II, *"the price of greatness is responsibility."*

China's global role

Chinese policies that may have been globally inconsequential and thus acceptable when China joined the WTO and had a $1 trillion economy are now consequential to much of the world. That's because China now is a globally integrated $13 trillion economy whose actions have global reverberations. If China is to continue to benefit from globalization and support the aspirations of developing countries, it will need to focus on how to limit adverse spillovers from its own policies and invest in ensuring that globalization can be sustainable.

Moreover, China would likely gain at home by addressing many of the policy issues that have been contentious, for example through:

- stronger protections for intellectual property, which will benefit China as it becomes a world leader in technologies;
- reduced trade barriers, especially related to investment rules and government procurement procedures, which will produce cost-reducing and productivity enhancing competition that will benefit the Chinese people in the long run;
- and an acceleration of market-oriented economic reforms that will help China make more efficient use of scarce resources.

This notion of global responsibility applies to Europe as well, and this is the third challenge. Our forecasts show growth in the euro area and the UK falling short of previous projections, and modest potential growth going forward.

The future of the European economy will be shaped by the way the EU addresses its architectural and macroeconomic challenges and by Brexit. The recent EMU agreement on reforms is welcome. Going forward, the euro area would gain by pushing further to shore up its institutional foundations. The absence of a common fiscal policy limits Europe's ability to share risks and respond to shocks that can radiate through its financial system. And crisis response will be constrained because too much power remains vested in national regulators and supervisors at the expense of an integrated approach across the continent.

All of this prevents Europe from playing a global role commensurate with the size and importance of the euro area economy.

The task for emerging markets

The fourth challenge is in the emerging markets. For all of their extraordinary dynamism, we have seen a divergence among emerging markets over the past year: between those who have not shored up their defences against shocks, including preparation for the normalization of interest rates in the advanced economies; and those that have taken advantage of the global recovery to address their underlying vulnerabilities.

Capital outflows over the past several months have shown how markets are judging the perceived weaknesses in individual countries. If global conditions become more complicated, these outflows could increase and become more volatile.

The fifth and final challenge is the topic you will take up this afternoon: the role of multilateral institutions. We know that these institutions have played a crucial role in keeping the global economy on track. In the nearly 75 years since the IMF was set up, our world has undergone multiple transformations—from post-war reconstruction and the Bretton Woods system of fixed exchange rates to the era of flexible rates; the rise of emerging economies; the collapse of the Soviet Union and transition to market economies; as well as a series of financial crises: the Mexican debt crisis, the Asian Crisis, and the Global Financial Crisis.

At each stage, we at the IMF have been called upon to evolve and even remake ourselves. Now, we see a rising tide of doubt about globalization and discontent with multilateralism in some advanced economies. Just as with the IMF, it is fair for the international community to ask for modernization in its institutions and organizations, to seek reforms to ensure that institutions serve effectively their core purposes.

This applies to groupings such as the G20, as well as international organizations. So, it was heartening to see the G20 Leaders to call for reform of the WTO when they came together in Buenos Aires. This reform initiative, which has the potential to modernize the global trading system and restore support for cooperative approaches, should now go forward.

The policy challenges we face are clear. As I have suggested, governments have their work cut out for them and may have to contend with less potent policy tools. It is essential they do what they can now to address vulnerabilities and avoid actions that exacerbate the next downturn.

The multilateral response

But we should prepare for the possibility that weaker national tools may mean limited effectiveness, and thus may result in greater reliance on multilateral responses and on the global financial safety net.

The IMF's lending capacity was increased during the global financial crisis to about one trillion dollars – a forceful response from the membership at a time of dire need. One lesson from that crisis was that the IMF went into it under-resourced; we should try to avoid that next time.

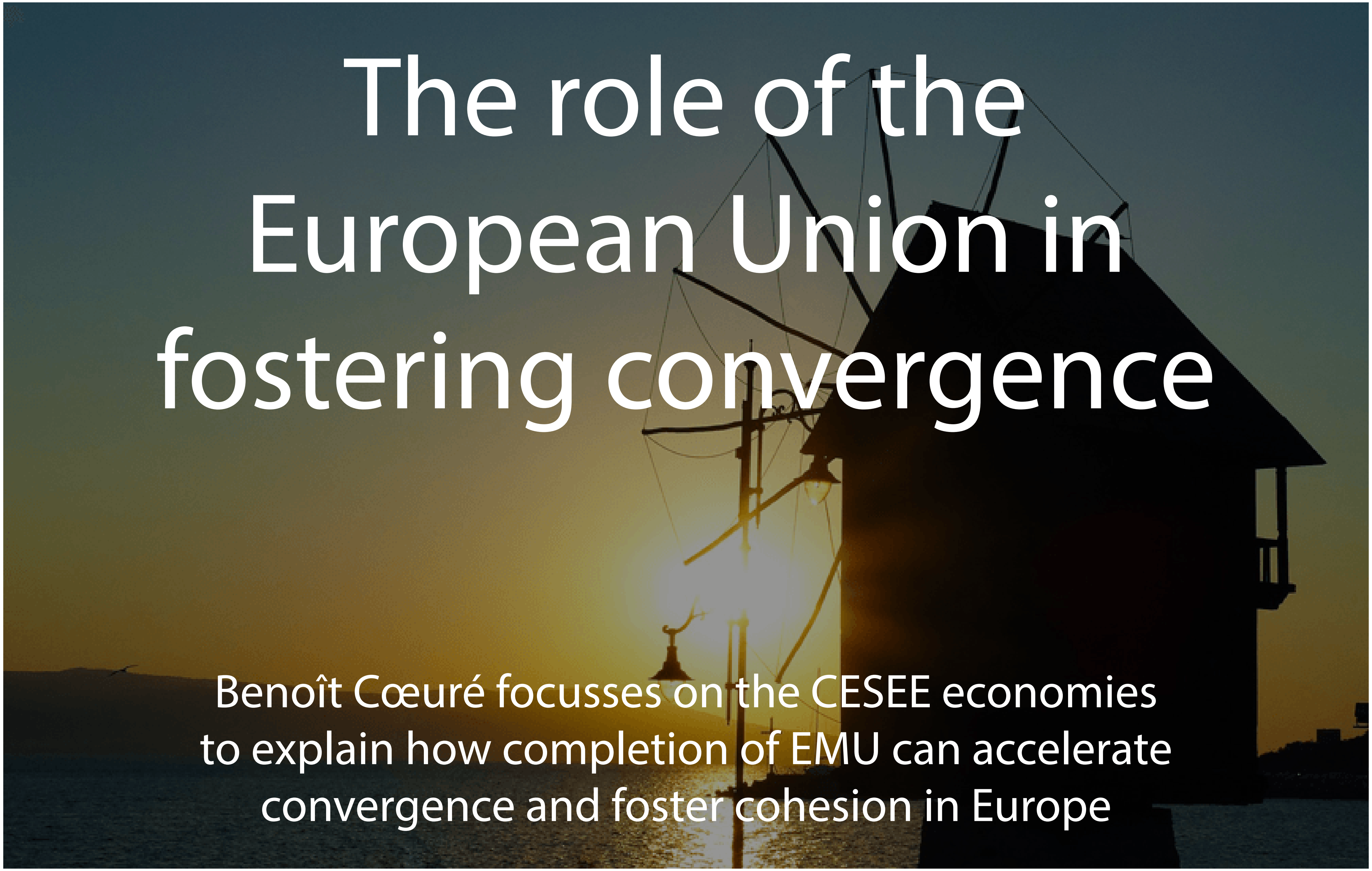
From that point of view it was encouraging that the G20 in Buenos Aires underlined its continued commitment to strengthen the safety net, with a strong and adequately financed IMF at its center. It is important that the leaders pledged to conclude the next discussion of our funding, the quota review, next year. But the stakes are bigger than any one decision about IMF funding. IMF Managing Director Christine Lagarde has called for a *"new multilateralism,"* one that is dedicated to improving the lives of all this world's citizens.

That ensures that the economic benefits of globalization are shared much more broadly. That focuses on governments and institutions that are both accountable and working together for the common good. And that can take on the many transnational challenges that no one government alone, not even a few governments working together, can handle: climate change, cyber-crime, massive refugee flows, failures of governance, and corruption.

Working together, we will be better able to prevent a damaging downturn in the coming years and a dystopian future in the coming decades. With ingenuity and international cooperation, we can make the most of new technologies and new challenges, and create a shared and sustained prosperity. ■

David Lipton is IMF First Deputy Managing Director

This article is based on a speech delivered at the Bloomberg Global Regulatory Forum, London, December 11, 2018



The role of the European Union in fostering convergence

Benoît Cœuré focusses on the CESEE economies to explain how completion of EMU can accelerate convergence and foster cohesion in Europe

I would like to focus precisely on three topics: growth, Europe and togetherness. I will argue that these three elements are needed to accomplish what the Treaty on European Union promises: economic and social cohesion[1]. I will focus on the economies of central, eastern and south-eastern Europe (CESEE), covering both those that are already part of the European Union (EU) and those that are EU candidate countries or potential candidates[2].

I will start with a brief review of the current state of convergence of CESEE economies, and then explain how three key European policy areas – the completion of the Single Market, the launch of a true capital markets union and the targeted use of EU funds – can help accelerate convergence and thereby also foster cohesion in Europe.

The current state of convergence

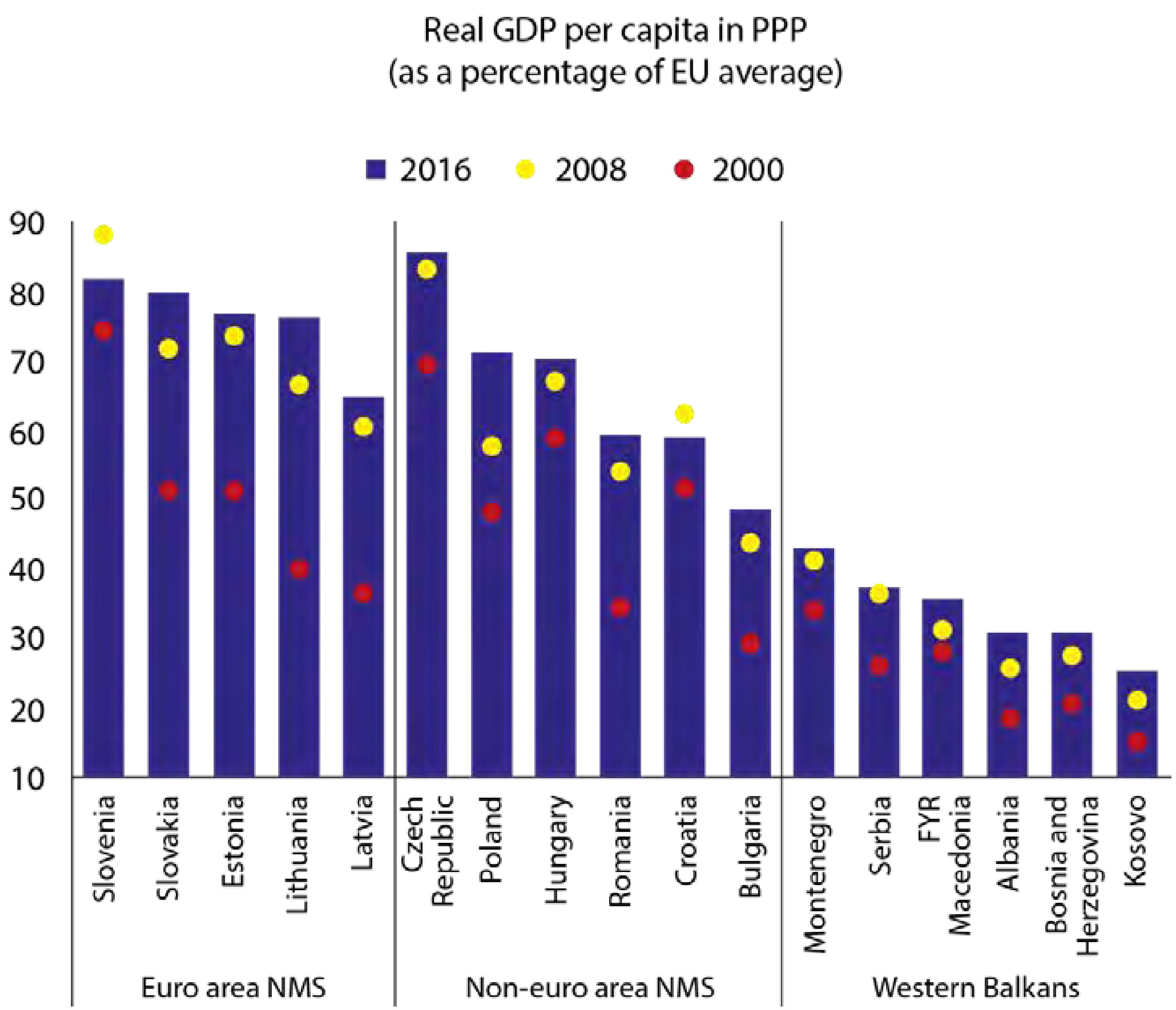
CESEE economies have seen significant improvements in living standards over the past two decades, in both absolute and relative terms[3]. Since 2000, growth in real GDP per capita has averaged 3.8% in the region as a whole, compared with 1.4% for the EU28. As a result, we have seen these economies make measurable and welcome progress in catching up to the EU average[4].

But this catching-up process has been neither linear over time nor homogeneous across countries. You can see this in Figure 1.

Clearly, for most countries, convergence towards the EU28 average has practically stalled since the outbreak of the financial crisis in 2008 – this is the difference between the yellow dot and the upper end of the blue bar.

And before the crisis, convergence was noticeably faster in economies that were already part of the euro area. In many of these economies, relative living standards increased by half, from 40 to 50% of the EU average in 2000, to

Figure 1. Uneven income convergence in CESEE countries



Sources: World Bank (World Development Indicators) and ECB calculations around 70% in 2016. But the further one moves to the right on this figure, and contrary to what neoclassical growth theory would suggest, the less compelling strong convergence becomes.

Achieving similar standards of living across our continent should speak to our highest aspirations. It is a recognition of history that economic prosperity, opportunity and peaceful societies are closely linked and mutually reinforcing

In the Western Balkans, for example, while relative income levels have increased, they have done so at a much slower pace. At current growth rates, fast convergence towards the EU28 average will remain illusory for many EU candidate countries or potential candidates.

These economies, and this you can see in Figure 2, would need much higher GDP growth rates than in previous years to even reach half of the EU28 average within the next 20 years or so, with the possible exception of Montenegro.

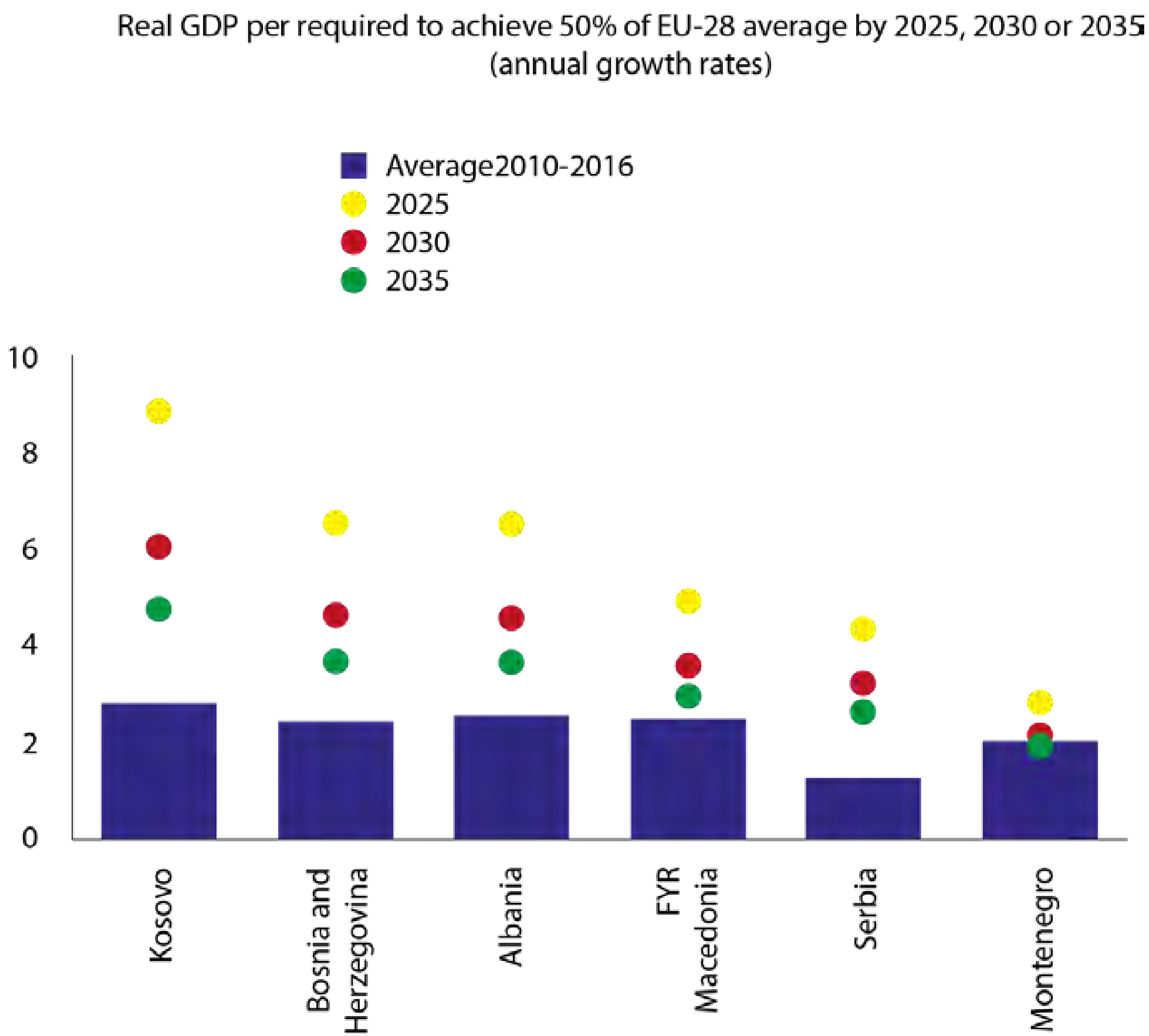
Clearly, this pace of convergence is disappointing. It implies that living standards in Europe will remain highly varied and uneven for a considerable period of time, even within the EU. And if there is no credible prospect of lower-income countries catching up soon, there is a risk that people living in those countries begin questioning the very benefits of membership of the EU or the currency union. Such doubts would be particularly worrisome in the unstable world we are currently living in.

We need the EU to remain a force for change, a source of growth and development and an anchor of stability. Action is therefore needed on two main fronts: first, to bring convergence in EU member states back onto its pre-crisis path and, second, to jump-start convergence in EU candidate countries and potential candidates.

To understand what needs to be done to tackle both challenges, it is useful to look at the drivers of growth and the factors that have recently been holding them back. You can see this in Figure 3.

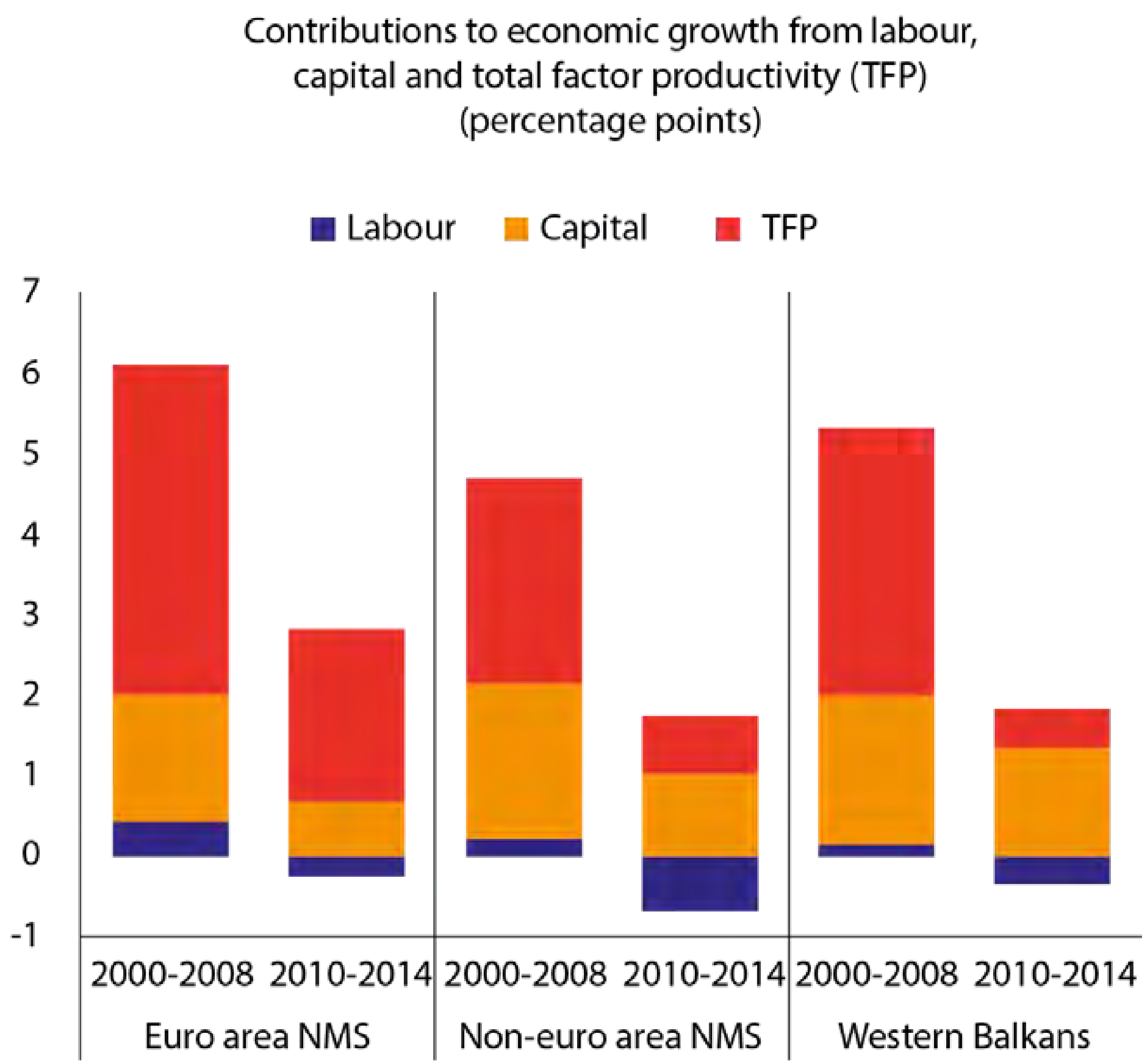
What you can see here is that, since the crisis, growth in all CESEE economies has essentially slowed because of two main factors: a sharp drop in total factor productivity (TFP) growth and, to a lesser extent, in the contribution of capital to growth.

Figure 2. Stronger income growth required for faster convergence



Sources: World Bank (WDI) and ECB calculations
Note: This assumes purchasing-power adjusted per capita GDP growth in the EU-28 of 1.2%, which is the average growth rate observed over 2010 to 2016.

Figure 3. Growth slowdown mainly due to a fall in TFP growth



Sources: Penn World Table version 9 and ECB calculations.
Note: Labour share in Albania and Montenegro assumed to be equal to the average observed in FYR Macedonia, Bosnia and Herzegovina, Serbia and Croatia. Average hours worked in the Western Balkan countries assumed to be equal to the average in new EU member states. Calculations assume standard Cobb-Douglas production function.

There are two things worth highlighting here. The first is that it is highly unusual that pre-crisis convergence largely reflected technological progress and innovation. During the transition phase, growth is typically based on capital and labour accumulation, and only later on TFP growth[5]. Or, to borrow the words of Paul Krugman, it is based first on perspiration and only later on inspiration[6].

The flipside is that these economies are now faced with a notable capital shortfall. The capital stock per person employed remains substantially below the EU28 average in almost all CESEE economies. You can see this in Figure 4 on the left-hand side.

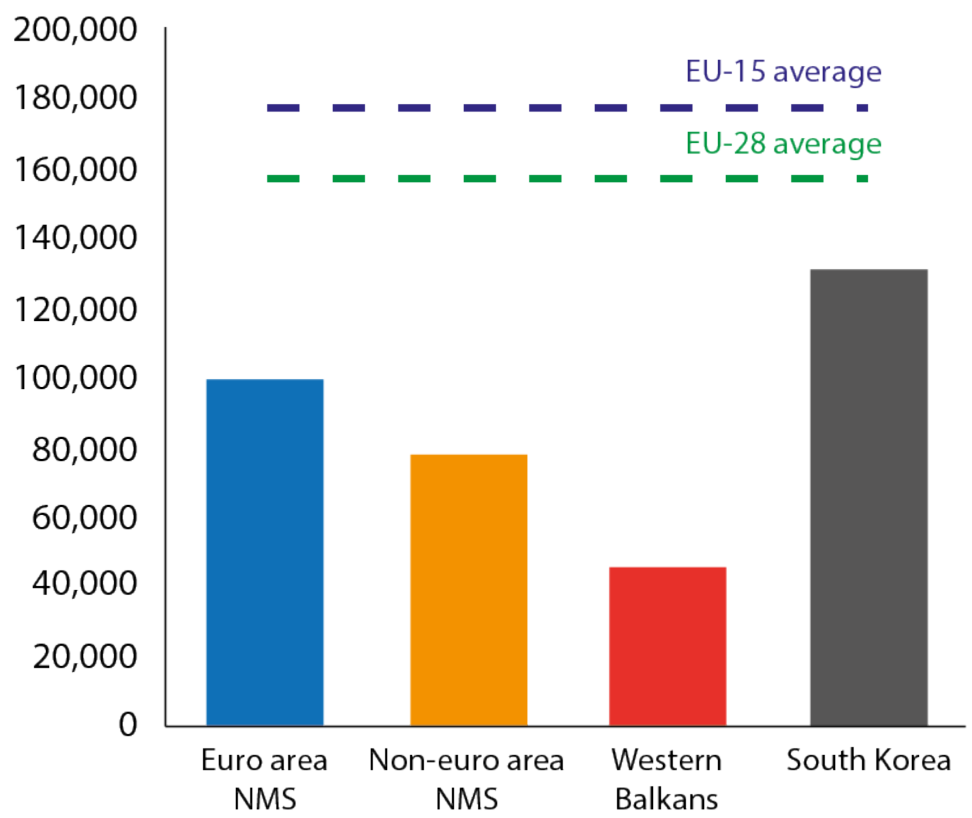
In CESEE euro area member states, it also remains well below other emerging economies, such as South Korea, with similar per capita income levels. And, worse, investment rates have fallen further since the crisis in all CESEE economies. You can see this on the right-hand side.

The second fact worth highlighting is that the remarkable contribution of productivity to growth, both in the upswing and in the downturn, is likely to be an artefact of the growth model adopted by most CESEE economies. This growth model relies, by and large, on deep integration in global production chains.

You can see this clearly in Figure 5. CESEE economies are some of the world's most integrated. They are far more integrated in global value chains than their EU peers, for example. Sizeable foreign direct investment (FDI) inflows in the pre-crisis period – which you can see on the right-hand side – have promoted the role of CESEE economies in global production processes. These inflows accounted for around 6% of GDP in the run-up to the crisis. In the EU28 as a whole, FDI inflows accounted for just 3.4% of GDP over this period.

