A change in the regulatory climate could help to reduce volatility in the markets and promote economic growth

Regulatory reform is the route to market recovery

As the burden of regulation continues to stifle the growth in the global economy that previous G20 summits have sought to trigger, the US could lead the way with a tax-reform programme that will inspire other countries to follow suit

By Robert Fauver, former G7/G8 sherpa, United States

When leaders of the G20 countries gather on 3-4 November in Cannes, they will once again be meeting at a time of high uncertainty and worry regarding the macroeconomic outlook for the world economy. Since their first meeting in 2008, each G20 summit has attempted to tackle critical financial market and macroeconomic problems.

The global economic and financial problems they have faced are in many ways unprecedented since the Second World War. While past G20 summit communiqués have issued lofty objectives, the actual results of the meetings have not met expectations.

Pledges by leaders have not been matched by their actions. As a result, the global economic and financial situation is once again unsettled, financial markets are vulnerable, foreign exchange markets are volatile, consumer confidence is weak, business investment has moved to the sidelines and unemployment remains stubbornly high.

The economic outlook for real growth, employment, inflation, exchange-rate stability and world trade remains weak and uncertain. Real growth rates slowed in all parts of the world economy over the second and third quarters of this year. As a result, global economic growth has slowed, too. Fears of a double-dip global recession have returned with a vengeance.

Growth in the US, which has been slowing throughout the year, is set to fall to below two per cent. European growth, meanwhile, is expected to be in the region of one per cent this year. It is only in developing countries that growth is expected to be solid. But there, too, it is slowing.

Equity markets in the US, Europe and Japan have been volatile and trending downwards over the summer months. Modest equity-market gains, recorded earlier in the year, have largely been lost. Foreign exchange markets have been subject to wide fluctuations and gyrations in recent months, with no clear trends in sight.

European concerns

While much attention has focused on the political debates over fiscal policy in the US in recent months, worry over European fiscal deficit control has led to wide fluctuations and liquidity problems in European bond markets. Concern about the financial future of several members of the EU has led to foreign exchange market problems and rising interest rates in European markets. There has even been speculation over whether the eurozone would comprise the same country members in the future as it does currently.

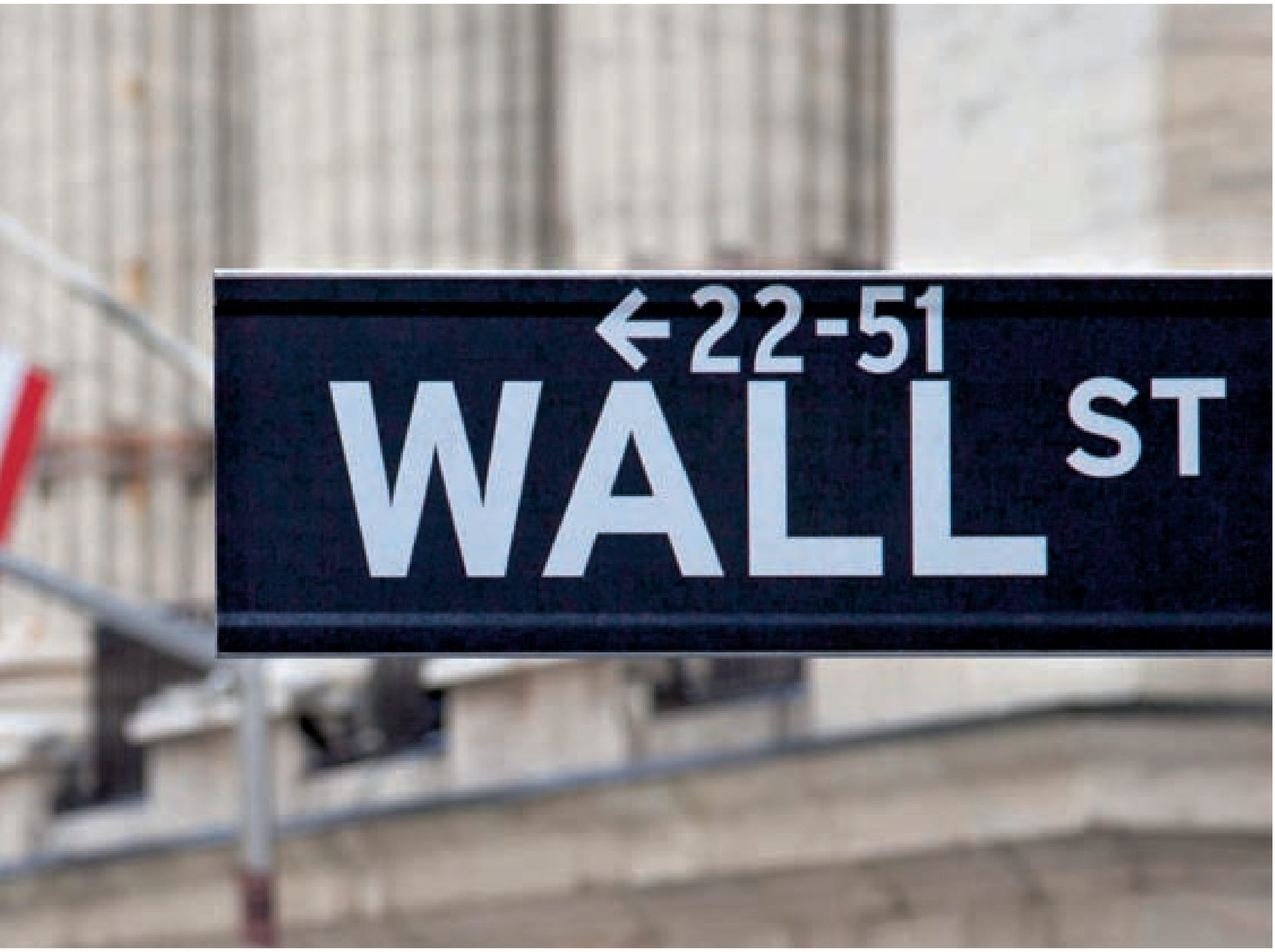
Restoring conditions that will foster sustainable, non-inflationary real growth should be the primary focus of the G20 at Cannes. With growth expected to hover around the level of one per cent in the advanced countries, the global economy is unable to create a sufficient number of new jobs to prevent the rise of unemployment levels around the world. While stronger real growth continues in the major developing countries, growing worries about a return of inflation has led to monetary tightening in a number of the non-advanced members of the G20.