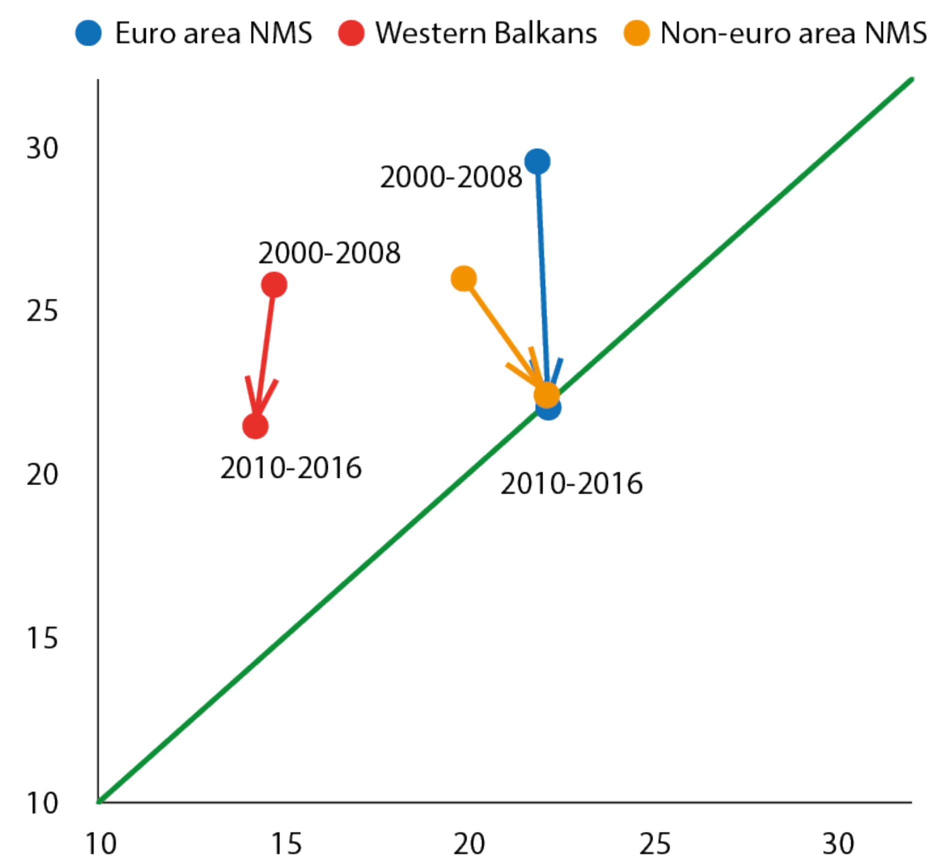
Figure 4. Capital stock remains comparatively low in CESEE economies

Per capita capital stock in CESEE economies in 2014 (in 2011 USD)



Sources: Penn World Table version 9, World Bank and ECB calculations.
Note: EU-15 refers to countries that joined the EU prior to 2004.

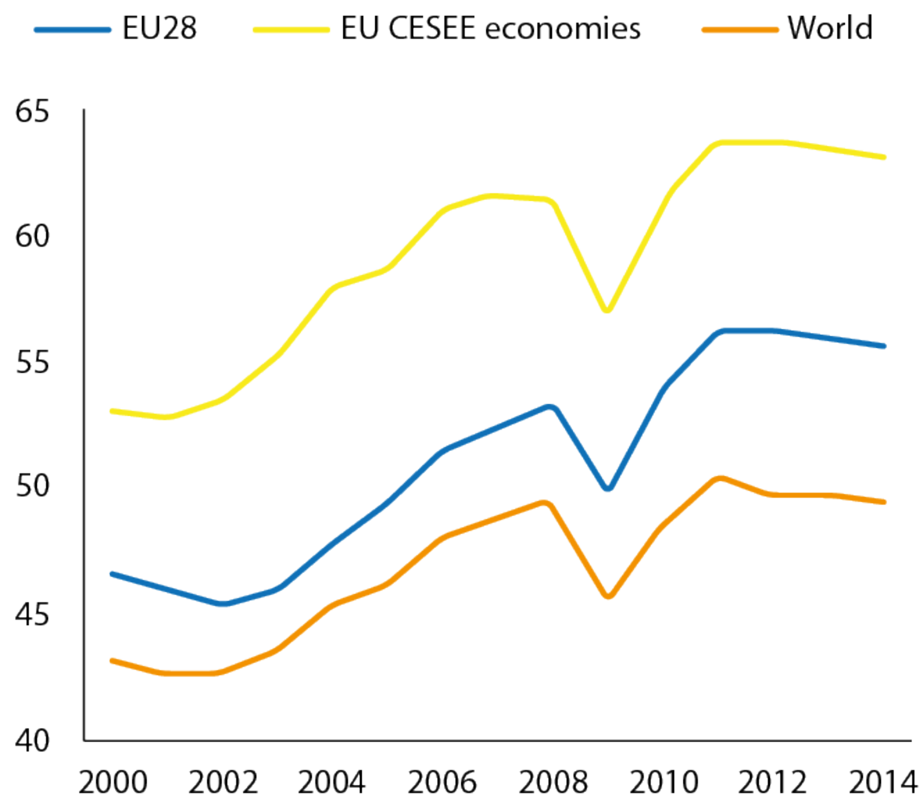
Average savings and investment ratios in 2000-2008 and 2010-2016 (x-axis: saving rate (as percentage of GDP); y-axis: investment rate (as a percentage of GDP))



Sources: IMF (World Economic Outlook) and ECB calculations.
Note: The 45-degree line is shown in green.

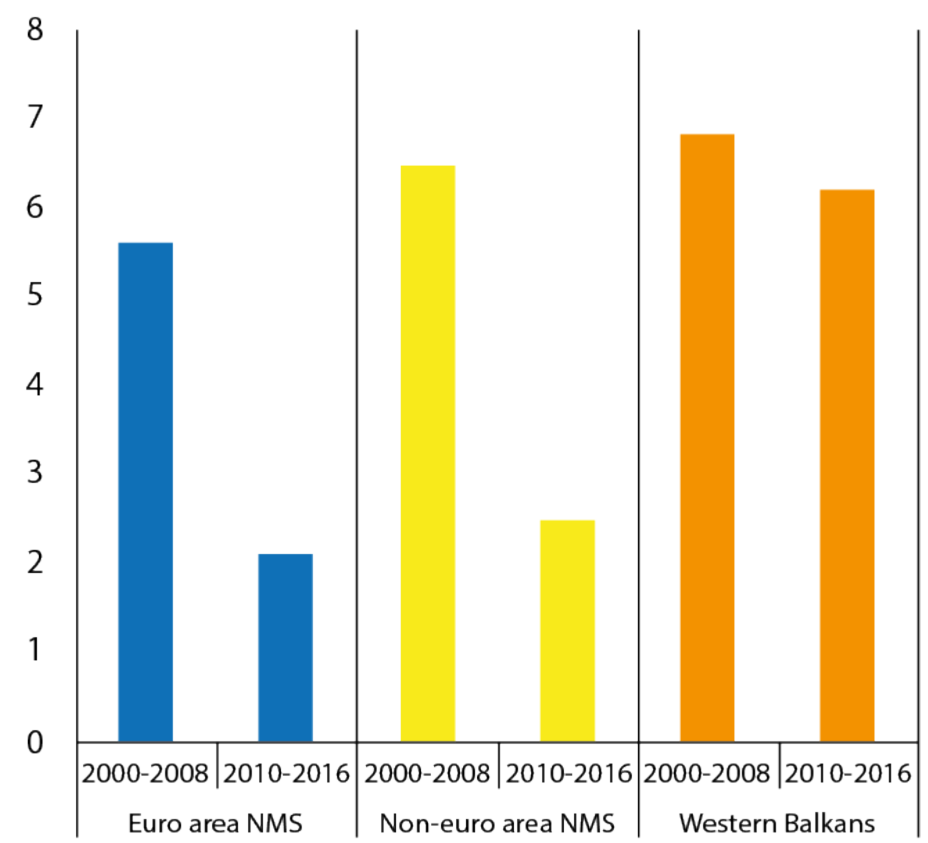
Figure 5. CESEE economies are some of the world's most integrated

GVC participation in 2000-2014
(share in gross exports of the sum of domestic value added in third country exports and foreign value added in own exports)



Sources: WIOD (2016) and ECB calculations.
Note: EU CESEE countries are Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Average foreign direct investment inflows
(as a percentage of GDP)



Sources: Wiiw (FDI database) and ECB calculations.
Note: Data in gross terms. Simple averages of country-specific data for regional aggregates.

The role of FDI in supporting TFP growth is well known[7]. By integrating local firms into global value chains, it facilitates the transfer of technology and expertise. The transfer of technology, moreover, does not stop at firms directly integrated into global value chains, but also extends to their domestic suppliers via local production networks[8]. Empirical evidence shows that, in the case of central and eastern European (CEE) economies, this transfer of technology has contributed to both strong TFP growth in the run-up to the crisis and to its more recent slowdown[9].

You can see this more clearly in Figure 6. There is a very close link between TFP growth in CEE economies and TFP growth in non-CEE EU countries. This link likely reflects the scale and scope of technology spillovers[10]. So, as FDI inflows decelerated and participation rates in global value chains levelled off, TFP growth in CESEE economies abated too.

Global value chains as a source of TFP growth in the future

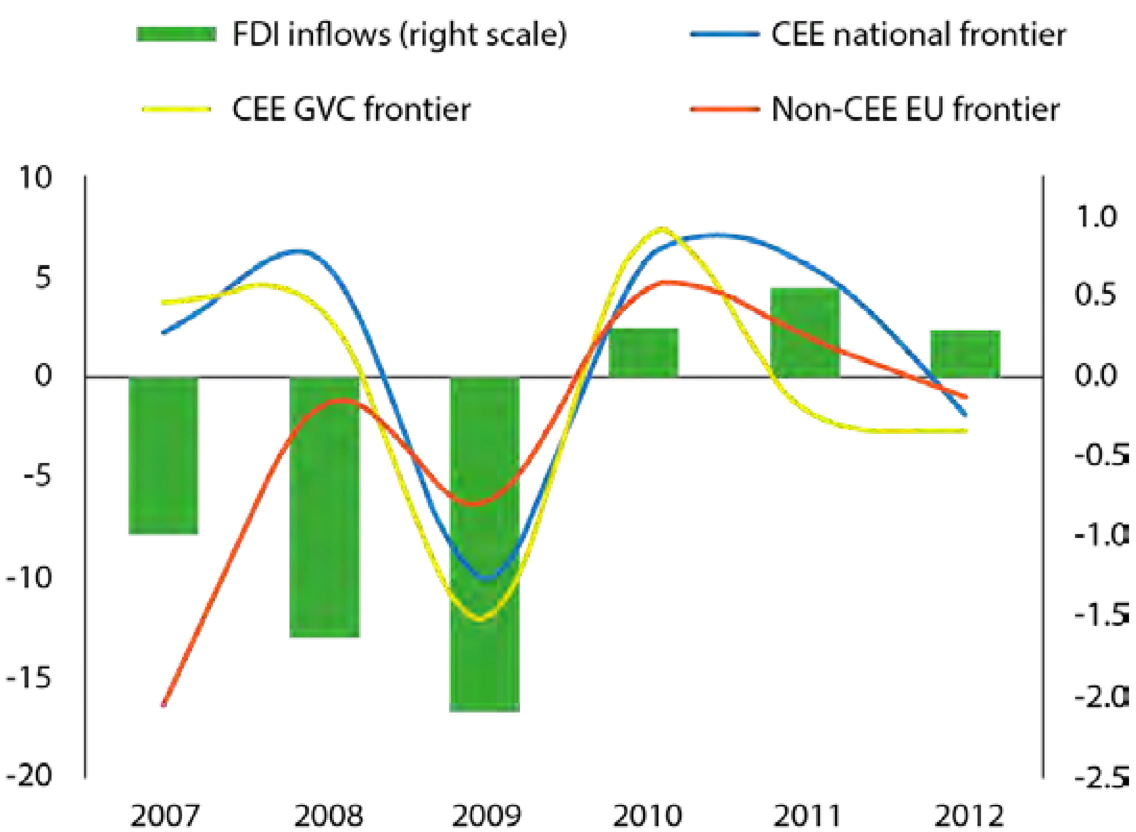
In sum, therefore, this diagnosis highlights two key facts: CESEE economies have a lack of capital, and a strong reliance on global production processes.

The easy answer, of course, is to brush away weakness in FDI inflows as a temporary phenomenon. After all, if the law of declining marginal returns on capital continues to hold, we should still expect capital to flow into catching-up economies, rebooting TFP growth.

I would be somewhat more cautious, however. It is true that weakness in trade and investment, worldwide, has been part of the collateral damage from the crisis. As we leave this legacy behind, headwinds should fade too. But the recent shift is also likely to reflect developments of a more structural nature – that is, the slowdown in global value chain formation may well persist[11].

Figure 6. Close link between TFP, GVCs and FDI developments

TFP growth of SEE national frontier, CEE GVC frontier, and non-CEE EU frontier and annual change in FDI inflows (annual growth rates; annual changes in percentage of GDP)



Sources: ECB staff calculations based on CompNet, WIOD (2016) and Vienna Institute for International Economic Studies (wiiw) (FDI database).
Note: CEE and non-CEE EU frontier represent firms in the 80th and 90th percentiles in terms of TFP in each country-sector-year. CEE GVC frontier is a weighted average of the most productive firms in non-CEE EU countries, with weights based on the share of imported intermediates of each CEE-sector pair from each non-CEE EU country-sector pair. The CEE countries are EE, HU, LV, PL, RO, SK, and SI. The non-CEE countries are AT, BE, DK, FI, FR, DE, IT, PT and ES. For FDI, the regional aggregate is obtained from the simple average of country-specific annual changes.

There are three main reasons for this. First, natural disasters and increasing climate-related disruptions have led firms to rethink the length and design of their value chains to mitigate the risks of costly supply disruptions[12]. This is becoming increasingly visible and may still amplify as climate change takes its toll on our economies.

Second, in the past sizeable wage differentials for unskilled labour made the international fragmentation of production processes worthwhile. Some of these wage differentials have narrowed considerably as emerging economies have grown richer. In the EU CESEE economies, for example, real wages have increased by slightly more than 50% since 2000. In the EU28, real wages grew by 18% over the same period.

And, third, the increased use of robots and artificial intelligence has the potential to turn global value chains on their head and cause firms to reconsider offshoring practices[13].

The second and third factors may be the most pressing ones. Put simply, if robots can deliver the same output more cheaply, more efficiently and closer to the consumer, then firms may have fewer reasons to spread production across countries.

By some estimates, the average price of industrial robots has declined by about 40% over the past ten years and is projected to fall considerably further[14]. A survey by the Boston Consulting Group revealed that more than 70% of senior manufacturing executives in the United States think that robotics can improve the economics of local production[15].

The implication is that, to the extent that growing automation and narrowing wage differentials make the outsourcing of production processes less profitable, policymakers in CESEE economies, and in emerging market economies more generally, will need to think about developing other growth models.

To reboot TFP growth and deepen capital accumulation they will need to stimulate domestic investment spending and help new, innovative industries to grow and develop. Only in this way will convergence towards the EU28 average accelerate.

These should be joint efforts, however, which brings me to the second part of my remarks. Europe can and should help, in three main ways. First, by providing the market that makes the development of new industries profitable. Second, by channelling funds to sectors and countries where capital can be used most productively. And, third, by providing direct financial assistance to foster convergence and support national reform efforts.

Reaping the benefits of the Single Market

Let me take each of these points in turn, starting with the market dimension. The EU's Single Market can be a valuable source of competitive advantage for firms located in CESEE economies, in particular when competing with other economies at similar stages of development.

It is the largest market in the world, offering the benefits of enormous economies of scale, and has helped establish product and safety standards that are used worldwide. There is compelling evidence that the Single Market has had a positive impact on exports, investment, innovation and productivity[16].

To exploit its full potential, and to accelerate convergence, two things need to be done. First, member states need to strengthen its enforcement so that Single Market initiatives translate into concrete and positive effects on the ground.

A key ingredient for this is efficient administration at all levels of government. Indeed, a lack of real convergence in income levels is, more often than not, the result of a lack of convergence in institutional quality[17]. You can see this in Figure 7 – a figure that makes a compelling point, notwithstanding the usual caveat on the two-way causality between institutional quality and income levels[18]. Most CESEE economies are still in the lower left-hand corner, meaning there remains a significant gap in overall institutional quality compared with the average level observed in the EU as a whole.

Some EU member states have recently renewed their interest in the process leading to participation in the exchange rate mechanism (ERM II) and the adoption of the euro. This could become a fundamental catalyst for institutional reforms in the years to come.

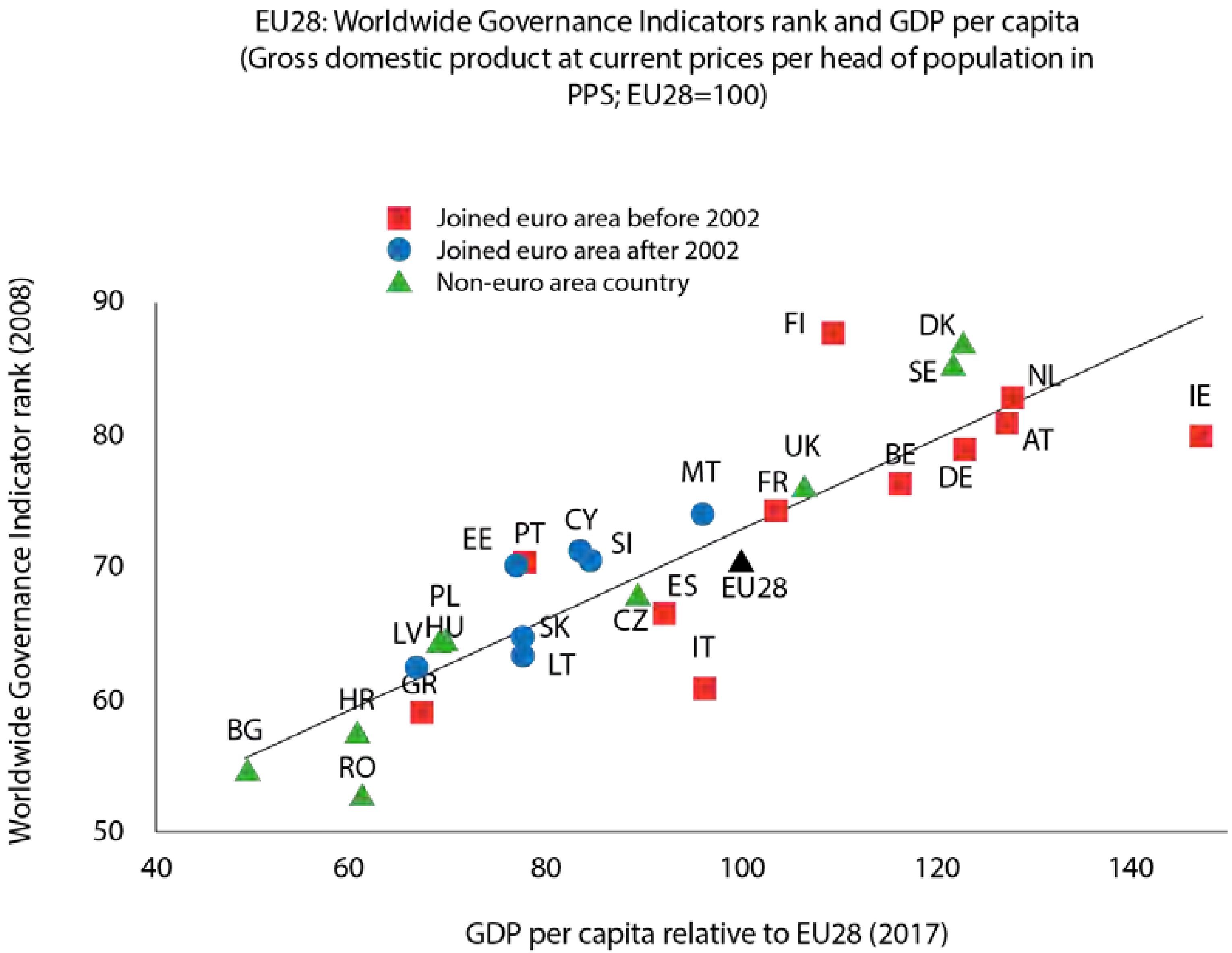
Second, the scope of the Single Market must be broadened. For the EU, this means expanding its reach into industries that are prime drivers of innovation and catalysts for future growth.

This is particularly relevant for CESEE economies. As you can see in Figure 8, most of these countries are still classified as modest or moderate innovators. There have been some notable improvements in certain countries over time, but in others the process of gradually catching up with their EU peers appears to have stalled, or even to have backtracked, in recent years.

The first priority is therefore to complete the Single Market for services, which already account for two-thirds of global GDP and employment, and represent many of the potential growth sectors in the age of digitalisation and automation.

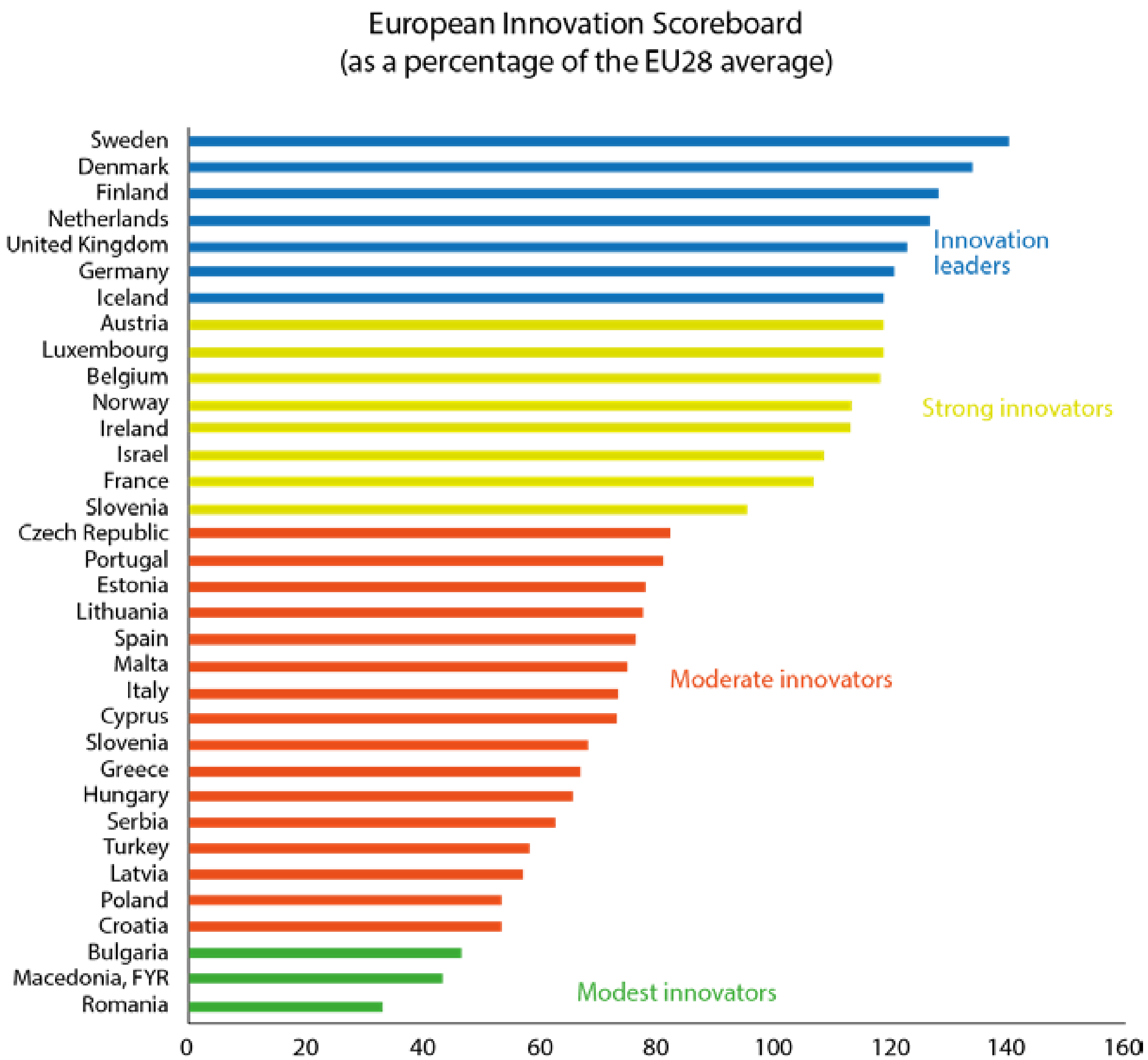
Research by the ESCB's Competitive Research Network (CompNet) shows, for example, that many firms in the EU services sector are far behind the productivity frontier, particularly in CESEE economies[19]. Reallocating capital and labour to more productive firms would help boost overall competitiveness and support employment.

Figure 7. A significant gap in institutional quality remains



Sources: Eurostat and World Bank.
Note: The Worldwide Governance Indicator is the composite rank of average positions in six broad institutional dimensions. Luxembourg is excluded because GDP per capita computations are distorted by eg. the high number of cross-border workers.

Figure 8. Most CESEE economies only modest or moderate innovators



Sources: European Commission (European Innovation Scoreboard).
Note: Data are available only for some CESEE economies.

A second, and more direct, avenue is to increase efforts to build a 'European data economy,' or a digital single market, as also advocated by the European Commission in its communication in November[20]. Digitalisation offers a particularly promising opportunity for catching-up economies to leapfrog more advanced economies and adopt new technologies faster than them, thereby mitigating the risk of being hurt by reshoring and premature deindustrialisation.

Convergence and the role of the capital markets union

The second key area where Europe can help – which is close to the heart of this conference – is by channelling funds to where they can be used most productively.

There is compelling evidence of the importance of finance for technological innovation and, ultimately, long-run growth rates[21]. Differences in the quality of financial intermediation across countries have been found to have significant implications for economic growth[22].

In particular, research is increasingly challenging the view that bank and market-based finance tend to support economic development and living standards in similar ways.

Evidence is growing globally that large banking systems are associated with more systemic risk and lower economic growth, in particular as countries grow richer[23]. In addition, recent work by ECB staff highlights that, during the euro area sovereign debt crisis, capital misallocation increased substantially among firms that were more reliant on bank finance[24].

Other research suggests that deeper equity markets are more effective in promoting innovation and productivity and, hence, in bringing economies closer to the technological frontier[25]. Recent ECB research, for example, suggests that if an EU member state were to increase its ratio of stock market capitalisation to bank credit from the 25th to the 75th percentile, the average growth rate of its most high-tech industry could be expected to increase by 3.1 percentage points, everything else being equal[26]. None of this is to say that banks will become redundant. They will continue to play their key social role of pooling savings and engaging in maturity and risk transformation.

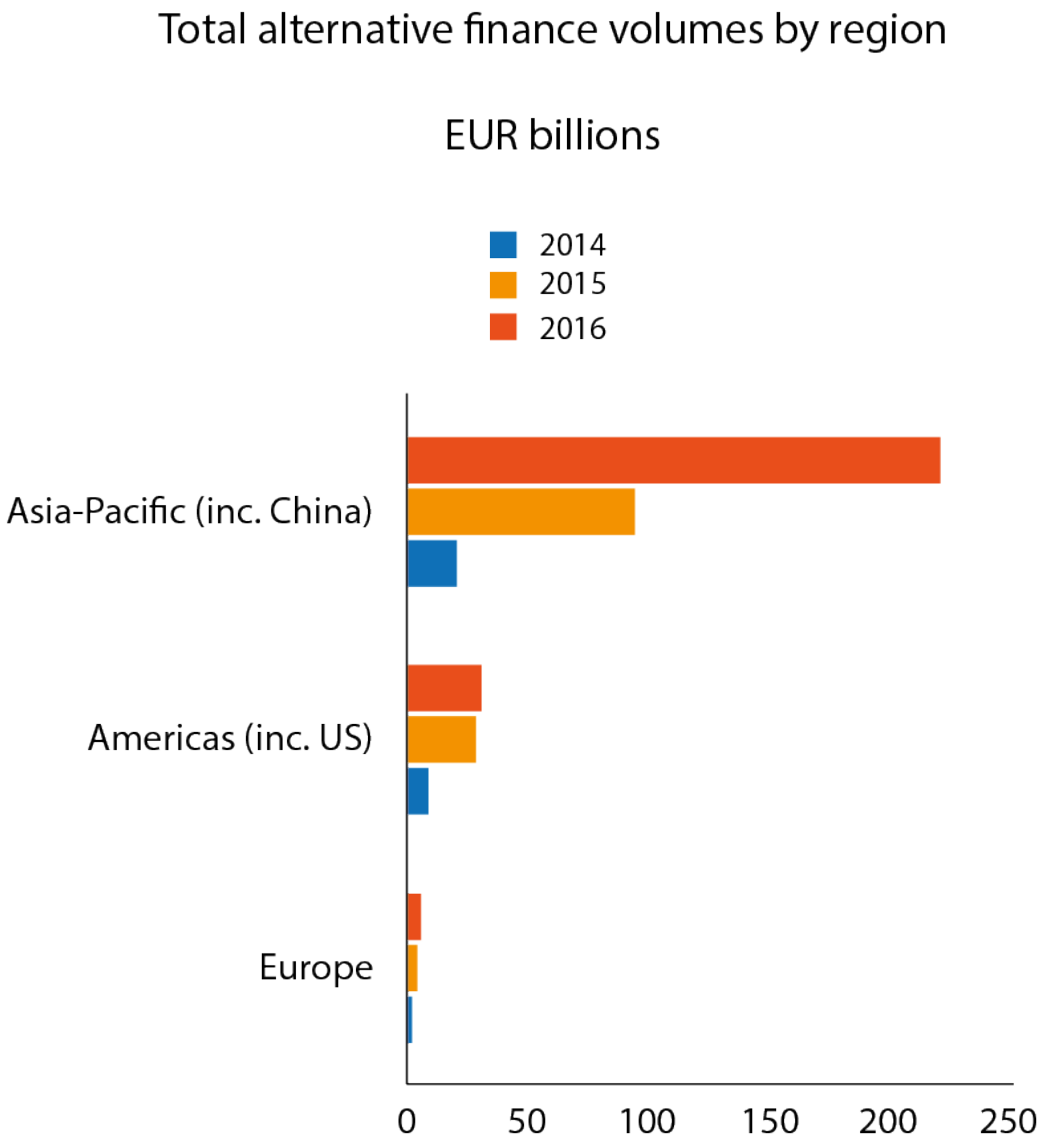
But recent findings are increasingly reflected in the ongoing policy discussion. The European push towards a capital markets union, for example, reflects not only the need for increased cross-border risk-sharing in a currency union, but also the hope that deeper and better-integrated equity markets will support innovation and productivity growth in the European Union[27].

This also includes making new innovative financial technologies available to firms and ensuring they are as safe as conventional technologies. Europe is spearheading this process. Europe's Payment Services Directive (PSD2), for example, has been revised to introduce more competition in financial intermediation by requiring banks to share account information with new contenders.

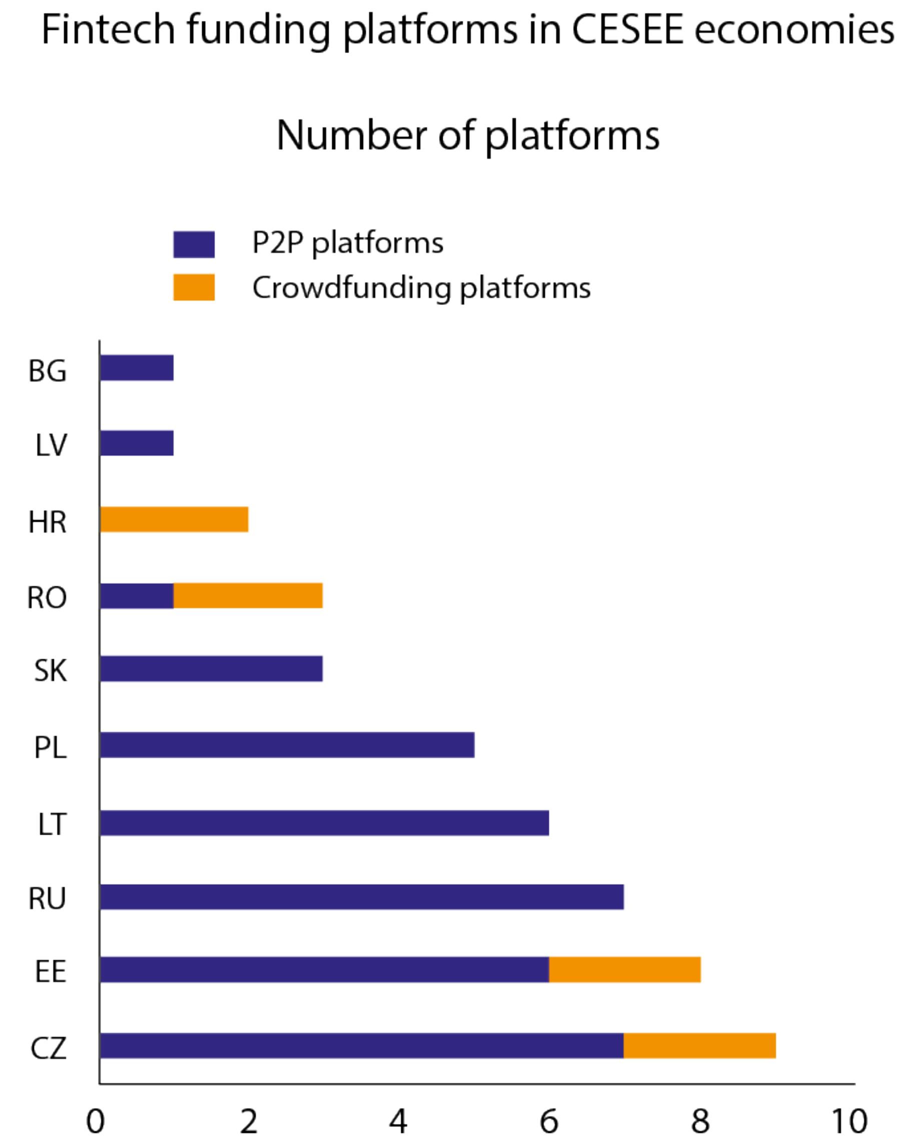
China, of course, is a prime example of new financial technologies supporting growth in the transition towards higher income levels. Although EU data requirements are more stringent – for good reason – there is considerable scope for such technologies, if used prudently, to also foster growth and convergence in the EU.

On Figure 9 you can see that in Europe more generally, and in most CESEE economies in particular, these technologies have not yet gained much traction. In other words, progress towards a true capital markets union can both support the funding of investments, thereby helping overcome the current lack of capital accumulation, and, at the same time, foster the use and distribution of new financial technologies that may themselves become a source of growth[28].

Figure 9. New financial technologies have not yet found much traction in Europe



Source: Expanding Horizons – the 3rd European Alternative Finance Industry Report, reports by the Cambridge Centre for Alternative Finance (2016).
Note: Data are based on information gathered from 344 crowdfunding, P2P lending and other alternative finance intermediaries across 45 countries in Europe.



Source: FinTechs and their emergence in banking services in CESEE (Stern, 2017).

Using EU funds to foster convergence

The third area where Europe can help is arguably the most contentious one. It relates to transfers between member states to foster convergence in the EU.

Such transfers are already happening, of course. Cohesion policy, designed to reduce structural disparities among regions and member states, was the second largest item in the EU's 2014-20 budget. Over this period, and this you can see on the left-hand side of Figure 10, the cumulated available funds for CESEE countries range from 8 to 21% of average annual GDP, with the allocation of resources linked to prevailing income levels. In other words, these funds are not negligible.

One problem, however, is that not all countries are equally successful in accessing them. One reason for this is linked to the importance of institutional quality, which I mentioned earlier. You can see this on the chart on the right-hand side, which suggests there is a positive correlation between institutional quality and a country's ability to effectively absorb available transfers and secure new funding opportunities.

Such patterns are even more visible when considering EU funding opportunities for social policies, education and training[29]. Under the European Fund for Strategic Investments plan, for example, CESEE economies have only been able to attract less than 5% of total funding allocated to social infrastructure projects.

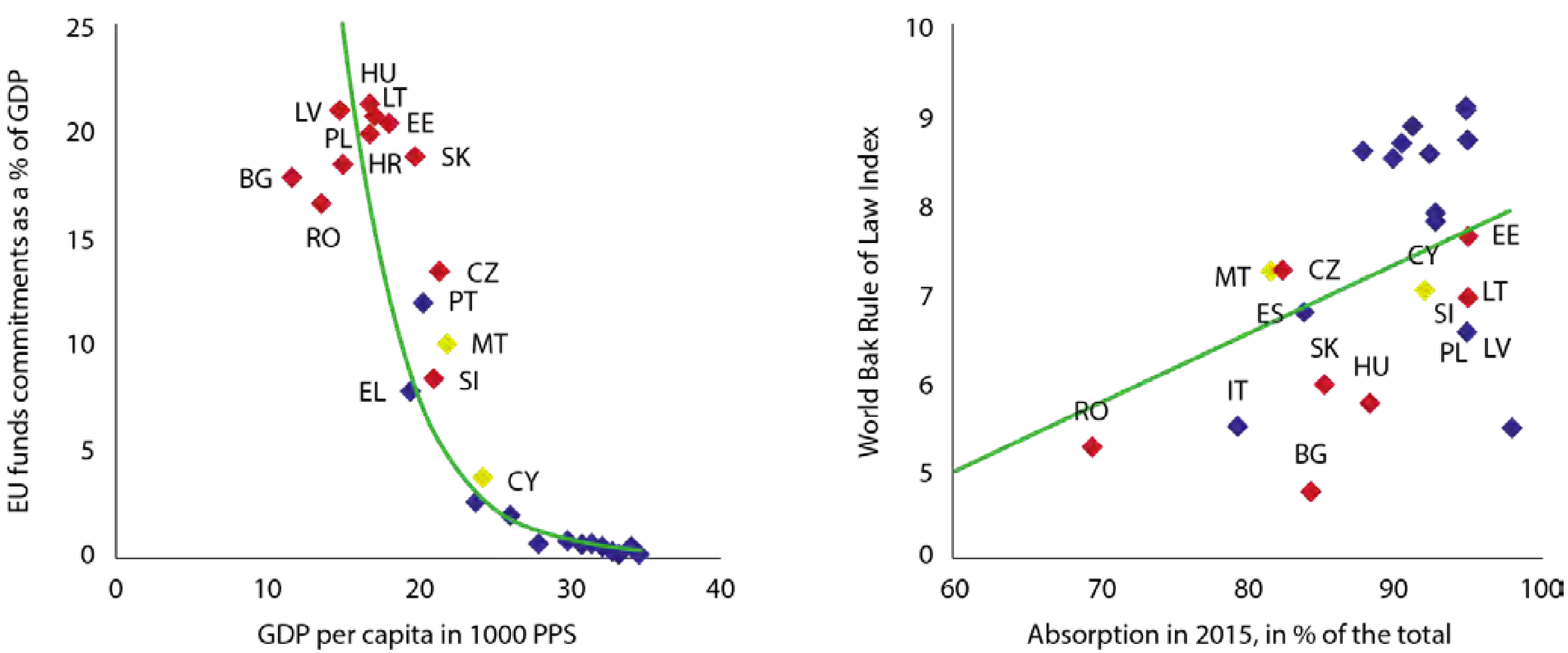
This means two things. First, we need to strengthen the ability of receiving economies to access and absorb funds. This should be part of the broader effort to improve institutional quality.

Second, EU allocation rules should be made as simple as possible. The European Commission has already made several important suggestions in this respect, with a single rulebook planned to cover several EU funds, less red

Figure 10. Cohesion funds sizable but not all countries equally successful in accessing them

EU funds for Cohesion and GDP per capita
(% of GDP, thousand PPS)

Absorption rate of EU funds for Cohesion and
Rule of Law
(index, % of total allocations)



Sources: European Commission, AMECI, and ECB calculations.
Note: Data for the 2014-2020 programming period; red diamonds refer to the EU11, blue diamonds for the EU15. For nominal and per capita GDP, 2010-2013 average is used. Data for ERDF, CF, and ESF. Luxembourg is not shown.

Sources: World Bank, European Commission, and ECB calculations.
Note: Data for the 2007-2013 programming period. The institutional quality index for 2015 is rescaled between 0 and 10, indicating low and high institutional quality, respectively. Data for ERDF, CF and ESF. Croatia is not shown.

tape and lighter control procedures for businesses and entrepreneurs benefiting from EU support[30]. Such initiatives are essential if we want people and companies to take full advantage of the opportunities that the EU provides.

Conclusion

Achieving similar standards of living across our continent should speak to our highest aspirations. It is a recognition of history that economic prosperity, opportunity and peaceful societies are closely linked and mutually reinforcing. The prospect that relative income levels in Europe, without further action, will remain unacceptably large for the foreseeable future is therefore a warning sign. It should urge policymakers to think in new ways about how convergence can be accelerated, and what role Europe itself should play in this process.

I have highlighted that we must begin by acknowledging that convergence requires joint efforts and responsibility. It requires member states to translate EU initiatives and recommendations into concrete and positive effects on the ground, and candidate countries and potential candidates to achieve institutional excellence as early as possible in the transition process. Convergence must be built on strong institutions. And adhering to standards, EU standards, is a powerful vehicle for growth.

Accelerating convergence also requires the EU, and the euro area in particular, to help underwrite this process. This includes completing the Single Market, building a new digital market and being serious about developing a true capital markets union. Transition economies need both the market and the capital to nurture and feed domestic growth initiatives. ■

Benoît Cœuré is a Member of the Executive Board of the ECB

Endnotes

1. Article 3 of the Treaty on European Union states that "[The Union] shall promote economic, social and territorial cohesion, and solidarity among member states."

2. EU members comprise Bulgaria, the Czech Republic, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia and Slovakia. EU candidate countries or potential candidates comprise Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro and Serbia (also referred to here as the "Western Balkans"). Kosovo is also included subject to data availability (without prejudice to positions on status, in line with United Nations Security Council Resolution 1244 and the International Court of Justice's opinion on Kosovo's declaration of independence).

3. See also Nowotny, E, D Ritzberger-Grünwald and H Schuberth (2018), "Structural Reforms for Growth and Cohesion – Lessons and Challenges for CESEE Countries and a Modern Europe", Edward Elgar Publishing.

4. See Zuk et al. (2018), "Real convergence in central, eastern and south-eastern Europe", ECB Economic Bulletin Article, Issue 3.

5. See, for example, European Bank for Reconstruction and Development (2017), Transition Report 2017-18, November.

6. See Krugman, P (1994), "The Myth of Asia's Miracle", Foreign Affairs, November/December.

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This article is based on a speech delivered at the Conference on European Economic Integration (CEEI), Vienna, 26 November 2018

The international role of the euro

Konstantinos Efstathiou and Francesco Papadia assess whether the euro area should pursue a greater international role for the euro, as outlined by Jean-Claude Juncker, and how it might go about doing so

European Commission president Jean-Claude Juncker raised, in his latest State of the Union address on September 12th, an issue that has been somewhat dormant over recent years: the international role of the euro. Indeed, he announced that the Commission would present plans *"to strengthen the international role of the euro"* before the end of the year.

This statement raises two important issues:

- Should indeed the euro area pursue a more important international role for its currency?
- What are the tools that the euro area could deploy to pursue this objective, if indeed it is deemed desirable?

Any plan about increasing the international role of the euro should start from the current situation: what is the actual international role of the euro, ie. its use outside the borders of the euro area, and how has it changed over the two decades of its existence?

One very important and very clear fact is that the euro is the second-most important currency in all possible international uses, whether in the private or in the official domain. The first-ranking currency by a good margin is the dollar, while other currencies cover minimal shares.

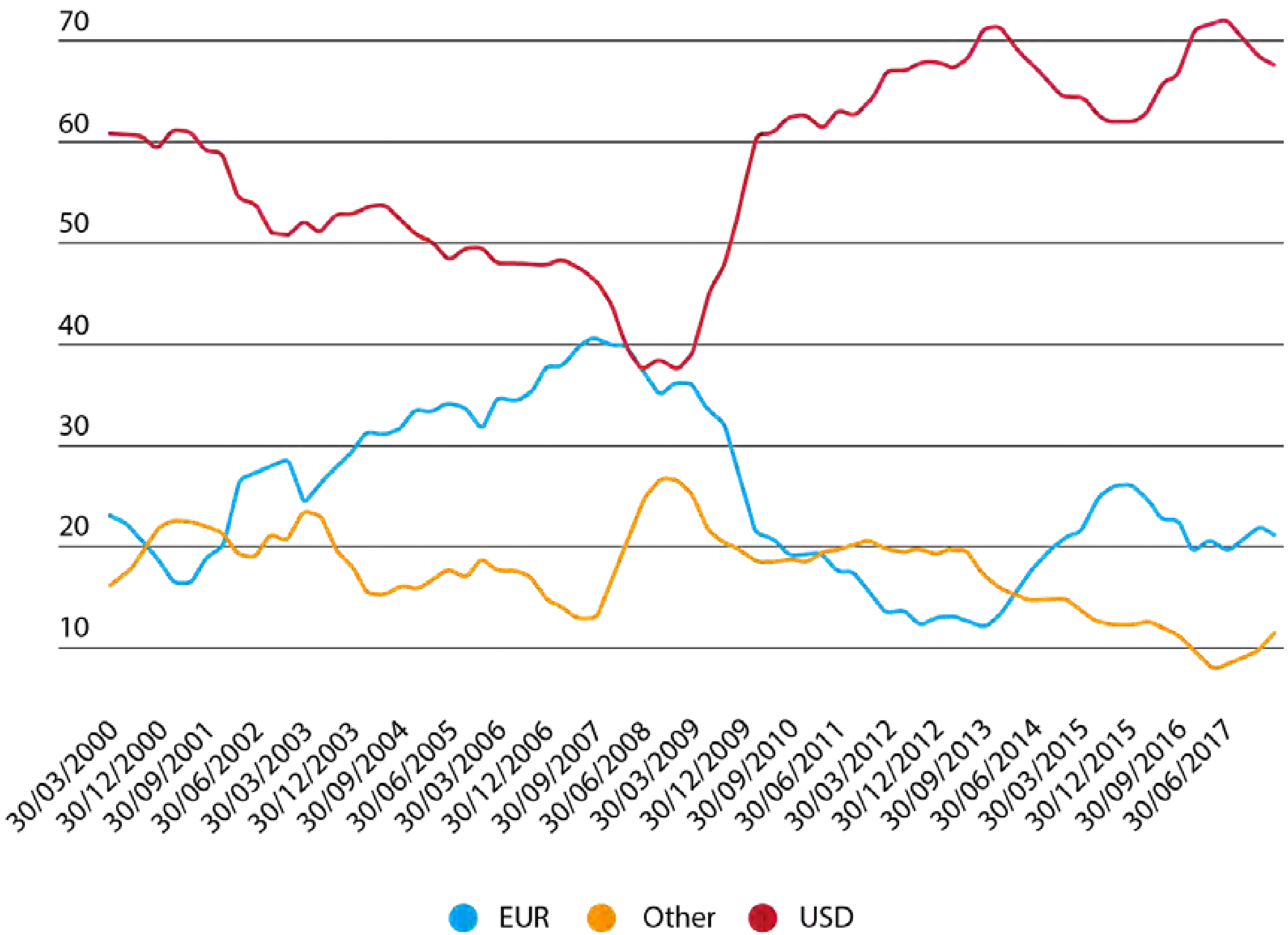
The ranking between the dollar and the euro has not changed in the last two decades, is very likely to remain unchanged in the foreseeable future, and can be seen as a continuation of the situation preceding the introduction of the euro – when the deutschmark and some other European currencies were internationally used. The shares of the dollar and the euro, however, have changed over time and what one has gained the other has lost.

This is visible in all possible international uses of the two currencies by the private or the public sector, but is clearest in the role of the two currencies to denominate foreign currency bonds, as in Figure 1, ie. when a resident of one country uses a foreign currency to issue debt.

The shares of the two currencies are of course much more stable if one looks at stocks, for instance of international bonds or foreign reserves, instead of flows as in Figure 1. But the phenomenon is still visible.

A larger international role of the euro could be promoted if the ECB would surpass its 'neutral' attitude towards it

Figure 1. Foreign–currency-denominated debt issuance by currency



Source: Decalogic via ECB (2018).
Note: the series are 4-quarter moving averages.

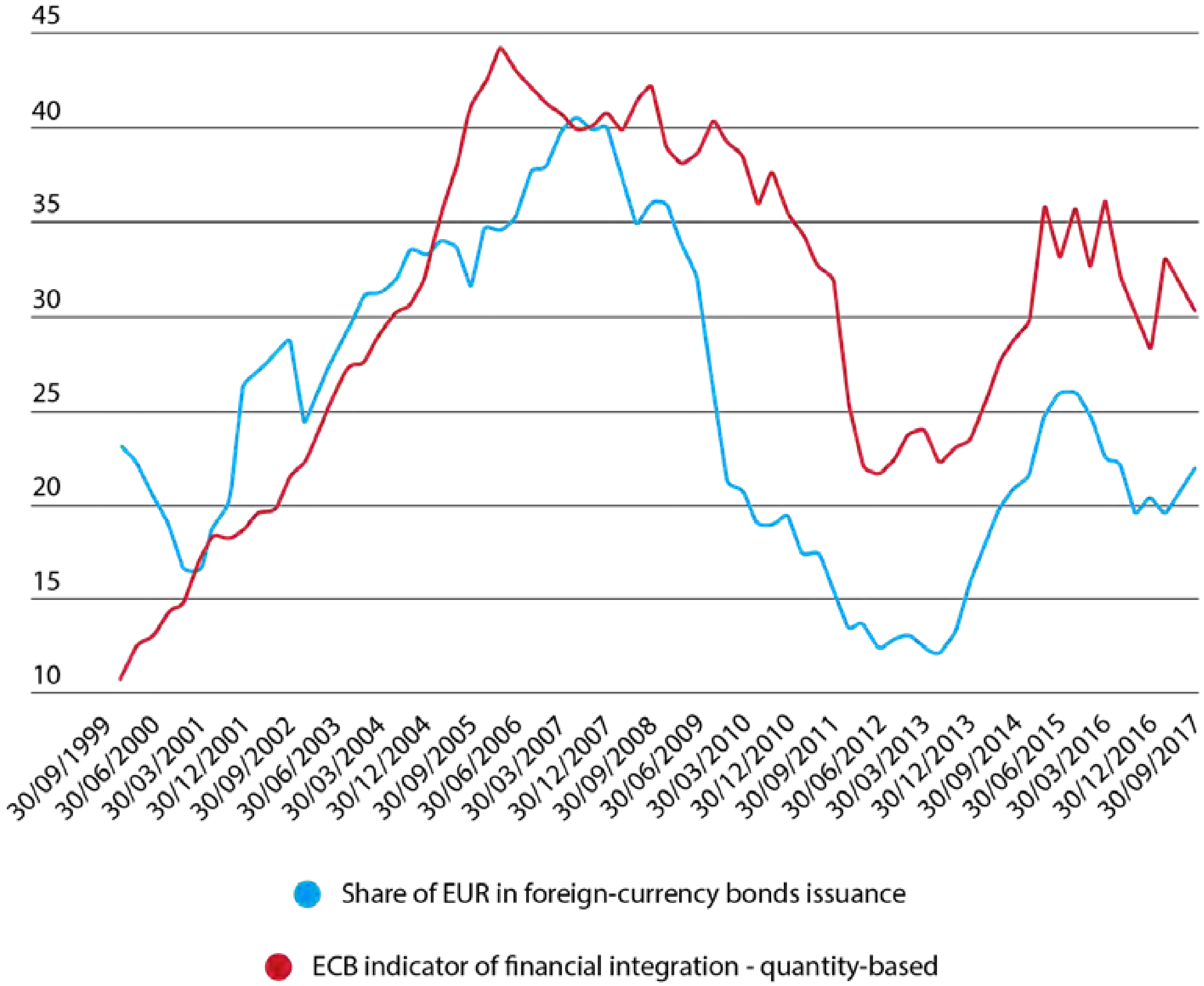
Theoretical considerations as well as empirical regularities allow for the establishment of the most important factors determining the relative international role of different countries:

- Size of the country issuing the international currency
- Development of the underlying financial market
- Freedom of capital movements
- Political and military power of the issuing country
- Financial stability of the issuing country, relative to the stability of other countries
- A policy by the issuing country to assist, or deter, the international use of its currency

The first four factors are characterised by strong inertia and therefore cannot explain the changes in the international use of the currencies that have taken place over the years. The last two, instead, can move quite significantly over time. One very important case in this respect is that of the fluctuations in the international use of the euro that took place before, during and after the Great Recession.

This is documented in Figure 2, reporting the share of foreign-currency-denominated debt issuance in euros as well as the degree of euro area financial integration, as captured in the index calculated by the European Central Bank.

Figure 2. Foreign-currency-denominated debt issued in euro and index of financial integration



Source: Decalogic via ECB (2018) and ECB.
Notes: Share of EUR in bonds issuance is a 4-quarter moving average.

Both series increased between the launch of the euro and the beginning of the Great Recession, decreased substantially in the course of that recession and started a recovery around 2012. This shows a high correlation between the international use of the euro and the stress in the euro area financial market (as measured by the changes in its integration).

Taking into account the evidence in Figure 1, the question about the desirability of a more important international role for the euro can be formulated more precisely: should euro area authorities pursue policies that would increase the share of the euro as an international currency?

One often-mentioned advantage of issuing an international currency, mostly elaborated with the example of the dollar in mind, takes the evocative name of 'exorbitant privilege'[1].

International seignorage is the first item under this general term, referring to the pecuniary advantage deriving from the use of zero-yielding banknotes by foreign entities and from the lower yield on external liabilities due to the international demand for the sovereign paper of the country issuing the international currency.

While seignorage was estimated at a non-negligible 1% for the US[2], the much lower circulation of euro banknotes outside the euro area – with respect to the foreign circulation of dollar banknotes – and the absence of federal euro bonds – covering the same role as Treasuries – make this advantage much less significant for the euro area. Also, the cheaper external borrowing allowed by the issuance of liabilities in one's own currency is less important for a jurisdiction, like the euro area, with large current account surpluses.

Another aspect, often mentioned for the US, is the 'denomination rents' that banks derive from the use of their 'home' currency in international finance. As for seignorage, the advantage for European banks to conduct international business in their domestic currency is not as important as for US banks, since the former banks have significantly reduced their international activity during the financial crisis. In addition, for their international business, European banks use foreign currencies (in particular the dollar) more often than American banks.

Overall, the financial advantages stemming from the international use of the euro are quite limited. Analogously limited, however, are the disadvantages that could derive from such use for the conduct of monetary policy.

These disadvantages made the Bundesbank reluctant to allow the deutschmark to be used internationally and are likely to have led the ECB to its policy of *"neither hindering nor promoting the international use of the euro"*. But the much larger size of the euro area economy, with respect to that of Germany, and the emphasis of the ECB on interest rates rather than on monetary aggregates substantially attenuate the fear that external shocks may affect the conduct of monetary policy.