Ongoing economic and financial problems continue to bring turmoil to markets in New York and around the world

As a result of the focus of recent financial and foreign exchange markets on fiscal imbalances in the advanced world, policy-makers have a considerably more limited selection of tools at their disposal than they usually have. By most measures, there is little room for new government deficit spending in Europe or the US.

Japan continues to require rebuilding funds in the aftermath of the natural disasters it suffered earlier this year. Moreover, after several years of monetary policy ease, very little scope remains for the further expansion of monetary policy in most advanced members of the G20. Monetary policy in Europe could be eased at the margin, but only modest gains should be expected.

Some would argue that reducing fiscal deficits in the current environment – particularly in the US – would be growth-positive because it would reduce capital market uncertainty and government crowding-out of private investment. Very few commentators in the US suggest that tax increases are appropriate for the present situation. Some argue that new stimulus spending is required, but the political climate probably precludes additional action of this kind. As a consequence, only marginal attention should be given to fiscal or monetary policy stimulus among the G20 members at Cannes.



Discussions among leaders should focus instead on the role of microeconomic policies in addressing current economic problems. A wide array of microeconomic issues would benefit from their attention. In most G20 members, labour-market rigidities add to the difficulty of reducing unemployment.

The problem of unemployment

In Europe in particular, long-term unemployment is a serious problem. Labour-market deregulation would increase flexibility in EU economies and lead to job creation. Wage and working-hours regulations, coupled with unfunded pension systems, hang over the efficiency of European markets. Few incentives exist to encourage the long-term unemployed to seek jobs.

Regulatory reform would benefit all G20 members. The economic cost of excessive government regulations is substantial. In some cases, simply complying with regulations is costly for small and medium-sized companies. In other cases, uncertainty over future regulatory change results in postponed investment decisions and slower job creation. For many, excessive regulations prevent market signals from being fully received by consumers and investors.

In some countries, especially the US, economic growth could be encouraged through major tax-system reforms. Over many years, the US federal tax system has become encumbered with tax preferences in response to political pressures, instead of developing economic efficiencies.

> “Restoring conditions that foster sustainable and non-inflationary real growth should be the primary focus of the G20”

Various tax subsidies have blunted normal economic signals and have led to a misallocation of investment funds. A significant tax-reform programme could free up resources for more economic purposes and add flexibility to the domestic economy. Such efficiencies could encourage domestic growth.