The most important benefit for Europe from a larger international role of the euro can be found in what one could call 'financial autonomy'. The influence over the EU, deriving from the extraterritorial reach of US rules, decisions and policies granted by the very extensive international role of the dollar, would be reduced if the euro had a wider international use.

This has become more relevant as the interests of the US appear more frequently different from those of Europe, as the case of Iran sanctions has recently shown. One could also link a wider international role for the euro to a multilateral set-up, in which the outsized role of any single currency would be reduced and competition between currencies would be enhanced.

Given the desirability of increasing the international role of the euro, the second question asked at the beginning of this piece is relevant: *"What are the tools that the euro area could deploy to pursue this objective?"*

A larger international role of the euro could be promoted if the ECB would surpass its 'neutral' attitude towards it. This would carry an important message and could be linked to the repeated requests of the ECB to complete banking union and progress on capital market union.

A possible operational development would be if the ECB would show willingness to enter into a series of swaps with central banks of countries that are extensively using the euro, while maintaining under its control the drawings on the swaps, lest they affect monetary policy.

The experience during the Great Recession has indeed shown that international money markets can seize up and central bank intervention may be needed to repair broken market intermediation. The opening up of swaps from the Federal Reserve of the United States to a number of central banks, including prominently the ECB, was a decisive step in this respect. The less forthcoming policy of the ECB in granting swaps to non-euro central banks was consistent with its 'neutral' policy towards the international role of the euro.

More importantly, the reversal of the gains in the international role of the euro accumulated in the first decade of monetary union, which accompanied the onset of the Great Recession, shows that substantial progress critically depends on the general stability of the euro area and, specifically, on the smooth functioning of its financial system.

So, for instance, the completion of banking union, progress on capital market union, the surpassing of the shock that will inevitably be wrought by Brexit, and the creation of a common 'federal' bond – which would cover in the euro area the role that Treasuries play in the United States – are necessary steps to increase the international role of the euro.

In a broader perspective, progress also in the set-up of euro area economic policy, in its fiscal and structural components, would favour a larger international use of the euro. In a still broader perspective, the international use of the euro would be expanded if the EU would pursue a more united, and thus more effective, external and defence policy.

These policies would have effects well beyond the international use of the euro and, while in principle desirable, they are not easy to be achieved. The choice to embark on them depends on broader considerations than just enhancing the international role of the euro.

The right perspective is that the broader international role of the euro, and the 'financial autonomy' that this would bring, would be an additional advantage to be taken into account while pursuing the aforementioned, much broader, policies. ■

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Endnotes
1. See McCauley 2015 for a recent formulation.
2. Combining evidence from US Treasury, 2006 and Cohen, 2012

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Panel counters UN climate conference

Switching away from fossil fuels not justified, experts say. Tom Harris and Jay Lehr review panel discussions that presented a more realistic view than COP24

For the first two weeks of December, the United Nations has been holding their 24th annual climate change scarefest, this time in Katowice, Poland. Dubbed COP24, the informal name for the 24th Conference of the Parties to the UN Framework Convention on Climate Change (UNFCCC), we are being told that the world is near its end if we continue to use fossil fuels. UN General Assembly president Maria Espinosa even went so far as to tell the international news agency *Agence France-Presse* that humankind is *"in danger of disappearing"* if we allowed climate change to progress at its current rate.

This is ridiculous, of course. The current rate of climate change is essentially zero since global temperatures have plateaued since the new millennium, a phenomenon known in the climate modeling community as the 'Global Warming Hiatus.'

Presenting a more realistic point of view in a panel held just a few blocks from the COP24 conference site, Dr Craig Idso, founder of the Center for the Study of Carbon Dioxide and Global Change, explained, *"Literally thousands of peer-reviewed scientific journal articles do not support a catastrophic – or even problematic – view of global warming."*

The panel, organized by The Heartland Institute, an Illinois-based free-market think tank, and the European Institute for Climate and Energy (EIKE), operated out of Germany, revealed that the goal of COP24 to redistribute the wealth of developed countries to developing nations to supposedly control Earth's climate is not based on solid science.

Where the speakers for COP24 offered no meaningful physical evidence to support their absurd gloom and doom predictions, the Heartland/EIKE team offered serious data to prove the opposite, including: sea levels are not generally rising more than 8 inches per century; hurricanes, floods, tornadoes, droughts and forest fires have not increased while carbon dioxide (CO_2) in the atmosphere has risen 40% in the past 70 years.

The panel event featured the unveiling of the latest in the *Climate Change Reconsidered* (CCR) series of reports from the Nongovernmental International Panel on Climate Change (NIPCC), an international network of climate scientists sponsored by three nonprofit organizations: the Center for the Study of Carbon Dioxide and Global Change, the Science and Environmental Policy Project (SEPP), and Heartland.

... it is clearly impossible to power modern societies with wind and solar alone or eliminate the fossil fuel back-ups required for the times when the wind does not blow and the sun does not shine

Titled *Climate Change Reconsidered II: Fossil Fuels* (CCR II – FF), this latest, over 700-page, CCR report was the culmination of the contribution of 117 scientists, economists, and other experts. It addresses environmental economics, the climate science overlooked or ignored by the UN's Intergovernmental Panel on Climate Change (IPCC), and, most importantly, the huge benefits fossil fuels provide to human health, welfare, living standards, and the global environment.

Joining Idso at the Heartland/EIKE event were Dr Horst-Joachim Lüdecke and Wolfgang Müller of EIKE; Dennis Avery, director of the Center for Global Food Issues; and James Taylor, Heartland Senior Fellow for Environment and Energy Policy. Let's tune in to hear what they had to say.

James Taylor opened the panel with the following remarks:

"At COP24 here in Katowice we have a gathering of the world's global collectivists, the climate totalitarians, the global ruling class elites. And what they want to tell us is that humans are creating a global warming crisis that necessitates people sacrificing affordable energy, people sacrificing abundant energy, and people sacrificing their own individual and national rights to turn over to the global climate bureaucracy…

"It is entirely fitting that this meeting is in Katowice… This is a mining area, particularly a coal mining area. This is a place where the economic impacts of restrictions on affordable energy and particularly fossil fuels are going to be felt hardest.

"Solidarity [Solidarity Labor Union] points out that half a million jobs in Poland alone rely on the coal sector. These are people that would be put out of work under the UN Agenda."

Craig Idso, a lead author for Climate Change Reconsidered series, spoke next and cited the five NIPCC volumes, explaining,

"Given what is compiled in those reports and the thousands of peer-reviewed scientific references therein, I can tell you with complete confidence that there is absolutely no observational evidence that provides any compelling support for the contention that there is something unusual, unnatural or unprecedented about Earth's current warmth. Neither are there any real-world data that confirm that floods, droughts, wildfires or hurricanes are becoming either more frequent or more severe as a result of global warming."

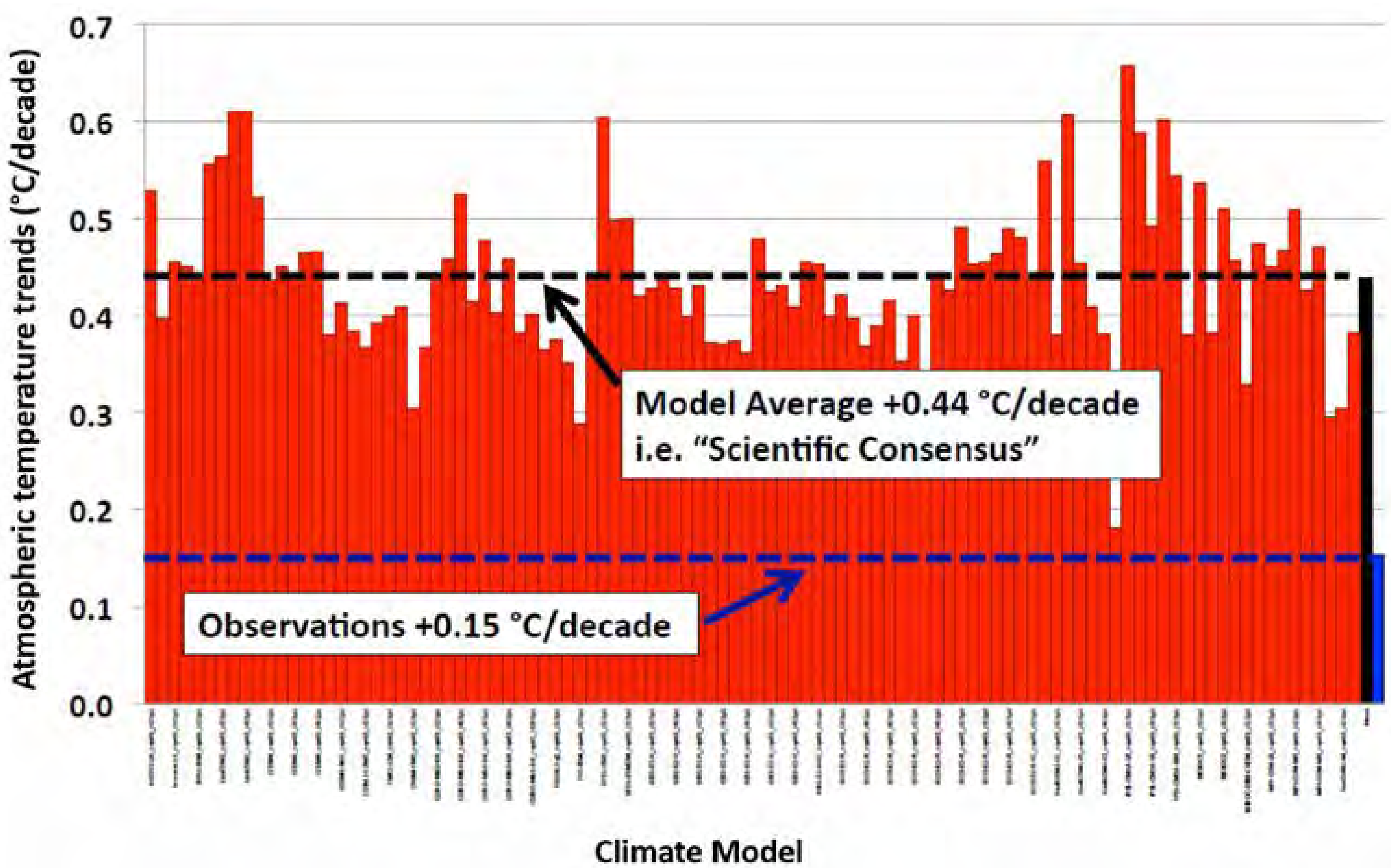
Idso continued to dash the popular, though unfounded belief that Earth's polar ice sheets are on the verge of disappearing and that sea levels are about to rise dangerously and swamp coastal lowlands. He also completely dispelled the notions that:

- *"searing heat waves are killing the poor and elderly and drying up precious farmland"*
- *"devastating diseases are spreading to regions previously considered immune to them"*
- *"migrating plants and animals will be unable to move to cooler locations fast enough to avoid extinction"*
- *"coral reefs will dissolve into oblivion as the oceans warm and turn acidic."*

Concerning the model forecasts on which the climate scare is based, Idso showed the below graph and said:

> *"... radiosondes [balloon] measurements shown in blue reveal that the actual warming rate is three times smaller than that predicted by the models [red bars show warming that should have occurred from 1979-2017, as predicted from 102 different climate models]."*

Model-predicted vs observed warming of the tropical troposphere



Similarly, Taylor finds that real world data does not correlate well with the original forecasts of the IPCC either. He stated:

> *"IPCC predicted in its first assessment report (1990) that temperatures would rise 0.30C each ensuing decade. Global warming has happened much more slowly than that, at a pace of merely 0.13C per decade. Now, IPCC has lowered its prediction to merely 0.20C per decade, and it will soon have to lower that one as well."*

Idso concluded:

> *"There is nothing unique, unusual or unnatural about the recent warming of the Earth.... The present run-of-the-mill warming, which began about 1860, is thus viewed as a garden-variety climate change of the type that has occurred over and over again for the past several hundreds of thousands of years without any help from humanity."*

Dennis Avery, a contributing author to the *Climate Change Reconsidered* series and co-author of the landmark book *Unstoppable Global Warming: Every 1,500 Years*, gave an overview of the history of climate change and society. He explained that societies become unsustainable, not because we overwhelmed our natural resources with overpopulation, as used to be thought, but because:

> *"Every so often, Mother Nature inflicted a little ice age on this planet and that gave us colder, shorter, cloudier growing seasons with massive changes in regional rainfall patterns and centuries-long drought that afflicted most of the Eurasian steppes, the whole Mediterranean basin, the American southwest, large tracts of Central and Latin America, and massive parts of China. Our cultures in the past failed because they couldn't feed their cities when the production from their fields was slashed by inopportune weather by 20 - 80%..."*

Indeed, we should welcome global warming. Avery said:

> *"The Earth has given us weather as good as we're enjoying today … about 10 to 15% of the last 200,000 years. We've had two 90,000-year ice ages [in this period] and the [rest of the years] have been split half and half between warmings like this—warm stable good crops—and climate chaos.*
>
> *"Climate chaos in the little ice ages—colder, less stable, storms, Noah's floods, centuries in which Europe, for example, could hardly harvested a grain crop because of the incessant rain. That was northern Europe, of course, and in southern Europe it was too dry to grow anything. Human number shrank.*
>
> *"Population surges in the past occurred during the global warmings when the crops were good…We supported [this larger population] successfully for centuries at a time [but] suddenly nature turns against our farmers. They couldn't feed the cities. Often, the farmers themselves couldn't find enough to survive. Egypt has a number of past cold centuries in which the Nile floods failed so consistently that parents were recorded by writers at the time of eating their own children…*
>
> *"Today, we've farmed beyond that vulnerability. We have improved our agriculture to the point where we could now almost certainly feed the population the Earth will have in the next little ice age from the farming resources and farming systems that we have today."*

Avery then explained that University of Hong Kong Archaeologist David Jang found that 90% of collapsed past societies failed during little ice ages. Avery said that in Mesopotamia around 2200 BC, one of the aspects of a little ice age that extended from Turkey down through Ethiopia was a 300-year drought that covered the whole region. There was *"no way to walk off. You were doomed,"* he said.

Avery revealed a very positive development of late:

> *"Stone Age man could feed about 2 people per square mile. Slash and burn farming can feed about 60 per square mile. But today humans are sustainably and consistently feeding 245 people per square mile and the average is still rising. Some of it of course has to do with what Craig Idso just told us about the enrichment of the air with additional CO_2, the plant food and the water enhancing factor that has done so much for us already and promises to do more."*

EIKE General Secretary Wolfgang Mueller spoke next about Germany's failed renewable energy experiment:

> *"Despite the fact that there is basically no science supporting this claim [catastrophic man-made climate change], there is in Germany this obsession with reducing CO_2—the decarbonizing of the economy and phasing out of fossil fuels. We started with the electricity sector and, you look back, what we do see: about 30,000 wind turbines installed in Germany, roughly 1 million solar installations on roofs and in fields, and at the same time, the CO_2 emissions didn't go down.*
>
> *"But something happened—electricity prices rose significant. In US dollars since, [we] paid 35 [or] 34 cents per kilowatt-hour. So, while we basically invested per year roughly 30 to 35 billion dollars in order to go green, we don't have any significant impact and … we created something which we now have to call energy poverty—fewer and fewer people are able to pay their electricity bills on time. They are disconnected from the grid.*
>
> *"So, while [Germany's] position is that we need more of it [solar and wind power], I have to say this is a very good example of insanity—when you do the same thing over and over again and just think next time there's a different outcome."*

EIKE's Dr Horst-Joachim Lüdecke followed up with a discussion about what science now knows about the influence of the changing sun on climate cycles. Lüdecke said:

> *"Science has very good indications for the influence of the Sun on the climate but nevertheless the IPCC refuses to consider it."*

The IPCC's 2013 Working Group 1 Summary for Policymakers' assertion that the impact of anthropogenic CO_2 on climate was 1.68 watts per square meter and that changes in the output of the sun were responsible for only 0.05 watts per square meter is *"ridiculous"* according to Lüdecke. He explained:

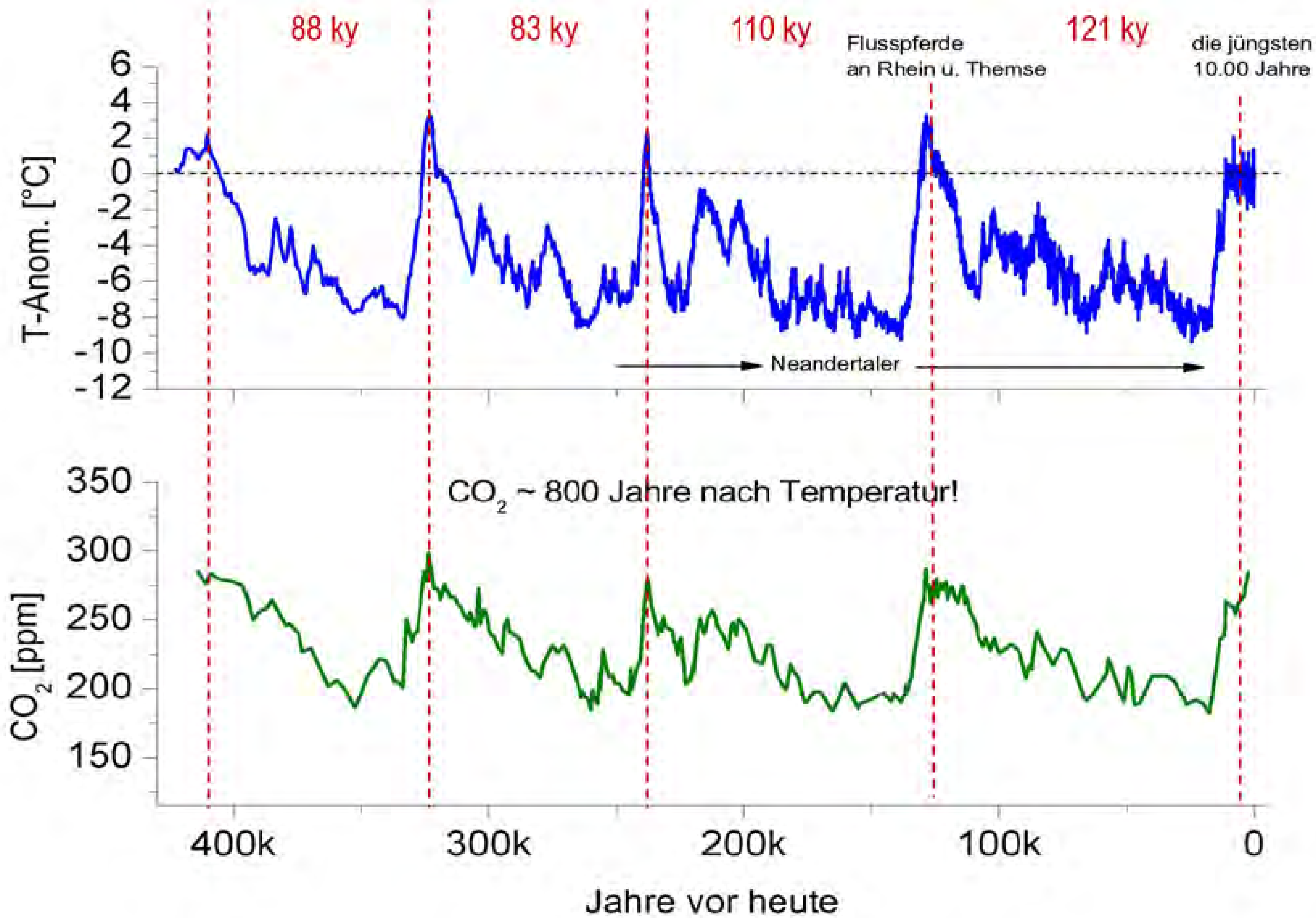
> *"The consequences of this neglection of the IPCC is that IPCC models, that does not include the power of the changing sun, cannot give reasonable results. Without including the Sun, it is impossible to model the climate. If there is any way to model the climate, you have to mention that the climate has so many parameters that it is a chaotic system, and it is my personal belief that it is never possible to [properly] model the climate."*

He also showed the famous Milankovitch cycles with periods of roughly 100,000 years as follows:

Lüdecke explained that the upper panel shows temperatures and the lower panel showed the CO_2 concentration of the atmosphere. He said:

> *"You see there is a very good correlation between the two-time series but, in reality, if you have a better time resolution, we know that CO_2 follows the temperature [by] about 800 years. That means that CO_2 is the effect and temperature is the cause, not vice versa. The explanation of this very interesting cycle is the change of the distance of the Earth from the Sun and the change in angle and the precession of the Earth's axis."*

Milankovitch Cycles: ~100.000 yr Period



HJLüdecke/V-Folie 2018

It should be noted that warmer water leads to more CO_2 outgassing to the atmosphere.

Lüdecke said:

> *"Man-made global warming today is a new religion. As one normally does not doubt religion, there are no real discussions about man-made global warming. The CO_2 alarmists avoid any scientific debate about causes of climate change—the religion of man-made global warming is not supposed to be questioned. Instead of this, they propagate worldwide action for establishing extremely expensive programmes to reduce CO_2 emissions. This means banning fossil fuels and replacing the reliable coal-powered stations [with] windmills and solar panels.*
>
> *"However, these renewables provide electricity only very costly and unreliably. In contrast to this, climate realists consider the scientific basics of climate change. In addition, they compare the huge costs of CO_2 mitigation against its absent benefits. Because of the deep differences between CO_2 believers and climate realists, a dialog between them is nearly impossible and seldom fruitful—if it takes place at all."*

American journalist HL Mencken's (1880-1950) asserted:

> *"The whole aim of practical politics is to keep the populace alarmed, and hence clamorous to be led to safety, by menacing it with an endless series of hobgoblins, all of them imaginary."*

Government officials who seek to extend their control over society have obviously come to the conclusion that man-caused global warming is the very best hobgoblin ever conjured up. In Katowice, speakers from around the world presented doom and gloom scenarios that, so they say, require the replacement of fossil fuels with alternative sources such as wind and solar power.

But it is clearly impossible to power modern societies with wind and solar alone or eliminate the fossil fuel back-ups required for the times when the wind does not blow and the sun does not shine. UN delegates apparently fail to understand that attempts to realize their goals would require the de-industrialization of developed countries and the consequent deaths of millions of people from starvation and/or exposure to the elements.

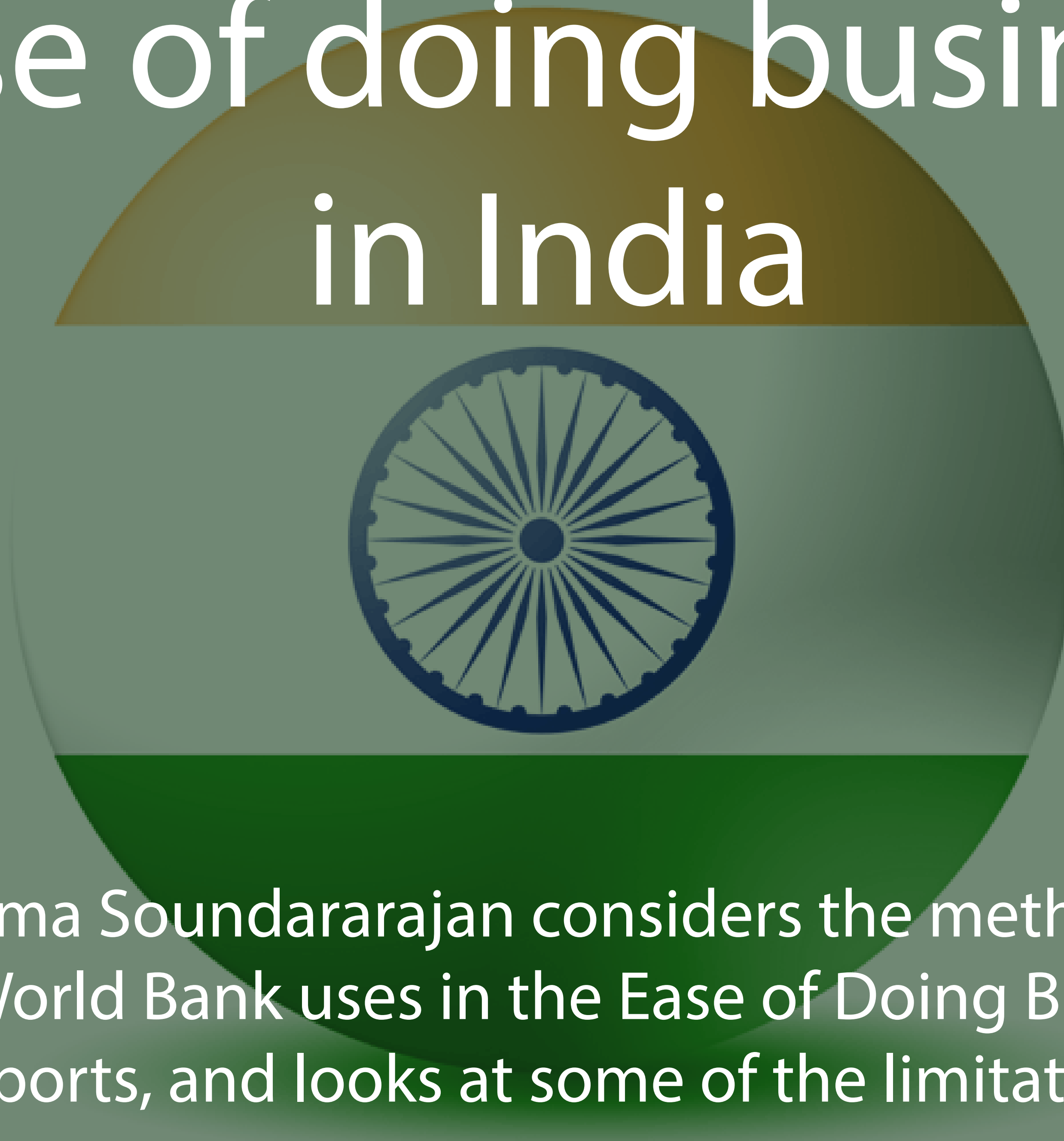
They also seem to not know that such a venture would eliminate the chance for the poorest of the poor in developing countries to ever climb out of poverty.

James Taylor ended the panel presentations by summarizing:

> *"It's extremely important that we stand up to the climate agenda that would impose expensive energy on the United States, expensive energy on the rest of the world, for absolutely no good. The reason why conservatives and skeptics challenge the science is because of these economic numbers that show the cost in the impacts of the UN climate agenda. And when we look under the hood and look at the science, [it] shows that there's nothing to be gained by sentencing ourselves to this poverty and human misery."* ■

Tom Harris is Executive Director of the Ottawa, Canada-based International Climate Science Coalition and is also a policy advisor to Heartland. Dr Jay Lehr is the Science Director of The Heartland Institute which is based in Arlington Heights, Illinois

Ease of doing business in India



Nirupama Soundararajan considers the methodology the World Bank uses in the Ease of Doing Business reports, and looks at some of the limitations

Recently there was some controversy surrounding the World Bank's methodology of *Ease of Doing Business* (EoDB) indicators. The case of India was discussed as an example. It has been suggested that the World Bank changes its methodology of calculation to suit the narrative of a particular kind of political campaign/ideology.

To prove this argument, this article uses the 'old methodology' of computing India's rank instead of the new methodology to show that there is in fact no significant jump in the rankings. This argument is further corroborated by the fact that investments in India, despite a significant jump in rankings, has not shown any remarkable increase. The latter is indeed a profound truth, but to assume that the rankings are merely a number and not the reality, only because investments have not grown, is over simplification of a more complex issue.

In today's global order increasing protectionism and general state of global economy, not to mention many other domestic limitations beyond ease of doing business, play a significant role in determining private investment. This is not to say that the World Bank's approach is perfect; it certainly has its limitations.

For instance, the World Bank only considers a couple of cities in each country and it is on the basis of the performance of these cities that a rank to the country is attributed. In the case of India, the rankings are based on doing business in Mumbai, the financial capital of India, and New Delhi, the national capital of the country.

Mumbai is the largest recipient of inward foreign direct investment (FDI), but this has also been attributed to the 'Mumbai effect.' Most companies have their head offices in Mumbai. So any FDI that comes into the country, irrespective of where the money is actually invested, is attributed to Mumbai since the company's head office is in Mumbai.

On the one hand it makes intuitive sense to consider these two cities, especially Mumbai. Having said that, the performance of Mumbai does not necessarily reflect the performance of other cities within the same state of Maharashtra, much less rest of India. The Indian government has been cognisant of this limitation.

Every year since 2014, the Department of Industrial Policy and Promotion (DIPP) under the Ministry of Commerce and Industry, in collaboration with the World Bank, has been releasing a comprehensive list of reform measures known as the Business Reform Action Plan (BRAP) for all state governments and union territories (UTs) to implement.

India follows a federal governance structure. This means that the responsibility of reforms under ease of doing business does not just lie with the central government, but with state governments too

The BRAP framework measures the state governments' and UTs' reform performance against a little over 400 recommendations on regulatory processes, policies, other practices and procedures spread across twelve broad reform areas.

These are labour regulation enablers, contract enforcement, property registration, inspection reform enablers, single window system, land availability and allotment, construction permit and environmental registration enablers, obtaining of utility permits, paying taxes, access to information, and transparency enablers.

The DIPP also conducts an input-based survey, seeking responses from state governments and UTs to assess the on-ground impact of any reform undertaken, and calculates the rankings of the states and UTs based on their implementation score.

Even though the state governments and UTs have been proactive in the implementation of these reforms, they have not necessarily led to any significant increase in either private and foreign investment or a growth in gross state domestic product (GSDP) of all states. In fact there is very little literature to suggest that an improvement in EoDB rankings for any country has led to any significant increase in investment or GDP.

The biggest drawback to even such an elaborate framework as DIPP's BRAP is that it approaches ease of doing business in a very unidimensional one-size-fits-all manner, when in fact, a more nuanced approach may actually lead to more visible outcomes.

India follows a federal governance structure. This means that the responsibility of reforms under ease of doing business does not just lie with the central government, but with state governments too. In fact, it also involves many urban local bodies within the state administration.

The socioeconomic landscape of each state is different from the other. Some states are agricultural states while some rely on manufacturing or the services sector to propel GSDP. A uniform approach to EoDB reforms will therefore have the desired effect only on few states, for the rest the reforms even if implemented completely may have little or no effect on their GSDP. For India as a whole it is almost a zero-sum game. To negate this, there are two alternative approaches to ease of doing business that India could adopt.

First, reform areas can be identified on the basis of a detailed cost benefit analysis for the state. An excellent example is the India Consensus Project for the Indian state of Rajasthan. The project was focussed on identifying interventions as part of the ease of doing business framework that would generate the most benefit for the state economy.

Pahle India Foundation’s study identified improving land records, specifically, conducting fresh round of land surveys and subsequent digitisation of land records, as a two-part reform that could potentially create exponential positive externalities. Our study found that every INR (Indian Rupee) 1 spent on surveying and digitising cadastral maps, leads to an additional benefit of INR 12 for Rajasthan’s economy.

This was found to be true for other states too. Every INR 1 spent led to a benefit of INR 14 for Bihar, INR 16 for Uttar Pradesh, INR 20 for Telangana, INR 23 for Maharashtra, and INR 31 for Tamil Nadu.

Amongst almost fifty other interventions for ease of doing business identified, digitisation of land records had the second highest benefit score. From an implementation point of view, this means that Rajasthan should ideally prioritise reforms in this area, in terms of both resource allocation and importance, for more visible growth in the state.

The second is to approach ease of doing business by sector and not by state. Each state would easily be able to identify three to five sectors that are of either economic or strategic importance to them. Under the current framework, even successfully implemented reforms typically affect a part of a whole chain of regulatory procedures. So while a couple of processes may have been 'eased,' other aspects of regulation remain as they were.

A classic example is that of a single window clearance system. In the BRAP framework, the single window clearance system has been given priority. Most states have in fact claimed to have implemented the same. However, a single window clearance has been implemented for most companies wanting to start a business, and that too only for those approvals that are required to register a company. Ideally a single window clearance system should be available for all regulatory approvals for every sector, irrespective of whether they are beginning operations, or they are businesses already present.

Approaching regulator procedures in silos also does not take into account the impact of lack of ease of doing business in one sector on the other. For instance, if the input sectors for any industry continue having trouble with their ease of doing business, the output sector in the same value chain will also face difficulties. Hence the second approach to EoDB has to be one that looks at integrated industry value chains.

The objective of easing doing business is to attract more private investment. Currently the Indian banking sector has been going through turbulent times and hence has affected growth of private investment. Foreign investment on the other hand has been coming in steadily in certain sectors like e-commerce.

Phase two to BRAP which should ideally be a combination of approach one and two. Developing economies are constantly trying to find the perfect balance between funding social welfare and economic development. A cost benefit analysis will help in prioritising.

The second approach will have more tangible benefits for industries that are already doing business and provide the necessary impetus to private investment. The initial phase of EoDB has been successful because the states have realised the importance of these rankings. It is now an ideal time to move to phase two for realising the real outcomes. ■

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Between a rock and a hard place

European companies are squeezed between US sanctions and the new EU blocking statute. Matthew Oresman and Henrietta Worthington discuss

The US recently re-imposed sweeping sanctions against Iran over the objection of the EU and various European governments. In response, the EU issued a new 'blocking statute' to counter these sanctions and provide some level of relief to European companies. However, European companies are now caught in the crossfire as this patchwork has created a host of complex options and processes for those who are still involved in Iranian-related transactions, even indirectly or unintentionally. European companies are very much caught between a rock and a hard place.

US sanctions

For European companies, 'the rock' is the very real possibility of being sanctioned themselves or incurring other penalties for breaching US sanctions. The US has confirmed that it intends to make life difficult for anybody doing business in Iran.

The US completed the 'snap back' of its rigorous sanctions regime on 5 November, along with the announcement of a large number of new Specially Designated Persons and Blocked Nationals (SDN) designations. Secretary of State, Mike Pompeo, has stressed the importance of the re-imposed sanctions, stating that they are *"an important part of our efforts to push back against Iranian malign activity"* and that *"the United States is going to enforce these sanctions."*

The impact of US primary and secondary sanctions is far reaching. For example, primary sanctions can apply to any person transacting in US dollars, even from outside the US, because virtually all dollar denominated transactions pass through the US financial system in some way, even if just for a moment when they are 'cleared.' Secondary sanctions can be applied to companies even when there is no US jurisdictional contact; secondary sanctions apply to a number of specific categories of activities, including participating in Iran's energy sector and engaging in transactions with Iranian SDNs.

The Office of Foreign Assets Control (OFAC) has shown its willingness to impose significant penalties on companies violating US sanctions. In 2015, the US Treasury fined BNP Paribas almost $9 billion for sanctions infringements in respect of Sudan, Cuba and Iran. Penalties of about $1.3 billion have just been announced for Société Générale for the same, and there are many other examples.

There is increasing pressure on the EU to come up with a workable solution, with Iran threatening to scrap what remains of the nuclear deal unless the EU can offer sufficient economic protection

EU Blocking Statute

The EU's Blocking Statute is the 'hard place,' as it aims to counter the effect of the re-imposed US sanctions. The EU has stressed its commitment to the Iran nuclear deal, and its amended legislation is testament to its intention to keep the deal alive.

The statute takes a three-pronged approach in its attempt to protect EU businesses. Firstly, it forbids EU companies from complying with US sanctions, unless they have a specific authorisation to do so. EU operators may apply for approvals in circumstances where *"non-compliance [with US sanctions] would seriously damage their interests or those of the Community."*

The EU has tried to put some weight behind this exception by publishing, for the first time, the mechanics for making an application. This could be indicative of the EU's intention to enforce any breaches which have not been specifically authorised. However, there are also queries as to the robustness of this provision, given the difficulties in proving that any withdrawal from Iran was due to US sanctions, rather than a legitimate business decision.

Secondly, the Statute nullifies any foreign court judgements based on US Iranian sanctions, including court rulings and arbitration awards.

Finally, it allows companies to recover damages incurred because of the US sanctions from the person who caused them. Exactly who will be the defendant in each case will depend on the specifics of the case, the kind of damage caused, the person or entity causing it, possible shared responsibility, etc. The language is vague enough to allow for the possibility that claims could be brought against the US by an injured company under this provision.

To further reinforce its commitment to the Blocking Statute, the EU also published guidance to help companies navigate its terms. EU operators are also required to inform the European Commission where their interests are affected by US sanctions on Iran.

However, whether the regulations really offer significant protection in practice remains to be seen. Member states are responsible for enforcing the regulations, which will lead to inconsistencies in implementation across the bloc.

Historically, there has been a serious lack of EU member state enforcement for breaches of blocking regulations. Only Austria has ever brought charges under the Blocking Statute and the case never even advanced to a prosecution. This is in stark contract to OFAC's eagerness to enforce US sanctions breaches.

A huge question mark remains as to whether a member state would sanction one of its prized corporate assets for complying with US laws in order to avoid high fines in the US. However, this is distinctly possible, particularly considering the current transatlantic trade tensions.

The House of Commons European Scrutiny Committee released their comments on the Blocking Statute, acknowledging that *"it puts EU and UK companies in the position of having to choose between risking enforcement measures at home (if they choose to comply with the American sanctions) or in the US (if they abide by the Blocking Statute and ignore the US legislation."* However, no guidance has been given on either side as to how companies should navigate these conflicting rules.

Other initiatives

Whilst the EU, and in particular Germany, France and the UK, have stressed their commitment to the Joint

Comprehensive Plan of Action (JCPOA), the US is holding all the cards. In July, Mike Pompeo and Steven Mnuchin formally rejected an appeal from E3 ministers requesting various exemptions to the re-imposed US sanctions.

The second wave of US sanctions – targeted at Iran's oil, financial services and shipping industries – provided no clarity or reassurances to EU companies.

Along with the completion of the 'snap back' came the announcement that SWIFT (the international financial messaging system) would comply with US sanctions. Secretary of State Mike Pompeo also highlighted the strict US position on enforcement against financial transfer messaging platform providers.

Heiko Maas, the German Foreign Minister, has indicated that Europe, like China and Russia, could look to create its own euro-based SWIFT system. However, the Chancellor, Angela Merkel, has warned against undermining the transparency of SWIFT, which helps to weed out financial crime – further provoking fears that Iranian transactions will move underground.

This has forced the EU back to the drawing board to develop financial messaging that is 'outside of US influence'. The most promising suggestion was for the EU to establish a 'Special Purpose Vehicle' (SPV) to process Iran-related payments, but this initiative looks to have collapsed.

In theory, this SPV would have sat outside the international banking system with the aim of protecting EU companies from the reach of US sanctions. It would work as a kind of clearing house, offsetting Iranian exports against purchases of EU goods whilst avoiding any actual banking transactions.

EU diplomat, Federica Mogherini, told the UN general assembly that the SPV would *"allow European countries to trade with Iran in accordance with EU law and could be open to other partners in the world."*

However, the idea has hit multiple hurdles, with no EU country willing to host the SPV. European companies also appear not to be buying into the idea and are instead bowing to the fear of consequence for breaching US sanctions.

A further blow came with Austria's confirmed refusal to host the SPV, prompting questions as to its feasibility. The EU was aiming to have the SPV up and running by the end of November, looking to Luxembourg to step up to the challenge, but this is looking increasingly unlikely.

Despite all good intentions, Europe will be heavily constrained in its ability to uphold its commitment to the Iran deal unless it is able to find a *"financially independent sovereign channel"* to move funds to, and from, Iran. With the commercial banks off the table, EU members are considering using their own central banks to handle Iranian transactions.

The gamble here is that the US wouldn't dare to sanction an ally's central bank. However, US pressure groups are already proposing that the US sanction individual central bankers if the banks themselves are off limits. Once again, it appears the central banks are afraid of being cut off from the all-dominant US financial market. No bank, as yet, has shown a willingness to take that risk. The European Investment Bank's board was quick to refuse any involvement.

In yet another show of US determination to cause the collapse of the Iran deal, it has offered its assistance to American allies importing Iranian oil to find alternative sources. National security adviser, John R Bolton, confirmed that the US *"[does] not intend to allow our sanctions to be evaded by Europe or anyone else."*

Even the waivers granted by the US come tinged with their commitment to cripple the Iranian economy. The pre-JCPOA system on Iranian oil exports has been reinstated and exemptions have been granted to eight countries on the condition that they commit to reducing their purchases. They must also use escrow accounts designed to keep hard currency out of the hands of the Iranian regime.

How are companies reacting?

The Blocking Statute is of particular relevance to EU subsidiaries of US companies. It does not apply to EU branches of US companies, or US subsidiaries of EU companies, which are only subject to US law. However, the long reach of US sanctions will leave EU operators with activities in Iran vulnerable.

Probably the best marker of the EU's success in countering the US's aggressive Iranian standpoint is the response of European multinationals to the re-imposed US sanctions.

Almost without exception to date, businesses caught by both the EU and US regimes are choosing to step away from the Iranian market. Companies including Total, Maersk, Eni, Boeing, and Peugeot were quick to confirm that they would exit their Iran activities.

BP also announced that it would be suspending a joint venture with an Iranian partner, stating that *"BP always complies with applicable sanctions. We cannot defy the United States."*

However, EU operators should be aware of the risks of cancelling planned activity in the absence of an authorisation, particularly if member states show the political commitment to apply the Blocking Statute strictly.

Whether such a cancellation is based on true economic considerations, or because of concerns related to US sanctions, may not be an easy analysis to demonstrate to EU regulators; obtaining authorisation therefore may offer a safer approach.

The EU has started looking to its SMEs to lead the charge on activities in Iran. Smaller companies with limited or no operations in the US have the opportunity to grow their Iranian businesses – provided the SPV, or other payment channel, can be secured.

Meanwhile, US diplomats have been working with exactly these companies to help them find new markets and business opportunities outside of Iran. US representatives from the Commerce Department have been holding seminars in the EU devoting time and resources to thwart any attempt for the SMEs to bring economic benefits to Iran.

SMEs may take the view that they are too small to be targeted by the US for sanctions breaches. However, they should be wary given all recent US rhetoric: they may not slip under the radar if the US wants to make an example of them.

What next?

US sanctions already appear to be taking their toll: Iranian oil exports are on the decline and its currency is plummeting. There is increasing pressure on the EU to come up with a workable solution, with Iran threatening to scrap what remains of the nuclear deal unless the EU can offer sufficient economic protection.

Whilst companies run the gauntlet between the conflicting regimes, the question remains as to which one they should obey. It is evident that businesses perceive the risk of falling foul of US sanctions to be a greater threat than the protection offered by the EU – and until the EU proves otherwise, they are probably right. The good news is that the Blocking Statute allows EU companies seeking to comply with US sanctions a process to obtain authorisation and avoid being crushed by the conflicting laws. ■

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Why global professionals turn to tradition when it comes to dating

Technology is being left out while modern matchmakers gain market share in the ever growing business of love, Kirsten Gray writes


Love
is
in the
air

Transparency, values, and most importantly honesty was largely lost in the wave of dating apps in recent years. Besides these irksome realities, many, especially the elite, just don't have the time to waste online. After matching people while working for Great Expectations in the 1980s, Jill Kelleher founded Kelleher International Matchmaking in San Francisco over 30 years ago.

There was a real void for matchmaking, and she was good at it. *"Kelleher launched in 86', and many of my clients were high profile. They did not want to be seen by everyone. Today, the elevated professionals I work with do not want to be on Match or Tinder. They are picky, have busy schedules, and have to protect their assets,"* says Jill. Today, with CEO and daughter Amber Kelleher-Andrews, Kelleher International has continued to grow which has made it one of the largest privately-owned matchmaking firms in the world.

In the digital age, there is too much choice. Having someone narrow the choices to a pool of people you are more likely to be interested in is critical in finding 'the one'. Algorithms, unlike their use with dating apps, are not part of the process in modern matchmaking services. *"We do have a way of customizing the matchmaking, but it is not calculated by a computer. We start with the priorities, asking the most important questions first, and then work our way from there,"* says Jill.

The individuals that come on board with matchmaking services are serious. They have given a lot of thought on how they are going to find love; they have the right attitude, and also realistic expectations. With online dating, people are simply choosing from a few pictures, and their potential date's perfected profile (if there is anything of value even in there). In matchmaking you are paired based on what's beneath the facade. Many singles online are also only looking for entertainment.

"Online dating has watered down courtship and the experience of dating. There's an illusion of a bottomless pool of singles to choose from so swipe-happy singles don't invest much effort - if any - in getting to know someone before they're onto the next. Our matchmakers push back on those attitudes and make sure the clients are as thoughtful in the process as we are at making their matches," Amber adds.

So where are all of these serious, and eager to find lasting love singles coming from? *"About 40% of our clients are referrals,"* says Amber of Kelleher. *"We love International referrals and are always excited to work with individuals overseas. With boots on the ground in several countries we are standing by and ready to search for specific matches no matter how picky someone is!*

Fortunate for us, our brand has been around for over 30 years and has been recognized both nationally and internationally as the top global matchmaking firm. People often know us best from television appearances and the airlines," she adds.

Kelleher's exclusive introduction agency actively works with discerning and affluent clients in the UK and internationally and includes some of the world's most jet-set men and women. And it's not just male billionaires looking globally for a spouse using their services, successful women also turn to Kelleher International for confidential introductions.

The way we work with these individuals is a specialized search based on their specific criteria. *"Right now I am personally focused on finding an amazing man in his 40's or 50's for a beautiful female elite client who lives in London,"* says Founder Jill Kelleher.


Founders, Amber Kelleher-Andrews and Jill Kelleher

Amber and Richard Branson

Finding a perfect match could take as little as a month, to as long as a year, because it's a lasting match that matters to modern matchmakers. Quite differing from the instant gratification of online dating apps. But sometimes you get lucky. Really lucky. *"70% of our clients find a winning match on their first introduction,"* says Kimberly Colgate Global Director of Memberships for Kelleher.

This may sound hard to believe but think about it this way. *"There may be someone in our network of singles for some time, but then a new client can walk in that is a fit for them. It is not necessarily the first match for both parties, but it would be a first and lasting match for the new client."* If that isn't amazing enough, Kimberly goes on to tell me that Kelleher has two generations of marriages and even siblings who both found lasting love through Kelleher.

Kelleher not only has high profile clients, but they also give back. *"We have created an experience that goes beyond the match. We match people with their passions, and members align themselves with other philanthropists. We like to call it changing the world one match at a time,"* says Amber Kelleher-Andrews, CEO of Kelleher.

In the last five years, Kelleher's introductions collectively have raised over forty million dollars for various philanthropic endeavours. Examples are raising funds during retreats on Necker Island for Richard Branson's Foundation (Virgin Unite) helping to preserve the rainforest in Panama (Mamoní 100), aid to the Virgin Island for recent Hurricane relief, endangered Wildlife in Africa (WildAid), mindfulness in schools in America (Mission Be), and changing the way we fish in the Galápagos Islands to name a few. *"One introduction alone has also led to a multi-billion dollar fund that is currently in the works,"* says Amber.

There are also times when singles contact Kelleher who are in transition and not quite ready for a committed relationship but looking for assistance to prepare them for the dating world. This is where the head of their *Matching On Purpose Coaching Team*, Chief Relationship Officer Sunya Andrews steps in.

"We focus on meeting our Clients where they're at, we specialize in personalized program design. We know that there is no black and white in love-making, some are very interested in personal growth opportunities while being matched, while others need a strong sounding board as they dive deeper into a relationship.

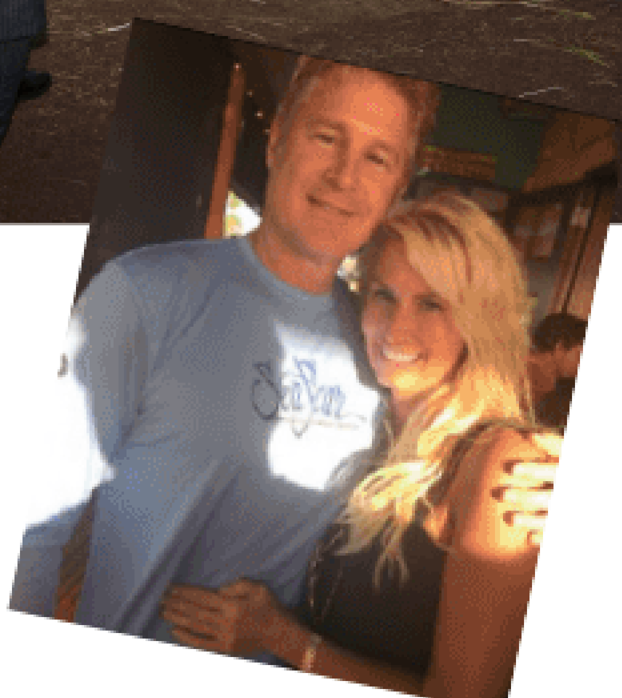
Most want honest constructive feedback and that's where our Matching Coaches shine... Our Clients success is our success, we are all on the same team, with the same goal, our Matching On Purpose Coaching Division gives our Clients the winning edge." says Sunya.

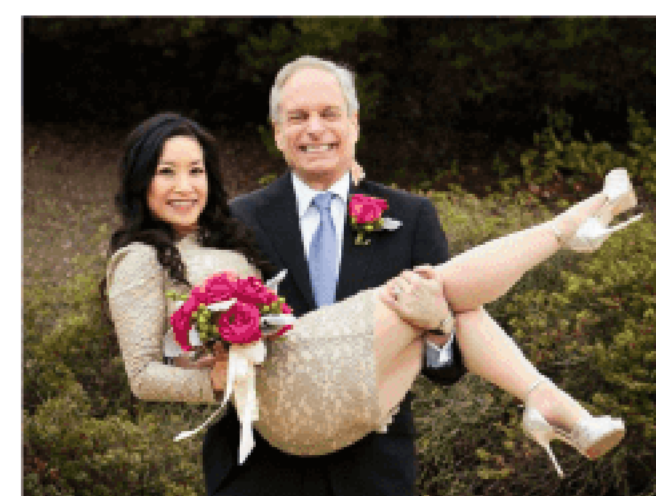
In today's world, there are endless means to find love. Today's matchmakers may be taking a modern twist in their approach, but their values lay in tradition, which is something many professional singles long for. At the end of the day, it all comes down to time, and many of us prefer it well spent.

And they lived happily ever after… ■

KELLEHER INTERNATIONAL

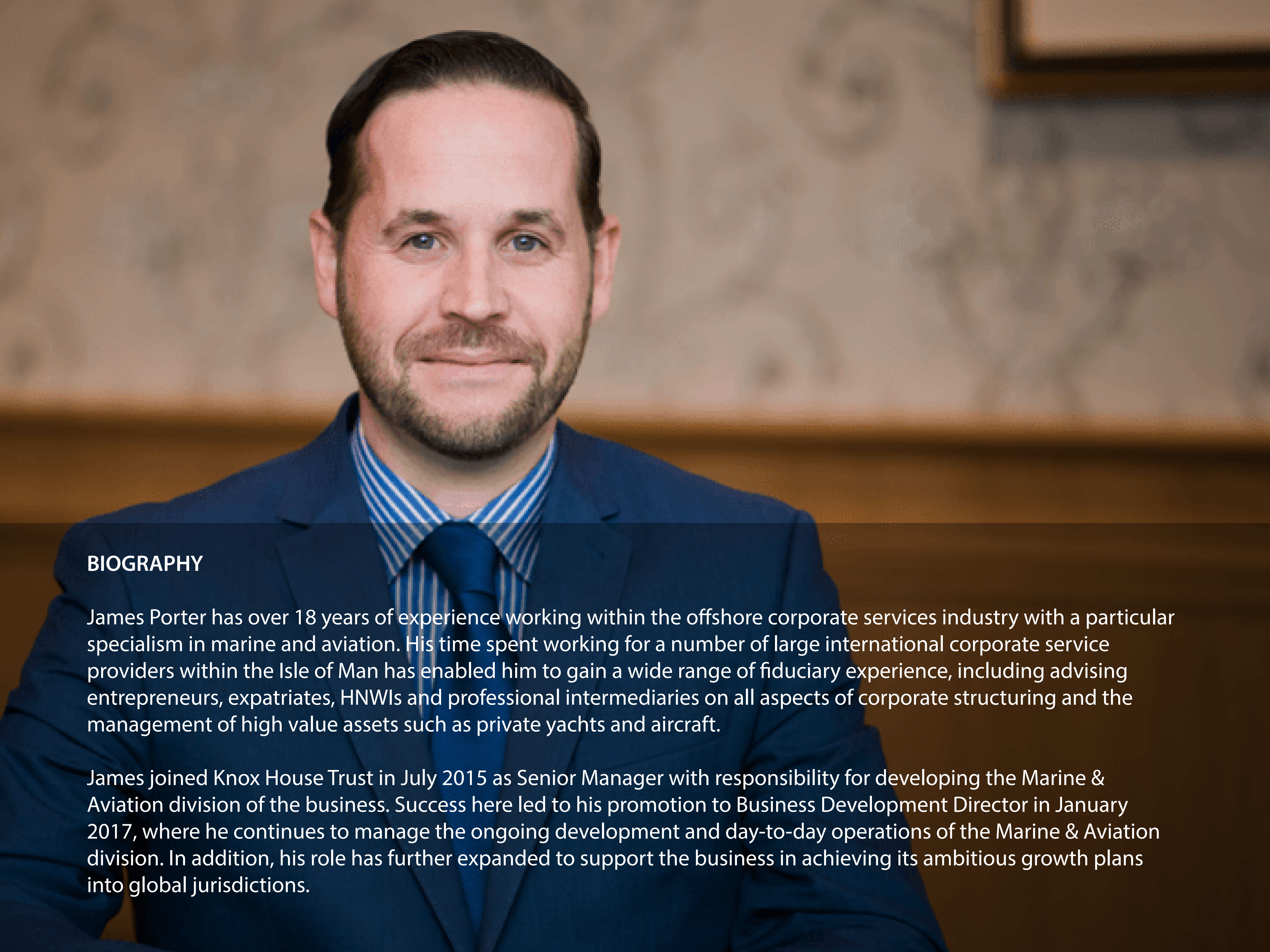
Kelleher success stories





Tailored expertise

In a Q&A with World Commerce Review, James Porter of Knox House Trust (KHT) discusses how the company's ethos of putting clients at the heart of everything they do has led to innovation, industry accolades and an ever expanding global client base within their business sector



BIOGRAPHY

James Porter has over 18 years of experience working within the offshore corporate services industry with a particular specialism in marine and aviation. His time spent working for a number of large international corporate service providers within the Isle of Man has enabled him to gain a wide range of fiduciary experience, including advising entrepreneurs, expatriates, HNWIs and professional intermediaries on all aspects of corporate structuring and the management of high value assets such as private yachts and aircraft.

James joined Knox House Trust in July 2015 as Senior Manager with responsibility for developing the Marine & Aviation division of the business. Success here led to his promotion to Business Development Director in January 2017, where he continues to manage the ongoing development and day-to-day operations of the Marine & Aviation division. In addition, his role has further expanded to support the business in achieving its ambitious growth plans into global jurisdictions.

What is the back story of KHT?

Knox House Trust (KHT) was established in 2011. We are an independent, privately owned trust and corporate services provider offering corporate and fiduciary services to a diverse and expanding global client base. KHT forms part of the dynamic Knox group of companies that collectively employs over 350 people, with assets under management and administration approaching £3 billion.

Being part of the wider group enables us to combine our services with those offered by the collective group, including investment, property services and financing. KHT also has a particular strength in Family Office management and runs a professional multi-family office which offers clients a 24/7 concierge service.

Our services further extend through our Knox House Marine & Aviation division, which was established in 2015. Today we proudly manage a large and diverse portfolio of aircraft and yachts. Yachts range from world renowned 70+ metre charter vessels and private superyachts, to the more adventurous 20+ metre explorer, sail and racing yachts.

We have been recognised by the industry for our innovative approach to the creation of truly bespoke solutions designed to the exact needs of our clients.

How we help our clients?

We place great emphasis on getting to know clients and advisers in the first instance. Fully understanding their circumstances from the outset enables us to develop effective strategies that not only protect but can also enhance assets. This is even more important in today's global marketplace where business has much more of an entrepreneurial nature, and can transcend international borders, making it vital to have people who understand the ever-changing landscape.

Our team of experts have crafted a robust and comprehensive range of services, which address the complex and sophisticated needs of high net-worth individuals. Our appeal is further strengthened by our independence, which enables us to act in a responsive and agile manner, and helps to drive our innovation and our desire to exceed expectations at all times.

... our team of experts have crafted a robust and comprehensive range of services, which address the complex and sophisticated needs of high net-worth individuals

All our relationships are director-led with the director having day-to-day responsibility for the client's affairs.

Part of my role is to get out on the road to promote our existing services and also to meet with industry leaders and advisers. Prestigious industry events such as Monaco Yacht Show, Corporate Jet Investor and EBACE (European Business Aviation Convention and Exhibition) are among those I annually attend. By doing so, we gain instant feedback on our service offering from both clients and industry leaders, and it's also invaluable in helping us to identify any service gaps or new opportunities within the marketplace.

Tell us about the introduction of your new Crew Services?

Much of our service evolution has come from client or adviser feedback, and their wish to use more of our services. Within our Marine & Aviation business this is no exception, as we continue to try to exceed expectations and offer a truly bespoke service.

We launched our Crew Payroll service in December 2017, which offers a wide range of payroll solutions. All are fully compliant with the ILO Maritime Labour Convention 2006 (MLC), which was created to establish international minimum working and living standards for seafarers.

Our team also manage all aspects of employer tax and social security liabilities through our fully automated payroll system. As with the yachting industry in general, it is an ever-changing landscape. Our team are continually monitoring the regulatory and legal landscape to stay ahead of the game and be aware of any emerging issues.

In July 2018 we further expanded our Marine offering with the launch of our Crew Recruitment service, which offers employment opportunities at every level from deckhand through to captain.

What experience does KHMA have within the Crewing sector?

We understand that the crew are the most important working part of any yacht. This ethos, together with our industry knowledge and proven experience, is what helps set us apart. Our team has over 20 years of experience working within the marine sector. During this time they have developed an extensive network of industry contacts and in-depth knowledge of legislation, practice and technical knowledge.

A proactive approach to monitoring the legal and regulatory landscape also ensures we are well aware of any emerging issues before they happen, enabling us to stay that one vital step ahead for our clients.

On a daily basis we interact with wealthy individuals, entrepreneurs, corporations and wealthy families, all of whom expect the highest levels of service excellence and commercial integrity from us, and within our crewing division this is no exception. Our ongoing attention to detail in managing client's affairs ensures that we continually deliver peace of mind and outstanding personal service.

You have also launched a Shipping service – tell us why?

We are based in the Isle of Man, which boasts one of the world's leading registers of ships and superyachts, so establishing a shipping service was a natural progression for us. The service requirements are of a similar nature to yachting, and our experienced team work closely with the Isle of Man Ship Registry to assist ship owners and charter companies with a range of corporate and specialist services.

The registry also provide advice and regulatory oversight for the vessels on the register and take a partnership approach to doing business – something which aligns to our core values in terms of a collaborative approach.

We favour working with both clients and their professional advisers to ensure we fully understand their requirements and personal circumstances. We can therefore create tailored solutions to meet specific needs.

Our Shipping services include applications for Ship Officer Certificate Endorsements, along with our ability to act as the Isle of Man representative person, for a wide range of ships, including offshore vessels, tankers, car carriers, cargo ships and many more.

You recently attended the prestigious Monaco Yacht Show – how was the show this year?

The Monaco Yacht Show has continued to go from strength to strength, attracting the elite of the yachting industry for over 28 years now. It brings together experts in the areas of naval architecture, marinas and shipyards, as well as yacht brokers, marine suppliers and media for a whirlwind four days at the end of September each year.

Visitors this year were able to admire 120 of the world's finest superyachts on display in Port Hercules; 40 making their worldwide debut.

For us personally, 2018 proved to be the busiest and most important yacht show of the year. In what was the 28th edition of the show, 2018 also saw a number of uncertainties and potential changes for the industry, including Brexit and the challenge of the Maltese and Cypriot leasing structures.

It is well known within the yachting industry that the EU Commission issued a notice to Malta and Cyprus in March of this year, advising that they intended to commence infraction proceedings against them in relation to their leasing structures. Malta robustly defended the structure while agreeing to revisit the general terms.

What we do understand is that guidelines to the new Malta Leasing structure have been drafted, but delays with formalising these guidelines continue. Attending the show allows the KHMA team to meet with new owners, client representatives and industry contacts to deliberate and discuss the challenges facing our industry, while also gaining first hand insights.

The yacht market is thriving and yacht sales continue to rocket, with many companies stating that 2018 has been the most successful year on record. Our contacts in the industry have suggested that the US high-net-worth economy, which has had a lift from President Trump's tax breaks, is the source of some of this increased activity.

With more deals signed and a sense of increased market activity afoot, the docks of Monaco were teeming with positive vibes. In summary, the 2018 Monaco Yacht Show was, by our account, a very successful show and the team are already putting plans in place for the Monaco Yacht Show 2019.

More recently, you attended the Superyacht Forum Conference – what were your key takeaways?

Developments in recent years have seen this conference featuring a core theme for each edition, and this year was no different, with The Perfect Customer Journey taking centre stage as the focal point.

The four-day event covered a series of topics, workshops and presentations from keynote speakers that analysed the current customer experience and debated better ways of engaging and connecting with future owners. In addition, there were several high-calibre industry speakers who presented on some of the most pertinent industry issues impacting on the yachting marketplace. Particular highlights for me included:

A panel of the industry's brightest minds who explored how, in the current climate of ever-increasing transparency, both public and legal perception of various taxation structures has changed, as well as how various jurisdictions have had to evolve their practices in order to benefit the superyacht owner.

During a session called 'The Insurance Market', the industry explored the factors that created the insurance market's race to the bottom, as well as analysing where the market is going and how this translates into tangible benefits for superyacht owners.

Another highlight was the 'Business of Ownership' workshop which discussed flagging regulation, finance and management from the perspective of professional service companies, and covered all aspects of ownership and use of superyachts.

However, the 'Future of Brokerage' stole all the limelight! We heard from three passionate yacht owners who explained how their smart initiatives are reinventing models of ownership and charter.

Ahoy Club and Yotha are challenging conventional models of ownership and charter. Ahoy Club in particular announced that they have launched a digital platform for chartering, and went on to promote their guarantee, which seeks to offer the lowest booking rates in the market, and will smash the current 20% model offered by the majority of yacht charter brokers. Needless to say, this session prompted much resistance from the marketplace.

The Superyacht Forum covered all aspects of 'The Perfect Customer Journey' and discussed how the market can continue to improve. The conversations with owners addressed many issues that the industry still needs to work on in the future and also reaffirmed some of what we are already hearing and experiencing with our own yacht owner clients.

On a final note – what do you see being the main challenges in 2019 for the Marine & Aviation industry?

In one word – Brexit! The decision to leave the European Union has led to a great deal of uncertainty. Despite widespread conjecture, we are all still in the dark as to what the consequences of this historic vote will bring, or how it will impact the superyacht market and the marine industry overall. That said, our team of Marine specialists continue to monitor developments and discussions as they unfold.

We will continue to attend high profile industry events and conferences, not only to seek out new business opportunities, but more importantly in these times of uncertainty, to stay connected with leading figures and decision makers within the industry. This will allow us to remain informed and to play a part in the industry debates and discussions as they take place, so that we can decipher the challenges and opportunities to come.

Rest assured, whether we face a 'deal' or 'no-deal' Brexit outcome, existing and potential owners will continue to need the expertise and advice relating to all aspects of yacht ownership from businesses such as ours – and our team will be here to carry on with business as usual, seeking out the best solutions for each and every client. ■

For more information about Knox House Marine & Aviation visit www.knoxhousetrust.com

Cybersecurity: at the forefront

Within the ever-evolving cybersecurity landscape it is important to share information and share communication. Bermuda participated at the recent Cybersecurity Risk Conference held in Baltimore, Maryland

Everyone, everywhere is concerned about, or at least interested in cybersecurity. Are the systems we have in place enough? What is best practice? What are other organizations and countries doing? What can we do to get ahead of the curve?

It is no secret that enterprises will have to change the way they do business and secure their digital assets in order to meet their ever-evolving needs.

Going hand in hand with the changing customer landscape and business practices is the general overarching need for a mindset change. While customers and system users are for the most part aware of the sensitivity of digital assets, comprehension often lacks on the scope, impact and possible severity of a cybersecurity breach.

It is also key to balance the needs of the customer with the need for tighter controls and practices due to the cybercriminal element. Cybercriminals and attacks evolve in the same manner as the customers they target or indiscriminately invade. It is important to remember that although the nature of attacks may not change, the tactics will. It is imperative that enterprises respond in like, through proactive education, awareness training, monitoring and controls.

Also, with the ever-evolving cybersecurity landscape, it is important to share new information and encourage communication; not just between fellow organizations but jurisdictions as well.

Bermuda in Baltimore

Recently a delegation of team members from the Ministry of National Security within the Government of Bermuda represented the Island of Bermuda by participating in the NIST (National Institute of Standards and Technology) Cybersecurity Risk Conference held in Baltimore, Maryland.

The conference aimed to share and explore best practices and to encourage stakeholder input on key cybersecurity and privacy risk management topics - and it did just that!

The three-day event was attended by an estimated 700 cybersecurity and privacy professionals from a wide variety of organizations ranging in size, background and needs, and covering topics that included privacy engineering, maintaining cyber-situational awareness and using NIST standards to develop an information systems risk management programme for a small Government.

It was apparent that the current cultural shift taking place in the cybersecurity sphere was phenomenal because more and more organisations were taking seriously the requirements for a safe and secure enterprise

The NIST Cybersecurity Risk Conference also aimed to provide an inclusive experience, one that not only gave guidance and direction to large enterprises but also to smaller business professionals that understand the importance of promoting digital awareness and security.

The value of the meeting of minds was not only the information that was expertly - and at times entertainingly - presented, but also the candid and fruitful conversations that were sparked.

The experiences shared through roundtable discussions and workshops allowed cybersecurity professionals the opportunity to present their real-life situations and allowed others to seek solutions through guidance in areas such as vendor management and compliance.

It was apparent that the current cultural shift taking place in the cybersecurity sphere was phenomenal because more and more organisations were taking seriously the requirements for a safe and secure enterprise.

Bermuda provided an overview of the Information Systems Risk Management Programme it developed to protect information and information systems within its Government departments. The presentation, led by Stuart Daniels, Security Manager for the Government of Bermuda, outlined the steps taken by the Government, recognizing that the security of Government information systems and other related critical infrastructure, were vital to the success of the country.

Stuart Daniels, Security Manager for the Government of Bermuda

Although Bermuda is a small island, it hosts many international businesses, and the Government of Bermuda is a diverse and complex organization which presents a unique set of challenges. Daniels explained how Bermuda has used internationally-recognized security standards to develop a programme uniquely tailored to its needs.

Daniels discussed that in order to meet the increasing needs of both the Government and the Island as a whole, specific strategic planning was utilized in order to first identify and categorize assets. That led to the establishment of clear delineations of roles and responsibilities within the organization.

Awareness and training for all users within every level of the organization was the next big push that took place. A formal process was implemented, ensuring that security was integrated into the systems' life cycle in a consistent, effective and efficient manner. This also required the development of appropriate policies, standards and procedures.

Foundational programme policies were developed and approved at the highest decision-making level: the country's Cabinet:

- Information Systems Risk Management Programme Policy
- Information Systems Security Categorization Policy
- Security Awareness and Training Policy

The programme also required that appropriate standards, procedures and practices be implemented and maintained for all NIST 800-53 Security and Privacy Control Families.

The Information Security Risk Management Committee, a cross-sectional, multi-disciplinary team, was established to guide the implementation of the programme in four phases:

Phase 1. Secure general support and common security control system.

Phase 2. Protect highly critical sensitive departmental systems.

Phase 3. Stabilize remaining business information systems, and

Phase 4. Maintain continuous monitoring and improvement.

As the programme matures, more advanced quantitative risk assessment methods and threat modeling processes are being developed to ensure the programme evolves to meet the ever-increasing threats. The country continues to push forward while maintaining the security of its cybersecurity infrastructure.

Cybersecurity is a mindset

Phased awareness training is an important facet of cybersecurity. Bermuda understands that effective cybersecurity begins with a core foundation of knowledge that sets the stage for effective application. Through continuous monitoring, the Government of Bermuda strengthens its first line of defense against cyberattacks through system users at every level. In this way, it is able to mitigate future negative-impact events.

Bermuda, like many other jurisdictions, has found the NIST Cybersecurity Framework to be a helpful tool for aligning information systems with business needs across departments and ministries while identifying information gaps and security control deficiencies, allowing for the focus to be shifted to specific areas for improvement. ■

Department of ICT Policy and Innovation, Ministry of National Security, Government of Bermuda

How online brand protection is adapting to new threats from the dark side

Online brand protection is a serious issue. Chrissie Jamieson discusses how organisations are adapting to the threats posed by cyber criminals

The protection of brands online has never been a more critical necessity, with losses to global businesses hit by fraudsters and criminals estimated at $323 billion during last year alone.

Threats now assail brands from many directions and by various methods, facilitated by the proliferating number of social media platforms, the increasing sophistication of cyber criminals, and of course, advances in technology. It is highly unlikely that this will change in the future, meaning that as threats evolve, businesses will have to adapt and respond accordingly. Reassuringly, there is already plenty of evidence that brands can – and are – realigning their capabilities so they can negotiate today's minefield of potential threats and emerge unscathed and successful on the other side.

Important new research offers insight into how organisations are adapting. In the *2018 The Future of Online Brand Protection — Threats, Trends and Business Impact Report*, 600 marketing decision makers from a cross-section of industries, in six different countries, were polled about their online brand protection strategies.

When compared with similar research in 2017, it is clear that the importance of having a plan in place to counter the threats and mitigate risk is increasingly recognised by brands. Whereas in 2017 64% of companies had an online brand protection strategy in place, in 2018 the figure rose to 79%.

Awareness is a catalyst for collaboration

This welcome change could be the product of a heightened awareness around the cybersecurity threats, as almost two-thirds of respondents (72%) said that online brand protection gained more attention within their organisations following a general increase of focus on cybersecurity. A further 82% were clear that brand protection would change over the coming year to include new threats from cybersecurity and fraud.

Aside from the influence of the threats, the research shows that the nature of online brand protection is also changing, with greater collaboration between departments, including involvement in the formation and deployment of strategies. In the past, online brand protection was largely down to the marketing department who, when necessary, would seek assistance from their legal colleagues. Today, however, multiple departments are assisting, including: IT security and risk (in 55% of companies); marketing (44%); brand communications (38%) and legal (37%).

... smarter brands will grasp how they need to improve protection of all the precious IP and years of work and nurturing that go into the creation of a successful brand

More involvement from the top team

As attacks on the integrity of brands proliferate, coming from more angles and making a significant impact on the business, the entire question of brand protection rises up the agenda for the board of directors.

This is reflected in the research with three-in-ten boards (30%) now involved in the formulation and implementation of brand protection strategies. This is a promising start, but there needs to be more – a fact recognised by the 46% of respondents who agreed that greater involvement from their board of directors was inevitable.

The realisation is growing that online brand protection is such a serious threat it needs to be more than a mere tick-box discussion item at monthly meetings. Board members must take an active role and ensure that once a strategy has been identified, it is followed through by all other areas of the business. The fact is brands are being threatened on multiple fronts, from counterfeiting to online fraud (like phishing or business email compromises). As a result, an online brand protection strategy needs engagement from all departments, and needs to cover the multiple threats.

The collaborative approach to brand protection extends to IT as well. Another 46% of respondents said they foresaw greater engagement from IT and security teams. It can hardly be more important for these two teams, which often have overlapping responsibilities, to have direct input into the implementation of brand protection tactics.

In fact, such is the state of change with regard to brand protection within organisations that 90% of brands surveyed believe the responsibility for it will change within the next year, with more involvement anticipated from the board and IT and security teams.

It is also interesting just how customer-focused businesses have become in their protection strategies – reflected in the 46% of respondents who said keeping their consumers safe is the primary focus of their policies, while 84% said that consumer behaviour now plays a major role in determining how their programme is prioritised.

How important is technology in brand protection?

There are many paths to effective brand protection – from specialists who develop solutions, to businesses that address the issue in-house, to third-party providers. Whichever methodology it is, success can come down to the right technology.

As the nature of threats changes, and counterfeiters, pirates and cyber criminals become more cunning, brands dare not risk failing to update their knowledge of shape-shifting risks and threats. With that in mind, how do organisations plan to allocate their budgets for brand protection?

Almost a quarter of respondents said they would spend most of it on new technology. In fact, 85% of brands have incorporated new technologies into protection strategies, including artificial intelligence (39%), big data (37%), machine learning (33%), and the dark web (25%).

The likes of AI, machine learning and big data analytics can be used to reconnoitre the threat landscape in a more efficient and effective way, giving brands a more front-foot approach to threats, especially concerning fraud.

When it comes to the dark web, while it may not be a new landscape, it is becoming more of a focus for threat-monitoring. The dark web is an illicit market place for physical goods and services, along with confidential data and intellectual property. The data that can be found here and the goods on offer can inflict serious damage on a brand. Proactively monitoring this area of the web ensures brands are better able to mitigate risk and neutralise threats.

Blowing the whistle on all infringements

According to the research, two-thirds of brands say infringement has increased in the last year.
It is the omni-channel landscape that presents a greater threat; the bigger the presence across channels, the bigger the risk. Almost two-thirds of respondents said they believed infringement had increased in the last year.
To understand more about the scale of the threat, respondents were asked which of the channels used for brand communications had been subjected to infringement and abuse over the last 12 months.

Websites experienced the highest levels of infringements (45%), followed by email (42%), social media channels (34%), mobile apps (31%) and online marketplaces (27%). It turns out that more than half (55%) of respondents said they are paying more attention to their domain name strategy and managing it more actively because of the strength of the prevailing cyber threat.

A further 14% said they intended changing their approach. It is not just for security reasons that domain management needs to form a key part of an overall brand protection strategy, but also to maximise portfolio values and keep costs down. Because of this it is important to select the best approach, depending on the needs of the brand and whether a proactive or defensive stance is more suitable.

When it comes to cybercrime methodologies, the vast majority of businesses surveyed had experienced phishing attacks in the last 12 months (86%). This included brand impersonation websites, malware distribution, scams compromising business email, SMS text (smishing) and phone impersonation (vishing).

Increasingly, the research shows, brands regard activity dark web activity as posing a genuine threat. More than half of respondents (56%) took this view, while a further 61% said they were actively monitoring dark web intelligence for emerging threats and brand-related activity.

How brand protection will evolve

If one thing is certain it is that the smarter brands will grasp how they need to improve protection of all the precious IP and years of work and nurturing that go into the creation of a successful brand. Almost six-in-ten decision-makers (59%) believe that the importance of having a brand protection strategy will grow over the next five years.

In terms of the likely shape of future threats, the finger was pointed at social media as the most probable source of trouble, with phishing and unauthorised websites not so very far behind. Apps, which are currently seen as a danger by more than two-fifths of respondents, are viewed as having the greatest potential to increase in risk as time unfolds. It is also apparent that while brands will invest in recruiting skilled personnel to bolster their brand protection efforts and to defend them from phishing and domain threats, nearly a quarter will look to new technologies.

Conclusion

Online brand protection is critical to the health of a business. The consequences of brand abuse, fraud and misrepresentation can be dire for a company's reputation, and ruin the trust that customers place in it. The effects on the bottom line will inevitably be extremely deleterious.

As the avenues of attack open to fraudsters, thieves and unscrupulous rivals become more numerous, brand protection is becoming a critical necessity that can make the difference between success and failure. Success will depend on the way organisations adapt how they tackle threats, using more advanced technology in the cyber sphere as part of a company-wide initiative that is led and overseen from the very top of each organisation. ■

Chrissie Jamieson is VP Marketing at MarkMonitor


Innovative cybersecurity
Adamson Middleton's Marine Technology Specialists present Mobile Device Management & Live System Monitoring to prepare the maritime industry for future cybersecurity threats

In June 2017, a global cyberattack, known as Petya, targeted various international industries, but the Trojan horse virus also heavily infected the maritime industry. Cybercrime prevention is in increasing demand as cybersecurity threats continue to develop with more advanced and problematic variations of malware.

What began as a harmless looking software update for accountancy programmes, essential for companies working with the Ukrainian Government, became one of the most notable global cyberattacks in history. The attack utilised payloads that infected the computers' Master Boot Record (MBR), overriding the Windows bootloader, and consequently triggering a reboot. This allowed the attackers full access to the computer and as reports of similar infections spread across mainland Europe, thousands of computers and networks were being controlled by the attackers, as users and companies were held to ransom for large sums of bitcoin to end the attack.

As a consequence, multinational companies were affected; including British advertising and law firms, French construction and retail companies, American hospital operators, and a Russian oil company. It also caused the radiation monitoring system at Chernobyl to fail. The attack marked a collaboration of international governments to combat cyberattacks, yet Petya's notable differences marked it as next generation in malware technology.

Unsurprisingly, the advancement in malware technology prompted the development of protective systems around the globe, but while governments focused on the financial industry, the yachting and maritime industry were left to defend themselves.

More than a year on from Petya, the maritime industry is still in dire need of advanced security protocols to brace against the force of developing cybersecurity threats. Most users think it won't happen to them, and it's something that only happens to other people; or that their free antivirus software is enough to protect them, but this is simply not true. With more and more people being connected on multiple devices and across multiple locations, cybersecurity has never been more important.

At Adamson Middleton, the team found that their clients were looking for a complete package from one location including their luxury assets (including aviation, automotive, real estate, art and collectables), yacht management and crew recruitment but also for security and support online and on-board.

Cybersecurity has become a growing issue for business and leisure environments with multiple devices, and the yachting industry has also felt the brunt of vulnerable security systems which threaten the entire vessel

As a result, in the lead up to the Monaco Yacht Show 2018, they introduced their new brand, Adamson Middleton Marine Technology (AM Marine Technology), providing global internet connectivity, entertainment packages and security solutions for marine clients by teaming with some of the industry leaders.

The technical specialists at AM Marine Technology have highlighted the need for consolidated connectivity solutions for the yachting industry, providing internet services which provide access to the best entertainment services and secure connections to the internet; a security gateway (including monitoring, management and traffic routing), and remote support from their team of experts. They also provide consultancy for both new and existing vessels ensuring that each yacht receives the best connectivity solutions and are prepared to weather the storm against the strongest threats.

The Internet of Things (IoT) has offered the availability of interconnected items, but better-connected devices also present difficulties in protecting the entire system. With a growing network, IoT devices are no longer isolated. They have moved from the workplace, into our homes, and will undoubtedly have a lasting impact on our lives. Using social media, spam emails and Trojan viruses, modern hackers can gain access to your devices, collecting personal and confidential information.

They no longer need to specifically target devices, primarily because interconnected items present the availability of one vulnerable device, which inadvertently infects the other items. The security issues IoT has raised have not gone unnoticed in the yachting and maritime industry, and with pre-existing problems, vulnerable devices on-board present new and arising difficulties in protecting private yachts from a total security breach.

Cyber criminals attack without discrimination of person or device with a blanketing approach. Steve Debnam, Technical Solutions Expert at AM Marine Technology, said *“Take a moment to think about the saved passwords and* *personal data you have stored on your mobiles, tablets, laptops and computers. It will not take long for you to unveil the devastating pattern that modern hackers are experts at discovering! Now, ask yourself, what security do I have that fully protects all of my devices?"*

Hackers look for easy access to devices lacking security systems, and the average user is more likely to breach your security systems accidently, rather than by direct breach of security via firewalls and internet services. There are two systems which perfectly secure backdoor security and work alongside Antivirus and Firewalls; Mobile Device Management and Live System Monitoring. According to AM Marine Technology's leading experts, these are now recognised as essential aspects for any interconnected environment, but especially within the yachting industry.

Recent international conferences surrounding the discussion of IoT devices have highlighted fundamental flaws in IoT architectures, meaning interconnected devices, such as mobiles, tablets and laptops, connected to a yacht's network have initial flaws which leave the bundle of devices primarily unprotected and weak.

Mobile Device Management, commonly known as MDM, is a solution that secures mobile devices, preventing them from attacks targeting the weaker items within the network, while still allowing full control of the internet connectivity to the owner, captain and management crew. MDM is a security software used to monitor, manage and secure mobile devices that can be deployed across various networks. Amongst numerous features, MDM secures emails, documents, browsers and app catalogues, ensuring all items are contained.

This has proved particularly useful for environments where large amounts of data are stored. This could be both personal and professional information. The yachting industry is fortunate to have internet solutions granting each vessel with its own network and servers, yet this makes the yachting industry weaker as individualised networks could potentially come under attack. Solutions such as MDM ensure security threats are taken into consideration and avoided.

Debnam added *"Any device used by the crew or guests while on board has the potential to be a threat, and the moment any device is brought on-board, or there is potential for a device to connect to your network, they can breach the security of the vessel.*

"MDM with AM Marine Technology, allows yacht owners and captains to set their own limits and decide which devices may access their network. Meanwhile the managerial aspects of maintaining the system, on a daily basis, is left to the Technical Specialists. Data is a difficult and tiresome topic to grasp but the threat on incoming devices from crew and guests is not, so the availability of continuous remote support and device management will prove essential in protecting vessels from cyber threats."

Similar to MDM, Live System Monitoring is one of two solutions which will prove essential for the future of internet security in the yachting industry. Anyone using your network can become a potential security breach, and it is quite common for information to be lost or stolen via backdoor access by remote login or information theft.

These monitoring systems are used to keep track of system resources and network usage on-board vessels. They enable yacht owners, captains, crews and guests to remain completely secure from potential cybersecurity threats whilst on-board or on land, and they prevent the intrusion of unnecessary or uninvited users that may pose a threat to the vessel's network.

"Live System Monitoring tracks every user system to fine tune monitoring at an individual level;" said Debnam, *"it prevents the possibility of disgruntled former employees having remote access or sharing files and information with unsafe sources."*

Preparing for disadvantageous situations does not ideally befall the yachting industry, yet it is paramount to the security of every vessel that possess entertainment systems, internet services, or any form of connectivity which allows you to communicate with the outside world.

Security threats are not a new issue in the yachting industry, but with hackers finding easier access by penetrating vulnerable devices which infect multiple, if not all, devices on-board, the industry is in increasing need of more advanced security solutions.

The availability of MDM and Live System Monitoring from AM Marine Technology provides a solution to an age-old problem within the yachting community. Technology has become as crucial as other aspects of the yachting world, and although this is led by the demand for more advanced and better equipped vessels, technology has also seen significant development in security measures.

Disgruntled former employees, incoming guests, and the crew manning the vessel may all carry devices which are potentially damaging, because they have the option to connect to your network, but the devices themselves may already be vulnerable and susceptible to attack. The network hosting the device does not necessarily know the device is weak but unfortunately hackers are looking for any vulnerable devices and once they connect to the yacht's network, they can upload their virus which has the potential to have devastating consequences on your vessel.

Alternatives such as Live System Monitoring offer yacht owners and captains security protocols to protect against potential infections, although there is no guarantee, as any device is harmful and there is always the possibility that any device could be weak enough for the cybercriminals to infiltrate.

There have been cases of hackers being able to infiltrate vessels and turn them off course, and other cases of documents, emails and both personal and professional data being removed or stolen. This threat only continues to grow, and as cybercriminals develop more advanced viruses, it becomes increasingly difficult to combat various forms of attacks which look and act like your everyday network.

The introduction of MDM and Live System Monitoring has enabled companies such as Adamson Middleton to protect the yachting industry from threats of this magnitude, and their endeavours with Marine Technology Technical Specialists have allowed them to provide protocols to support and protect their clients from various cybercrimes which allow their customers to enjoy the luxury lifestyle which was intended.

Cybersecurity has become a growing issue for business and leisure environments with multiple devices, and the yachting industry has also felt the brunt of vulnerable security systems which threaten the entire vessel. Security solutions, provided by AM Marine Technology, can combat the developing threats associated with the yachting industry, as well as securing all incoming devices from crew members and guests, ensuring vessels are given the correct level of protection. ■

Post-Brexit transfers of personal data: the clock is ticking

EU-UK talks on a future data-sharing relationship have yet to start. J Scott Marcus says this bodes poorly for the UKs future status under GDPR

The UK government would like to keep EU-UK data transfers largely the same following the country's separation from the EU. But talks have yet to even commence on a future data-sharing relationship, and a landmark European Court of Human Rights ruling in September bodes poorly for the UK's future status under the EU's General Data Protection Regulation.

The UK economy is closely integrated with that of the rest of the EU. One need only consider the number of UK firms with branches in the EU27, and the number of EU27 firms with branches in the UK, to realise that data interchange is of vital economic importance.

Assuming that the UK indeed leaves the EU as a result of the Brexit referendum of June 23rd 2016, transfers of personal data from the EU27 to the UK may become problematic. This problem has long been recognised, but the associated risks have increased markedly in the past few weeks. Aside from the obvious risks associated with the UK 'crashing out' with no agreement at all in place, newly visible developments include:

- An acknowledgement by the UK's digital minister Margot James (on October 24th) that substantive talks on data sharing between the EU27 and the UK had not yet even commenced; and

- A landmark ruling by the European Court of Human Rights (ECHR) (on September 13th) to the effect that GCHQ, the UK government's intelligence and security organisation, has breached human rights in its mass surveillance programme.

In its 'Chequers' White Paper, the UK Government called not only for an Adequacy Decision to permit personal data to be transferred in both directions largely as it is today, but also for a close integration of the UK into the ongoing evolution of EU27 privacy policy. The developments noted above call into question whether this is a realistic hope in the limited time remaining.

The disruption of the UK 'crashing out' with no agreement in place would likely be severe.

If the UK is to avoid economically harmful limitations to its ability to transfer personal data to the EU27, UK security services should be working now to consider undertakings that the UK would be willing to offer in order to address the concerns that the ECHR has already raised

The linkage between data transfers and surveillance for purposes of national security

The UK has already implemented the EU's General Data Protection Regulation (GDPR) in UK national law. Prime Minister Theresa May has rightly claimed that the UK has *"exceptionally high standards of data protection"*. This is all well and good, but it is not sufficient to ensure continued transfer of personal data to the UK post-Brexit.

For the UK to no longer be an EU or EEA member state would raise issues that previously emerged in a case brought by Austrian privacy activist Maximilian Schrems. A European Court of Justice (ECJ) ruling on October 6th 2015[1] invalidated data transfers from the EU to the US under a Safe Harbour agreement that had existed since July 2000. The finding was that the personal data of EU users is not adequately protected when it is transferred to the US from the EU because US firms make the data available to the US National Security Agency (NSA), for which the Safe Harbour protections are either unavailable or irrelevant[2].

As long as the UK is an EU member state, transfers of personally identifiable data to the UK are governed by Article 23 of the GDPR, which permits member states to take liberties with data protection and data transfers when doing so *"respects the essence of the fundamental rights and freedoms and is a necessary and proportionate measure in a democratic society to safeguard … national security"*.

If the UK were no longer an EU (or EEA) member state, the UK would become a third country relative to the GDPR, and transfers of personal data would instead be governed by Articles 45 through 49 of the GDPR. Article 45 of the GDPR is consistent with the Schrems Decision, but it establishes a much higher threshold for transfers of personal data.

In order to establish an adequacy decision (the GDPR equivalent of Safe Harbour), the European Commission would be obliged to take account of *"the rule of law, respect for human rights and fundamental freedoms, relevant legislation,* *both general and sectoral, including concerning public security, defence, national security and criminal law and the access of public authorities to personal data"*. In light of GCHQ activities, the UK would be unlikely to get a free ride.

Even if there were strong economic and political grounds to do so, these privacy issues cannot simply be waved away. In the EU, privacy is treated as a human right under the European Convention on Human Rights. It is not easy to grant administrative latitude to the enforcement of a human right.

What sequence of events is likely?

Prior to the developments of the past few weeks, one might have expected the following sequence of events:

- Brexit takes place in some form other than EEA membership (unfortunately):

- The Commission grants an Adequacy Decision permitting EU27 personal data to be shared with parties in the EU).

- An appeal similar to the Schrems case is filed and works its way up to the ECJ.

- The ECJ rules as they did in Schrems, thus invalidating the Adequacy Decision, but probably allowing the UK and the EU27 time to put other arrangements in place.

- There would then be the risk that data transfers would be blocked until and unless an agreement analogous to Privacy Shield[3] were negotiated between the UK and the EU27. The agreement would ideally be better structured than Privacy Shield, which has not yet been shown to be effective.

In light of the September 13th finding of the ECHR, one has to wonder whether it will still be possible for the Commission to issue the Adequacy Decision that appears in the second bullet. Recall that the ECHR found the UK guilty of abuse of human rights in September due to its overbearing surveillance. Under these circumstances, the Commission may not be able to grant the Adequacy Decision; having granted it, there is no assurance that it would be sustained.

As previously mentioned, in granting an Adequacy Decision the Commission is obliged under Article 45 of GDPR to take into account *"the rule of law, respect for human rights and fundamental freedoms, relevant legislation, both general and sectoral, including concerning public security, defence, national security and criminal law and the access of public authorities to personal data, as well as the implementation of such legislation, data protection rules, professional rules and security measures, including rules for the onward transfer of personal data to another third country"*.

Given that ECHR has already ruled that the UK's surveillance services are in violation of Articles 8 and 10 of the European Convention on Human Rights, can the Commission grant the Adequacy Decision in the absence of concrete commitments from the UK security establishment?

The Adequacy Decision entails a complex procedure consisting of (1) a proposal from the European Commission, (2) an opinion of the of the European Data Protection Board, (3) an approval from representatives of EU countries, and (4) the adoption of the decision by the European commissioners. This presumably cannot take place overnight.

Even after the Adequacy Decision is in place, it might or might not be sustainable. The European Parliament and the Council could at any time request that the European Commission amend or withdraw the adequacy decision on the grounds that its act exceeds the implementing powers provided for in the regulation. In the absence of concrete commitments from the UK security establishment, the Parliament would likely have concerns over an Adequacy Decision.

Aside from that, a case similar to the Schrems case should be expected. In the absence of changes on the part of the UK security establishment, a similar ECJ outcome should be expected.

Implications

This seems to be headed for a rather bad place. In the unlikely event that the UK were to become an EEA member (or were it not to exit at all), all of this could be avoided. In all other scenarios, and especially in the 'crashing out' scenario, problems with data transfers appear highly likely.

This is in nobody's interest. It would harm both the UK and the EU27 economies.

These problems are not amenable to a quick fix through legislative or administrative measures. Most probably needed are some actual accommodations in the manner in which the UK conducts surveillance for purposes of national security.

The ECHR did not argue that surveillance is prohibited per se; what they argued, rather, is that it must be subject to a range of procedures and protections, as established in the case law. Notably, the ECHR *"was satisfied that the intelligence services of the United Kingdom take their Convention obligations seriously and are not abusing their powers, [but] it found that there was inadequate independent oversight of the selection and search processes involved in the operation, in particular when it came to selecting the internet bearers for interception and choosing the selectors and search criteria used to filter and select intercepted communications for examination.*

Furthermore, there were no real safeguards applicable to the selection of related communications data for examination, even though this data could reveal a great deal about a person's habits and contacts."

If the UK is to avoid economically harmful limitations to its ability to transfer personal data to the EU27, UK security services should be working now to consider undertakings that the UK would be willing to offer in order to address the concerns that the ECHR has already raised[4]. ■

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Endnotes

1. As the ECJ's press release notes, "United States public authorities are not themselves subject to [the safe harbour agreement]. Furthermore, national security, public interest and law enforcement requirements of the United States prevail over the safe harbour scheme, so that United States undertakings are bound to disregard, without limitation, the protective rules laid down by that scheme where they conflict with such requirements. …" An additional concern was that "the persons concerned had no administrative or judicial means of redress enabling, in particular, the data relating to them to be accessed and … rectified or erased." See http://curia.europa.eu/jcms/upload/docs/application/pdf/2015-10/cp150117en.pdf. The decision itself appears at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62014CJ0362.

2. See also J Scott Marcus and Georgios Petropoulos (2016) 'Data transfers under the threat of terrorist attacks', Bruegel.

3. See J Scott Marcus and Georgios Petropoulos (2016) 'Data transfers under the threat of terrorist attacks', Bruegel.

4. There may be implications for EU27 security services as well under the UK equivalent of the GDPR, but these seem less immediate at the moment.

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Can you control how your data is collected online?

Alex McCready writes on when and how individuals can seek compensation for damage caused by misuse of data, and offers advice on how you can retain more control on data collected

We all know that data is big business. Companies are vying to gather as much information about you or I as possible based on our online habits. However, in a post-GDPR world, how internet companies gather this data is still a contentious topic. One of the most hotly contended areas concerns how big internet companies are using cookies to track our behaviour online.

However, Google and other UK data controllers, will have breathed a sigh of relief this month. The English High Court has decided that if data controllers such as Google misuse our data we can only seek compensation from them if we have suffered 'damage'.

The case concerned an application for compensation arising from the so-called 'Safari Workaround', by which Google allegedly used its 'Double Click' technology on the iPhone Safari browser to obtain information about users' internet usage through its cookies without their consent or knowledge. The claimants argued this breached data protection legislation and sought compensation.

In theory, under English law individuals can obtain compensation if they suffer 'damage' arising from a breach of data protection legislation. That damage can be pecuniary (ie. financial loss) or the suffering of emotional distress. However, in this case the claimants didn't even try to argue damage of any sort – they argued the sheer fact of the breach was sufficient. The English High Court disagreed.

So what lesson should would-be claimants learn from this?

Simply that when pleading your case, you must set out how damage has flowed from the breach.

So what does the future hold?

In a future where data is king, there will inevitably be many more David vs Goliath battles between individuals and online platforms about the (mis)use of our data. Indeed, *Fortune* recently reported that Twitter is being investigated by Irish privacy authorities over its refusal to give a user information about how it tracks him when he clicks on links in tweets.

... those who would like to retain a bit more control over how their data is collected should read-on

For many, the fact that companies monitor our online behaviour via cookies has become a fact of life. Indeed, some of us may even like the expediency of targeted advertising. But those who would like to retain a bit more control over how their data is collected should read-on…

1. Clear the decks: Delete the cookies you already have in your browser settings. For example, on Google Chrome this can be done by:

a. Clicking on the three-dot menu icon in the upper right-hand corner. Select 'Settings'.

b. Scroll down and select 'Advanced' which will produce and additional drop-down menu.

c. At the bottom of the Privacy and security menu select 'Clear browsing data'. You can then choose to delete just the cookies or all browsing history and select how far back in time you go. Click the 'Clear Data' button once you're happy.

2. Manage your cookies: You can manage how cookies are saved going forward. Go to the 'Privacy and Security' menu (by following steps (a) and (b) above) and click on 'Content Settings' which should be listed second from the bottom. Then click on 'Cookies'. In that panel will be a drop-down list of options for the storage of cookies. You can also decide whether you want to block third-party cookies or not.

3. Browse in private: Not everyone knows that it's possible to browse privately on search engines. For example, on Google Chrome to can hit Ctrl+Shift+N and go 'Incognito'. That will prevent the Google Chrome browser from saving information on pages you've visited, what you've searched for, cookies and information entered on forms. Warning: Your activity might still be visible to the websites you visit though.

4. Privacy on social media: make sure you've checked your Privacy settings on sites like Facebook and Instagram are at the highest level of security. For example, on Facebook you can also turn-off targeted ads by going to the 'Settings' panel and clicking on the 'Ad Settings' section and turning off 'online interest-based ads'.

Alex McCready is Head of Reputation and Privacy at Vardags

World Commerce Review is pleased to announce that Ron Shaw of RA Shaw Group has been awarded the Lifetime Achievement in Architecture and Design 2019.

The World Commerce Review awards celebrate achievement, innovation and excellence across several fields of endeavour. Our award programs are tailored to provide a comprehensive analysis of the very best in each market.

The WCR awards are recognised as the principal indications of professional conduct and excellence.

The selection panel took into account product innovation, on-going customer support and best practice criteria as well as a continuing commitment to deploying the best possible solutions for the benefit of their clients.

Cyborg supervision

James Proudman explores the impact of AI, and advanced analytics more broadly, on the safety and soundness of the firms the Bank of England supervise

Recognising faces comes instinctively to humans. Until fairly recently, however, it proved beyond the ability of computers. Advances in artificial intelligence (AI) - the use of a machine to simulate human behaviour – and its subset, machine learning (ML) – in which a machine teaches itself to perform tasks – are now making facial recognition software much more widely available. You might even use it to access your bank account.

Because it is so easy for us but so hard for computers, facial recognition is a good illustration of the challenges faced in developing AI. Enabling a machine to teach itself to recognise a face requires sophisticated algorithms that can learn from data. Advances in computational power and algorithmic techniques are helping machines become more human and super-human like.

ML also requires lots of data from which to learn: data are the fuel that powers it – the more data used to train the algorithms, the more accurate their predictions typically become. Hence advances in AI are often associated with Big Data and the recent huge advances in the volume and variety of data available (see Figure 1).

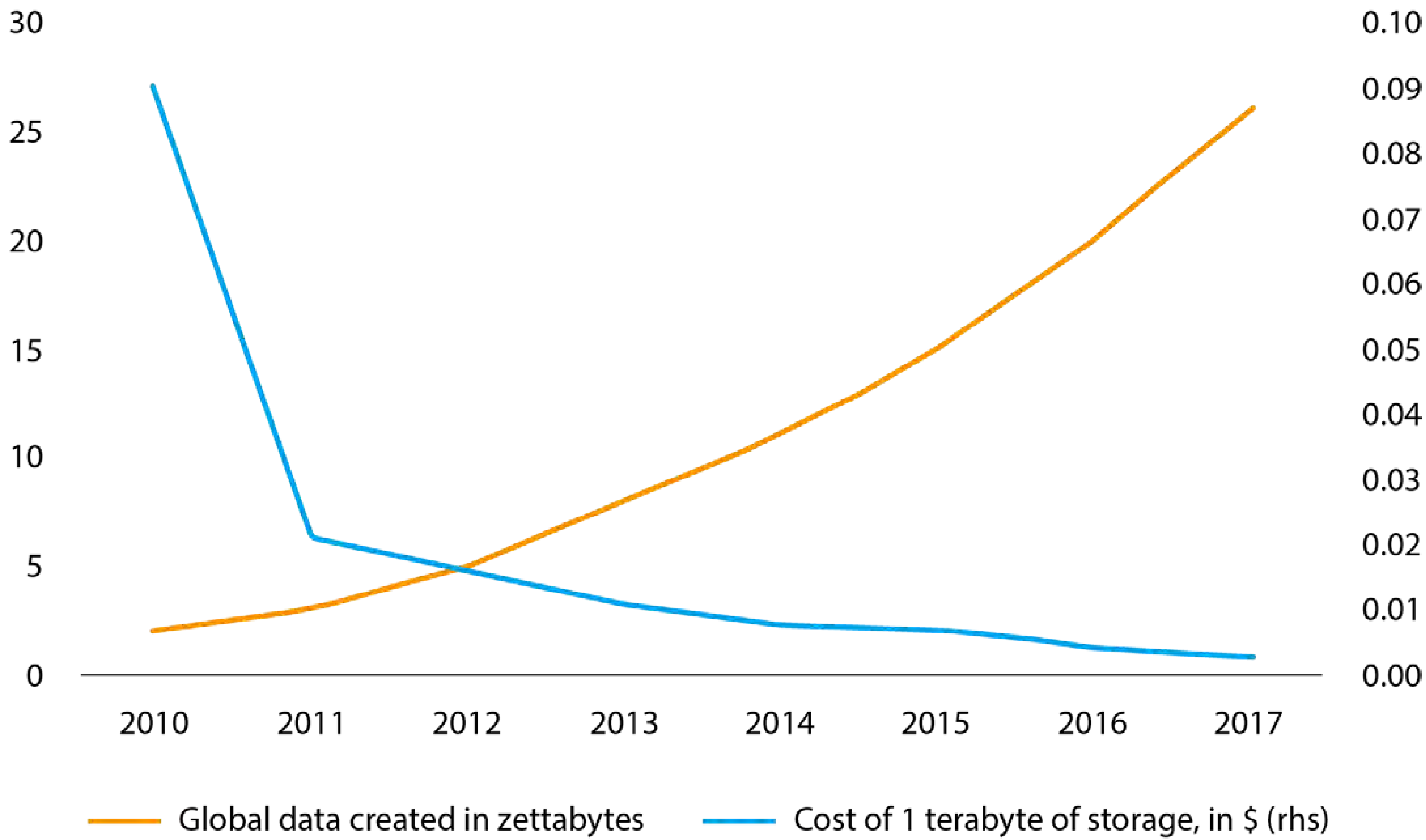
As the sophistication of algorithms and volume of data rise, the uses of AI in every-day life are expanding. Finance is no exception. I want to explore the impact of AI and advanced analytics more broadly, on the safety and soundness of the firms we supervise at the PRA, and how we are starting to apply such technology to the supervision of firms.

In particular, I want to explore the seeming tension between the PRA's supervisory regime that is firmly centred on human judgment, and our increasing interest and investment in automation, machine learning and artificial intelligence.

Changing the nature of the risks we supervise

Like many other firms, banks are looking to harness the power and speed of AI. If you were to take some parts of the

Figure 1. The quantity and cost of data



Source: Financial Stability Board (2017) media at face value you might be tempted to conclude that a revolution is underway. There are plenty of examples of innovation to point to – from the use of ML-driven financial-market trading algorithms; to the introduction of online banking platforms that generate alerts to customers on trends and irregularities in their spending habits; to new apps that suggest switching utility providers to the cheapest provider[1].

On closer inspection, however, the situation seems rather less revolutionary and more evolutionary. No hard data on industry-wide uptake are available but intelligence from supervisors is that the scale of adoption of advanced analytics across the industry so far is relatively slow. There is clearly, however, the potential for usage to accelerate.

... until machines can fully replicate human cognition – a remote possibility for the foreseeable future – supervisory judgment will still have a central role to play

At the macroeconomic level, changes in technology, including AI, could, over time, profoundly affect the nature of the financial services consumed and may result in changes to the structure of the financial services industry. This set of issues is being explored at the Bank of England by Huw Van Steenis in his review of the future of the financial system. What matters to us as prudential supervisors is the extent to which the development of advanced analytics changes the risks to the safety and soundness of the firms we supervise.

Increasing levels of automation, machine learning and AI could improve the safety and soundness of firms in some ways. For example, until recently, most firms were using a rules-based approach to anti-money laundering monitoring. But this is changing and firms are introducing ML software that produces more accurate results, more efficiently[2], by bringing together customer data with publicly available information on customers from the internet to detect anomalous flows of funds[3].

ML may also improve the quality of credit risk assessments, particularly for high-volume retail lending, for which plenty of data are available and can be used for training machine learning models. Recent research, for example, analysed more than 120 million mortgages in the US written between 1995 and 2014 and identified significant non-linear relationships between risk factors and mortgages becoming non-performing. These 'jumps' in the chance that a loan defaults – sometimes with just a small change in circumstances – are precisely the kind of non-linear relationships for which machine learning models are well suited[4].

ML is also starting to influence how wholesale loans are arranged. In contrast to retail lending, the idiosyncratic risks and limited data available for corporate lending make typical automated underwriting more difficult. But ML can still be used to improve the quality of underwriting by making use of non-traditional data. For example, natural language processing of annual reports and social media can give firms useful information on the quality of the credit[5].

But the increased use of ML and AI may also increase some risks to the safety and soundness of firms. Implementing ML and AI at scale is likely to require considerable investments by firms in their data and technology capabilities. While in the long-run these investments could increase revenue, in the short-term they are likely to increase costs. They will also amplify execution and operational risks. And even if firms eventually are successful in embedding new tools and techniques, these may make their businesses more complex and difficult to manage.

For example, while ML models could alter banks' trading and retail businesses – enabling them to make better decisions more quickly – the opacity, however, of these models may also make them more difficult for humans to understand. Boards, senior management and staff in firms may consequently need different skills to operate an effective oversight, risk and control environment.

Changing the methods by which we supervise

Advanced analytics are also likely over time to lead to changes to the way we do our jobs as supervisors. To see how, it is perhaps easiest to go back to the basics of what prudential supervision actually is.

Our approach to promoting safety and soundness is based upon forward-looking judgement-based supervision, in which we identify the key risks facing firms and set supervisory strategies to mitigate them. Described as a business process, it can be broken down into a number of simple steps:

1) rule-setting and reporting;

2) analysis and monitoring; and

3) setting and communicating a supervisory strategy to mitigate identified risks.

Each of these aspects of supervision is amenable to automation, machine learning or AI to some extent.

With respect to rule setting, for example, a project is underway to use advanced analytics to understand the complexity of the *PRA Rulebook*[6]. We hope to use the results to identify ways to simplify our rules to make them easier to comply with.

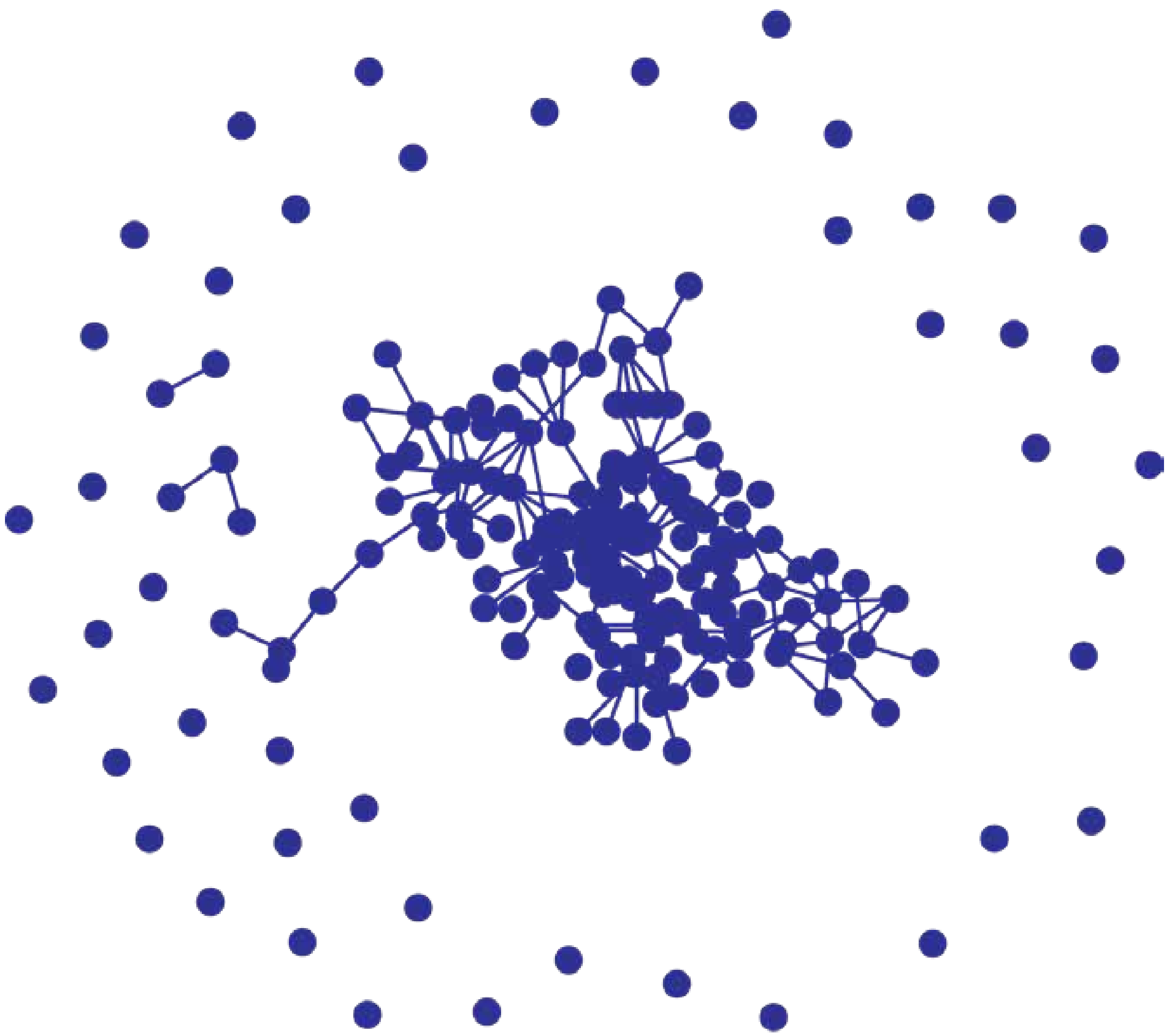
The *PRA Rulebook* contains 638,000 words – 77,000 words longer than *War and Peace* in English translation. The complexity of the language used can make the text difficult to read. Another layer of complexity is added because of cross-references and links between different parts of the *Rulebook*, requiring the reader to refer backwards and forwards, disrupting reader flow.

Figure 2 is a visualisation of the *Rulebook*. Each node is a part the *PRA Rulebook*. Each line between the nodes is a cross-reference in the text. When parts of the *Rulebook* are linked together, tweaking one part can have unintended consequences for others. We can quantify the interconnectedness of different parts of the *Rulebook* using the PageRank algorithm, the same algorithm used by Google's search engine. A higher score implies greater connectivity of a particular part to other parts. Happily, most parts of the *Rulebook* are self-contained and 'structurally simple'. Looking further into the future, a bigger win might be to automate the *Rulebook* entirely.

Regulated banks are required to submit large quantities of data to regulators. The cost of collecting and reporting data to meet regulatory requirements is a significant burden to both regulators and regulated firms. Regulatory data collections also have significant time lags, normally 4 to 6 weeks.

One solution is to make the data reporting process better tailored to the needs of supervisors. Digital regulatory reporting (DRR) is the automation of regulatory data collection, and could potentially lead to significant

Figure 2. Textual complexity of the *PRA Rulebook*



Source: Amadxarif et al. (n.d.)

improvements in both the cost and timeliness of data. The idea is based on machine readable reporting requirements that firms' systems could automatically interpret and satisfy via a secure regulator-firm digital link.

This would allow regulators to collect data on an ad hoc basis from firms as required, in close to real time without any manual intervention at either end. That would enable supervisors to specify the data they needed to solve a particular puzzle – exposures to a particular country, for example – and transmit that data request to firms in a machine-readable form. The data would then be 'grabbed' directly from firms' systems and sent back to supervisors automatically.

The FCA and Bank of England are currently undertaking a DRR pilot with participants from a number of regulated firms. It is too early to say what the outcome of this early pilot will be, but initial findings suggest it is feasible. There remain significant technical challenges to be overcome. And regulators would need to guard against the moral hazard that could arise if firms perceived that responsibility for the accuracy and congruence of data had transferred from regulated entities to regulators.

Setting regulatory standards and collecting data is only the start of the supervisory process. Working out what the data mean is a second stage. Recent research has demonstrated how machines can now outperform doctors in the diagnosis of certain forms of skin cancer: machines can be taught to recognise cell clusters more accurately than the human eye can.

This does not, however, imply there is no role for doctors in the treatment of cancers; quite the opposite. By using technology to perform certain roles, doctors can free up time to focus on cancer treatment and patient care[7]. This is an example of what is sometimes referred to as human-centred automation *"… which considers where humans can often do tasks or make better judgements than machines, and designs automation around these strengths"*[8]. In a similar way, by introducing ML to perform complex tasks, we ought to be able to free up and focus supervisors' time where it is most needed.

Take the case of credit unions. Of the 570 or so UK domiciled credit institutions, about 450 are credit unions. These are very small and simple providers of credit facilities that between them account for 0.07% of the assets of the UK deposit taking sector. Because none of these lenders is sufficiently significant to the stability of the financial system as a whole, we supervise these entities in a proportionate manner. That is to say, we only intervene intensively in the event of likely failure, to ensure that insolvency is orderly and that depositors are paid out promptly.

Recent work at the Bank investigated the predictive power of the regulatory returns for these firms[9]. It found a significant and stable correlation between simple explanatory variables and the probability of default one, two and three years later. In most banking data sets, this structural relationship is obscured by the intervening hand of supervision - leaving few if any observable banking failures.

The research has the practical application for focusing our scarce supervisory resources in a systematic and efficient way on those credit unions where they are most likely to be needed. The tool cannot yet be classified as ML, as there is no learning involved. But it does demonstrate how more advanced analytics can be used to enhance effectiveness of supervision, and we are beginning to experiment with introducing genuine ML into this tool.

The task that lies at the heart of supervision – the third step I referred to above – is setting strategies to reduce prudential risks. For each firm that the PRA deems sufficiently critical, we form an assessment of the key risks to its safety and soundness. From that, we articulate a strategy of actions by the bank to mitigate the likelihood and the consequence of those risks.

The nature and intensity of the supervisory strategy for a firm – and the resources we allocate – are proportional to the scale of the risks to its safety and soundness, and to the threat the firm poses to the wider economy. We then monitor progress against the delivery of the strategy, as well as the underlying risks themselves.

This approach relies on judgement – about where the key risks lie, the supervisory strategy required to mitigate those risks, and how to respond to risks crystallising. It is a matter of debate how far and how fast AI will be able to move in the direction of making complex judgements. It seems to me to be highly unlikely in the foreseeable future. Perhaps the main contribution it will make is to improve the efficiency and productiveness of strategy-setting.

A typical problem faced by supervisors, for example, is the 'needle-in-a-haystack' problem: if something is going wrong in a firm, it can be necessary to find out who in the firm made relevant decisions, based on what information, and why the checks and balances of the firm – the board, and second and third lines of defence – did not work.

Advanced analytics can assist. The information to investigate would likely come in many forms – spreadsheets, regulatory returns, management information, e-mails, meeting agendas and minutes. And the information sources may evolve – firms' definitions of products, business lines, risks, committees and so on do not stay the same.

So – along the same lines pursued by law firms for example – one big win is the ability to produce structured data from a range of sources, the analysis of which traditionally required significant manual effort. Over time it may be possible, for example, to train tools to recognise business lines via their numerical characteristics and patterns, and their unstructured data alongside structured regulatory returns.

ML also allows documents with similar characteristics to be classified together and analysed, either within or across banks. For example, it could be used to follow the escalation trail from the most junior to the most senior committees. This sort of work is labour intensive when performed by humans: aided by machines, supervisors could in future devote time to those areas where humans have a comparative advantage.

Setting a supervisory strategy without effective communication is pointless, as we rely on the firms to take actions to mitigate the risks. To achieve complex supervisory outcomes – which often require significant, multi-year remediation by firms – boards and senior management of firms have to understand the context and rationale for what we are trying to achieve, as well as what we would deem to be a successful outcome. So getting our communications right is key. But how clear are those communications?

Firms have developed a wide range of more-or-less polite methods for providing us with feedback on the letters we write to them. But letter writing is an art rather than a science, and evaluating objectively how clear we are does not lend itself easily to traditional forms of quantitative methods. Advances in ML, however, are helping.

We recently analysed the letters we write to firms on the key risks they face and our supervisory strategy. We quantified a number of qualitative features of these letters, for example, how blunt we are in our messaging, how personal we are in terms of to whom we address the letter, and the overall sentiment expressed by the letter. We then used an ML model called random forests to detect whether, for example, the PRA writes to firms differently than the prior regulator, the FSA. (We do.)[10] On the back of that project, we have built an app that now enables supervisors to analyse their written communications. Supervisors can use the app to analyse any of their draft documents before they are sent to firms.

Conclusion

Advanced analytics, machine learning and AI seem to be everywhere now – from image and voice recognition software to driverless cars and health care. Banks too are also seeking to apply these tools and techniques to the range of their activities, many of which used to be seen as the preserve of experts: from risk assessment, to financial crime prevention and trading in the financial markets. These trends are likely to accelerate.

Banking supervisors need to adapt to technology too. Supervisors need to stay abreast of how technology is changing the risks the banks are running and how they are being controlled. And just as advanced analytics are opening an ever wider range of banks' activities to automation, so too are they creating new possibilities for us to supervise banks more efficiently and effectively.

But until machines can fully replicate human cognition – a remote possibility for the foreseeable future – supervisory judgment will still have a central role to play. My central expectation is that over coming years the PRA will develop a form of 'cyborg supervision' involving humans and machines working ever more closely together and leveraging their comparative strengths. ■

James Proudman is Executive Director, UK Deposit Takers Supervision, at the Bank of England

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The Isle of Man's banking sector - where are we now and what is the future?

The banking industry is undergoing a seismic shift. John Hunter is confident that the Isle of Man is well-placed to face future changes

There is no doubt that the banking industry is undergoing a seismic shift. In 2018 and the upcoming years, banks are facing various challenges and opportunities related to regulations, legacy IT systems, disruptive models and technologies, new competitors, and a restive customer base while pursuing new strategies for sustainable growth.

For years, we have seen the restructuring of banking operations around the world - and the Isle of Man has been no different. Our economic sectors are served by a strong base of private and retail banks that support the growth of businesses and enterprise on the Isle of Man. In this article, we look at the current state of the Island's banking sector, the Alternative Banking Regime and share our outlook for the future.

The current state of the Isle of Man's banking sector

The Isle of Man is an established banking centre with £35.8 billion deposits. It is aligned with international regulatory standards and is committed to protecting depositors.

The Isle of Man is home to an array of domestic, UK and international banks including Barclays Bank, Cayman National Bank & Trust Company (Isle of Man), Conister Bank, HSBC, Isle of Man Bank, Lloyds Bank International, Nedbank Private Wealth, Santander UK, Standard Bank Isle of Man, The Royal Bank of Scotland International.

The Island's banking sector provides a diverse range of services including deposits, treasury services, foreign exchange, trust and corporate services, residential mortgages, investment property finance, commercial finance, corporate finance, asset and wealth management. Though sterling based, the Island is highly experienced in multi-currency banking, making servicing global clients all the easier.

John Hunter is Head of Banking and Fiduciaries, Isle of Man Department for Enterprise

The Alternative Banking Regime

The Alternative Banking Regime (ABR) is an innovative framework designed to open the Isle of Man banking sector with the objective of providing banking services tailored to a wider and more diverse sector of businesses including e-gaming, fintech and e-business.

The Island can now offer three types of licence, namely, Retail, Non-Retail and Representative Office. The ABR is part of a suite of initiatives created to support the Island economic sectors and to attract banking operations, in particular private banks, foreign bank branches and representative offices.

... businesses and individuals look for a service that is specific to their needs and objectives

The ABR expands the existing Class 1 (deposit taking) banking licence to include:

- Class 1 (1) – for typical existing banks and any taking retail deposits.
- Class 1 (2) – for non-retail deposit takers - those that provide services to a very limited class of individuals, and corporates.
- Class 1 (3) – for Representative Offices of Foreign banks not able to take deposits in the Island.

Banks operating under the Class 1(2) and Class 1(3) would not participate in the Depositors' Compensation scheme thereby removing this liability from them.

The Class 1(2) licence is a restricted deposit taking licence which enables a bank to carry out deposit taking only for a limited and specified customer base, 'restricted depositors.' In summary the definition of a 'restricted depositor' is regarded as:

- A body corporate,
- An individual who certifies that they have a minimum of £500,000 net worth, or

- An individual who is a trustee of a particular trust, who certifies that the assets of that trust are valued at a minimum of £500,000.

In the case of deposits held jointly, each depositor must meet one of the criteria above in their own right. Corporation tax on profits for retail deposit-based businesses is set at 10 percent with all other banking activities rated at 0 percent.

The ABR creates a unique opportunity for banks to develop a new proposition. It should be noted that wider ownership models would be permitted, rather than just those of existing banking groups, subject naturally to the usual rigorous tests of transparency, fit and proper and adequacy of financial resources.

For technology based or other financial services businesses the ABR can offer the opportunity to explore a natural progression in to the provision of banking services in an environment that is both supportive and financially attractive.

Outlook for the future

Whether it is the change created by Open Banking or the innovation from fintech disruptors, it is no secret that the global banking industry will continue to transform. Recent years' developments have highlighted that there is no 'one size fits all' for banking. Instead businesses and individuals look for a service that is specific to their needs and objectives.

By listening to the demands of the customers and the institutions themselves, we created an innovative regime with the flexibility to be effective whilst retaining its fundamental regulatory and corporate governance requirements. ABR represents an important part in the evolution of the Island's banking sector, and we are excited and confident in the sector's future. ■

John Hunter is Head of Banking and Fiduciaries, Isle of Man Department for Enterprise

Business aviation is a global industry, requiring global focus

International advocacy will continue to be a key mission for NBAA. Ed Bolen says we must maintain our focus on the challenges confronting business aviation access, growth and safety

This is an unquestionably exciting time for the international business aviation industry. New aircraft deliveries are up, new airframes with exciting capabilities are reshaping the market and business aviation operations are on the rise in nearly every market across the globe, including throughout Europe.

Of course, just as our industry provides the ability transcend borders, we must also recognize how matters affecting business aviation operations in one region often carry far-reaching implications. That is why the National Business Aviation Association (NBAA) continues to advocate on behalf of our industry worldwide.

NBAA collaborates with global industry stakeholders on matters ranging from environmental responsibility, to concerns over slot allocation, airspace access, flight time limitations and other restrictions to the industry.

As one example, NBAA has worked the British Business and General Aviation Association (BBGA) to ensure that general aviation and business aviation interests are represented as the United Kingdom's Civil Aviation Authority works to develop a far-reaching master plan defining the country's airport network for the next 30 years.

Currently, economic pressure on UK airports to accommodate low-cost air carrier operations has threatened to squeeze out business aircraft that must compete with airliners for available slots under EU Regulation 95/93, which states general aviation and business aviation receive only those slots that are not taken by scheduled operators.

This situation is compounded by recently-enacted noise-related night curfews from which business aircraft were once exempt. Combined, these challenges have left aviation planners and third-party handlers having to advise passengers they might not get what they want in terms of desired landing or takeoff times at their preferred airport.

The upcoming UK Brexit from the European Union further complicates the situation, with concerns over valuation of the British pound, cabotage issues for EU-registered aircraft and possible diminishing of the European Aviation Safety Agency's jurisdiction over the region.

While these matters continue to pose challenges to operators, our industry has also realized significant progress towards aviation access. This includes refinements to the Prior Permission Required (PPR) system at Geneva Airport

This renewed effort reflects our industry's long-standing commitment to emissions reduction, including, among other aims, carbon neutrality from 2020 forward

(LSGG), home of the annual European Business Aviation Convention & Exhibition, or EBACE, jointly sponsored by the European Business Aviation Association (EBAA) and NBAA.

This new approach allows for more flexibility, accommodating scenarios such as the need to change an aircraft due to maintenance or other issues. Efficiency and slot availability in Geneva have also increased under the new 'match requirement' in which operators file a flight plan, then request a slot reservation. This ensures that any files with mismatches between flight plans and slot requests are not included in the system.

Taking the reins to address environmental concerns

Environmental sustainability is another key concern for all aviation stakeholders, and it's an area in which business aviation has continued to lead. For example, a coalition of international business aviation organizations joined government officials earlier this year at EBACE to redouble their focus on advancing the development and adoption of Sustainable Alternative Jet Fuel (SAJF).

This renewed effort reflects our industry's long-standing commitment to emissions reduction, including, among other aims, carbon neutrality from 2020 forward. At the heart of this initiative is a new product – the *Business Aviation Guide to the Use of Sustainable Alternative Fuel (SAJF)* – focused on raising awareness and adoption of available and emerging sustainable alternative jet-fuel options, and providing a roadmap for the education about, and use of, SAJF.

Business aviation stakeholders were also represented, through IBAC, as the International Civil Aviation Organization (ICAO) worked to adopt its upcoming Carbon Offsetting Reduction Scheme for International Aviation, or CORSIA, which aims to cap worldwide carbon dioxide (CO_2) emissions from aviation.

Earlier this year, the ICAO Council agreed upon a set of standards and recommended practices in line with measures previously outlined through the 2009 Business Aviation Commitment on Climate Change (BACCC), including the industry's pledge for carbon-neutral growth after 2020.

Addressing such far-reaching issues requires that our industry maintain a global perspective. One of the most effective methods for doing so is through NBAA's support for influential annual industry events like EBACE that also serve to underscore the importance of business aviation to local leaders in business and government, as it positively impacts communities by aiding companies in efficiently performing day-to-day operations, generating new jobs and spurring economic activity and local investment.

These themes will continue at the 2019 edition of EBACE, taking place in Geneva from 21-23 May. EBACE traditionally provides a convenient opportunity to view a wide array of aircraft and aviation products in a single location, hosting a wide variety of exciting announcements for new products and features, as well as high-quality education sessions focused on issues of particular importance to European business aviation users and operators.

For those unable to attend EBACE, the matters affecting the worldwide business aviation industry will also be in focus at other NBAA-sponsored events around the world, including NBAA's own Business Aviation Convention & Exhibition (NBAA-BACE) that for 2019 will return to Las Vegas, NV from 22-24 October. As the world's largest event dedicated to the global business aviation industry, NBAA-BACE brings together approximately 25,000 attendees, exhibitors and other stakeholders to discuss the latest matters affecting international business aviation operations.

It is certainly quite encouraging to see our industry continuing its rebound from the depths of the 2008-2009 economic recession. That said, we must also maintain our focus on the challenges confronting business aviation access, growth and safety, which is why international advocacy will continue to be a key mission for NBAA. Business aviation remains a strong and vital industry across the globe, and these efforts are crucial towards ensuring that it continues to grow and succeed for years to come. ■

Ed Bolen is President and CEO of the National Business Aviation Association (NBAA)

Kindness in leadership

'Kindness' is seldom mentioned as a desirable leadership trait in MBA or executive programmes but it can have enormous benefits for organisations. Gay Haskins and Lalit Johri argue that it's time we all became more kindly

In a global climate of increasing complexity, competition, intolerance and impatience, there has been a steady erosion of public trust in both public and private sector organisations and their leaders. At the same time, there are calls for a more responsible and respectful form of leadership in business and society, for a leadership that fosters a sense of inclusion, connection and belonging.

Those of us who live in English-speaking countries or speak English on a daily basis, will hear the word 'kind' very often. It is one of the 500 most frequently used words in the English language. Kind actions are praised and remembered: they have a 'boomerang' effect, Kindness begets Kindness. Such acts cost nothing to give but create significant value.

The idea of kindness having a positive effect on humanity is present throughout religious thinking: it is both a virtue and a practical act, a behavioural as well as a cognitive or emotional response to others. As well, the world's great philosophers have discussed and written a great deal about kindness.

The Confucian 'Golden Rule' of "*Do unto others as you would have them do unto you*" has been an inspiration throughout the ages.

Yet research has indicated that kindness is not regularly considered in the leadership programmes at business schools nor in the leadership literature. In the words of Mary Farebrother, former Director of London Business School's Senior Executive Programme: *"While working in executive education, I didn't come across an organisational value statement or leadership competency framework that mentioned kindness. Although integrity, respect, collaboration and teamwork were highlighted, kindness was absent."*

Kindness-based behaviours

We sought input from 200 leaders around the world in public and private sectors in both large and small organisations. A number of these had been participants on Saïd Business School's Oxford Advanced Management and Leadership Programme and others came from the authors' own wide networks, including members of EFMD and European Women's Management Development Network (EWMD).

For employees, kindness can result in greater happiness and contentment, higher motivation and energy, higher engagement and participation, and greater loyalty and commitment. The relationship between teams and management have also been found to be more creative, innovative, collaborative and positive when trust is more prevalent

Irrespective of their country of origin, these worldwide leaders emphasised that kindness in leadership has a universal appeal and is characterised by a variety of kindness-based behaviours. These included: adopting a humane approach; fairness and equity; accommodating personal issues; treating others with respect; caring and being responsive; communicating with a personal touch; sharing information in a transparent way; explaining logically; listening intently and valuing the views of others; counselling and mentoring; and being inclusive as a leader.

A garment finishing company in Bangladesh, for example, showed kindness through the provision of nutritious meals to all employees to ensure their health and wellbeing. At a large retail chain in Turkey, the foremost element in the code of conduct is respect. This has been found to promote harmony and happiness, leading to high-quality consumer services: 'happy employees create happy customers.'

A large number of respondents reported that they avoided impersonal emails or written office memos to communicate on personally sensitive issues, preferring instead to deal with issues via one-to-one or small group meetings. Simple gestures were found to matter a great deal.

We hope, therefore, that our new book, Kindness in Leadership, will open the door to a consideration of the strengths that kindness can bring to an organisation and the commitment and trust it can inspire among employees.

Vivian Unt, owner-manager of the Vivian Vau shoe salon in Estonia, said:

> *"Most commonly, kindness is expressed through little gestures that are not part of required conduct but are said and done because they make people feel good".*

Kindness-based beliefs

The leaders also subscribed to beliefs that gave them a rationale for adopting kindness in their leadership style. In many cases these became part of the values and culture of the organisation that they led. These included beliefs that:

- people are central to the success of any organisation, contributing to success through their imagination, vision, inspiration, problem-solving abilities and personal drive
- equity and fairness are important ideals in enhancing employee self-confidence and loyalty
- respect and care stimulate ownership and commitment

13th

Several primary and secondary schools have kindness as a core value and celebrate World Kindness Day each year on 13 November

It appears from our interviews that kindness in leadership can be facilitated across the whole organisation if leaders share these types of beliefs. Sally Waterston, founder and director of the UK business and IT consultancy Waterstons, states her beliefs as follows:

"We believe completely in people first – we don't have fixed hours, we don't have fixed holidays – we measure people on what they do and not when they do it. People said it would not work but we are still here 22 years later and making a profit. I am absolutely passionate about kindness but not from a paternalistic point of view. I think it should be within the company, it should be peer to peer and we see it every day in our business."

The impact of kindness in leadership

These examples suggest that these kinds of leadership behaviours and strong beliefs in the value of kindness can have a positive impact on the culture of an organisation, its well-being and its performance.

For employees, kindness can result in greater happiness and contentment, higher motivation and energy, higher engagement and participation, and greater loyalty and commitment. The relationship between teams and management have also been found to be more creative, innovative, collaborative and positive when trust is more prevalent.

This parallels evidence from the growing field of research into factors affecting employee engagement, which consistently shows that levels of engagement are linked to a sense of being valued, having the opportunity to develop and progress within the organisation, and enjoying positive relationships with colleagues. Furthermore, being known as 'a great place to work' helps to attract and retain the best talent.

This positive impact was stressed by Richard Everard, chairman of Everards Brewery Ltd in the UK:

> *"Kindness is at the very heart of our philosophy, but it demands that everyone lives and breathes it every day. The human, financial and societal outcomes are tangible and will endure through future generations."*

500

Those of us who live in English-speaking countries or speak English on a daily basis, will hear the word 'kind' very often. It is one of the 500 most frequently used words in the English language

Educating for compassion, empathy and kindness

If kindness can have the positive impact on organisations and on society that these leaders suggest, should it not also be more central in education and development programmes?

We looked at a number of initiatives around the world and found that a growing number of primary and secondary schools are stressing the importance of kindness, compassion and empathy in their objectives and curriculum. Several schools have kindness as a core value and celebrate World Kindness Day each year on 13 November.

In 2016, Harvard Graduate School of Education published a report called *Turning the Tide: Inspiring Concern for Others and the Common Good through College Admissions*. It tackles the intense focus on personal achievement and academic performance and the advantages enjoyed by more affluent students.

It calls for an admissions process that also focuses on a concern for the common good, citizenship, empathy and kindness. Compassion is now a core value at a number of universities, especially those that have signed the worldwide Charter for Compassion, committing to building a more compassionate world.

There is also a growing number of training and research programmes, focusing on compassion and empathy and related behaviours, including kindness. Some of these have been pioneered through medical schools and research centres following breakthroughs in neurological research and have been targeted at the healthcare sector where compassion, kindness and empathy can be core organisational values. These initiatives could certainly be relevant to business schools, their faculty and to degree students and executive education participants.

However, as we saw at the opening to this article, kindness does not yet really appear on the leadership agenda within business schools. But perhaps the door is opening?

Putting kindness on the business school agenda

Although few business schools put kindness to the fore in their MBA and/or executive programmes, behaviours, concepts and approaches that have links to kindness are increasingly emphasised.

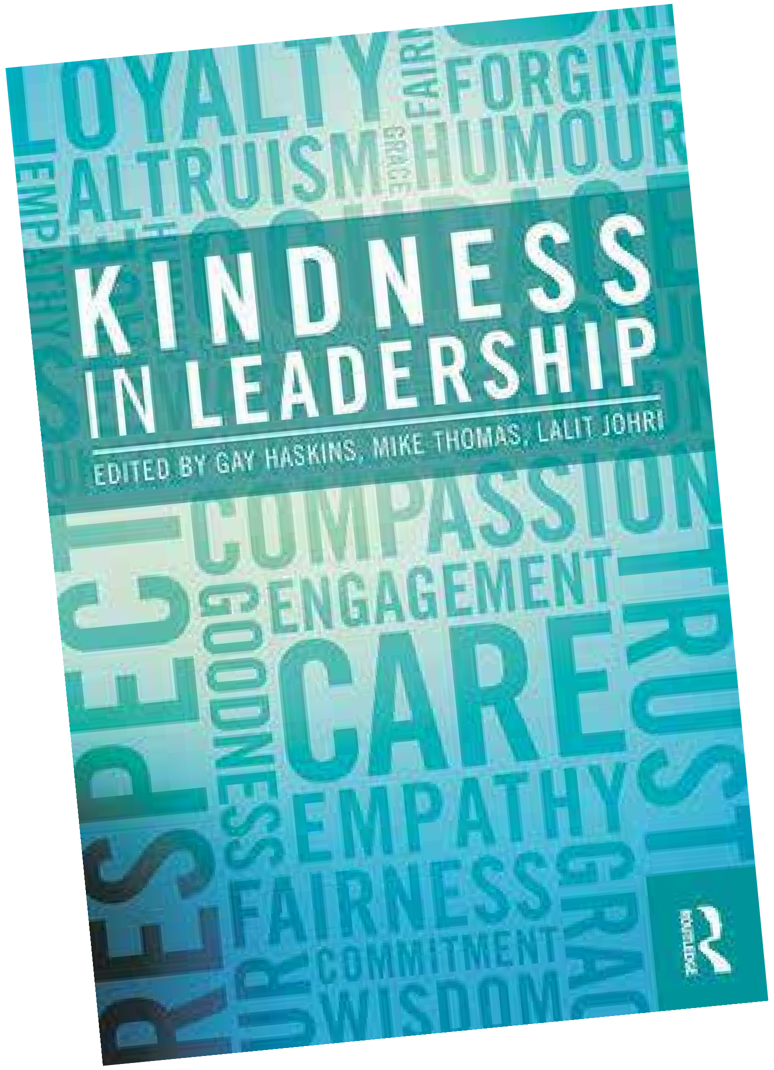
Emotional intelligence, for example, has been widely embraced in leadership teaching. A Coursera online course, *Inspiring Leadership through Emotional Intelligence*, developed by Richard Boyatzis at Case Western University in the US, focuses on emotional intelligence, hope, mindfulness and compassion and their role in alleviating stress and building leadership capabilities.

Mindfulness programmes are widely integrated into MBA and executive programmes and loving-kindness meditation aims to create a powerful inclination to act kindly whenever we can. Much work has be done through the University of Michigan's Ross School of Business to foster awareness of the importance of compassion in the workplace. Ross has formed the Compassion Lab, a network of scholars working in this area around the world, www.compassionlab.com. The Roffey Park Institute's work on compassion is also significant.

It was featured in *Global Focus* in 2016 and the Institute has now developed an online tool to assess individual propensity for compassion. Other initiatives include increasing our understanding of the power of empathy and compassion through the arts: improvisation, drama, poetry and literature, for example.

In addition, programmes that emphasise responsible business conduct and responsible leadership will certainly cover areas linked to kindness in the broader societal context.

John North, Managing Director of the Globally Responsible Leadership Initiative (GRLI), spoke about the importance of empathy when he was interviewed for *Kindness in Leadership*. He said:



"Really empathising with less advantaged people may require business leaders to make decisions that may not be in their own interest. This will be truly heroic."

Kindness: the MBA reaction

As well as interviews with business leaders, we sought perspectives from MBA/EMBA students at three institutions with which we are directly involved: the Saïd Business School, University of Oxford; EADA in Barcelona; and students on the MBA programme at the University of Central Lancashire (UCLAN).

In all three schools, we found that students were very intrigued by thinking about kindness. One wrote that kindness was central to his Buddhist faith and that combining this with his work was a great challenge. Another said: *"It's likely to be a hot topic in future. An organisation with a reputation for kindness would attract [students]".* Our interviews suggested an appetite for the inclusion of kindness in the leadership curriculum.

Haskins, G, Thomas, M, and Johri L, Kindness in Leadership, Routledge 2018.

Available quoting promotional code FLR40 from
www.routledge. com/9781138207332.

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We would suggest, therefore, that the time is ripe for incorporating kindness into business school MBA programmes and research. If business schools are to address the calls for a more responsible and respectful form of leadership, kindness could be a central to making this happen.

Kind and kindness are simple words and easy for everyone to grasp. In an inclusive world, we urge business schools and management centres to give them greater attention. ■

ABOUT THE AUTHORS

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