Removing regulatory burdens to energy development in the US could also stimulate growth. Vast, undeveloped energy sources could be exploited rather quickly if the regulatory climate were eased. New natural gas deposits and shale fields could significantly reduce US demand for imported energy. Approval of the US-Canadian gas pipeline would create jobs and dependable natural gas supplies. Offshore oil and gas exploration would create new jobs and energy sources.

Benefit to developing countries

Regulatory reforms would also be of benefit to the developing-country members of the G20. Market inflexibilities – especially those that are related to international trade – prevent the flow of market signals to their domestic economies.

The Cannes communiqué should focus on old-fashioned cooperation and coordination, drawing on the experiences of the G5 and the G7. The G20 needs to deliver a manageable set of regulatory reforms that can be implemented across all members. The communiqué should include specific commitments in an appendix, so that investors and consumers can identify expected change and act accordingly. ◆

The contribution of Liechtenstein to safeguarding the stability of the global finance system

Klaus Tschütscher,
Prime Minister of Liechtenstein

Financial stability is probably the most important precondition for the development of Liechtenstein as a financial centre. The Liechtenstein Government therefore sees it as its duty to go along with the measures for the stabilisation of the financial sector demanded by the G20 Group and to support international efforts to reform the global finance system. The authorities and the finance sector will accept their responsibility for safeguarding the stability of the financial centre Liechtenstein also in the future.

Liechtenstein is situated in the heart of Europe and has a well-diversified economy, the foundations of which are based on a stability-oriented budgetary policy, a robust industrial scenario and a sound financial sector. The creditworthiness of the country was very recently assessed once again by the rating agency Standard & Poor's as AAA. Liechtenstein is a member of the European Economic Area (EEA) and is consequently also part of the common European financial services market. Liechtenstein and its financial sector attach great importance to its recognition and acceptance as an up-and-coming financial centre.

Liechtenstein is one of the few states worldwide that did not require any supportive measures for the financial sector during the recent financial and economic crisis. The banks trading in Liechtenstein remained stable and fully functional at all times. The basis for this exceptional demonstration of stability are the sound equity and liquidity ratios of the banks, which lie far above the current and expected international minimum levels, and conservative business models. The Liechtenstein financial system is furthermore backed by a strong and independent supervisory authority and high regulatory standards.

Liechtenstein is one of the few states that did not require supportive measures for the financial sector during the recent crisis. The country's banks remained stable and fully functional at all times

The financial centre Liechtenstein has, however, major external dependencies. First, there is a dependence situation because the larger banks have foreign subsidiaries, while others are themselves subsidiaries of foreign companies. Second, Liechtenstein is bound to two legal systems – to Switzerland through the Customs and Currency Treaty and to the EEA – and these are not always compatible. Finally, the banking sector relies on the Swiss infrastructure, especially on the payment systems.

Liechtenstein's banking sector is exceptionally large as compared with the national economy of the country, which means that there is a close connection between the economic health of the banks and the prosperity of the country. At the end of 2009 the banking sector's assets exceeded the annual GDP of the country by about 10 times.

The Liechtenstein Government has established a group of experts to regularly examine and develop supervisory and regulatory standards. The Liechtenstein authorities also seek to improve international cooperation with other authorities. The Ministry of Finance and the Financial Market Supervisory Authority have recently signed a joint declaration of intent with countries of the European Union for the improvement of international crisis management.

For more than a decade, Liechtenstein has recognised that for the effective combating of money laundering regulatory measures and mechanisms are necessary that meet the highest international standards and must be implemented by authorities equipped with the appropriate powers and know-how. It is only through transparency and cooperation that we can counter the misuse of our financial centre. My country today stands for an uncompromising, zero-tolerance policy in the combating of money-laundering, white-collar and financial crimes. The effectiveness of our systems is acknowledged. With their experience and know-how, our authorities are supporting states where the corresponding systems are still being developed. Our law and practice is constantly and actively being adapted to the recent developments of the relevant standards.

Transparency and cooperation is also the central element in the taxation area by which the stability and reliability of the set of rules and regulations applying to the financial centre of Liechtenstein are assured. With the declaration of 12 March 2009, Liechtenstein has recognised the international standards on the exchange of tax information developed by the Organisation for Economic Co-operation and Development (OECD) and has committed itself to their implementation. We are pleased that the Global Forum on Transparency and Exchange of Information for Tax Purposes has recognised our measures and has assessed our legal framework as being very largely in conformity with the standard. The recommendations made by the Global Forum will be carefully examined by the Government, and the necessary measures will be initiated and carried out as a top priority.

Liechtenstein's capital, Vaduz, with a view of the castle

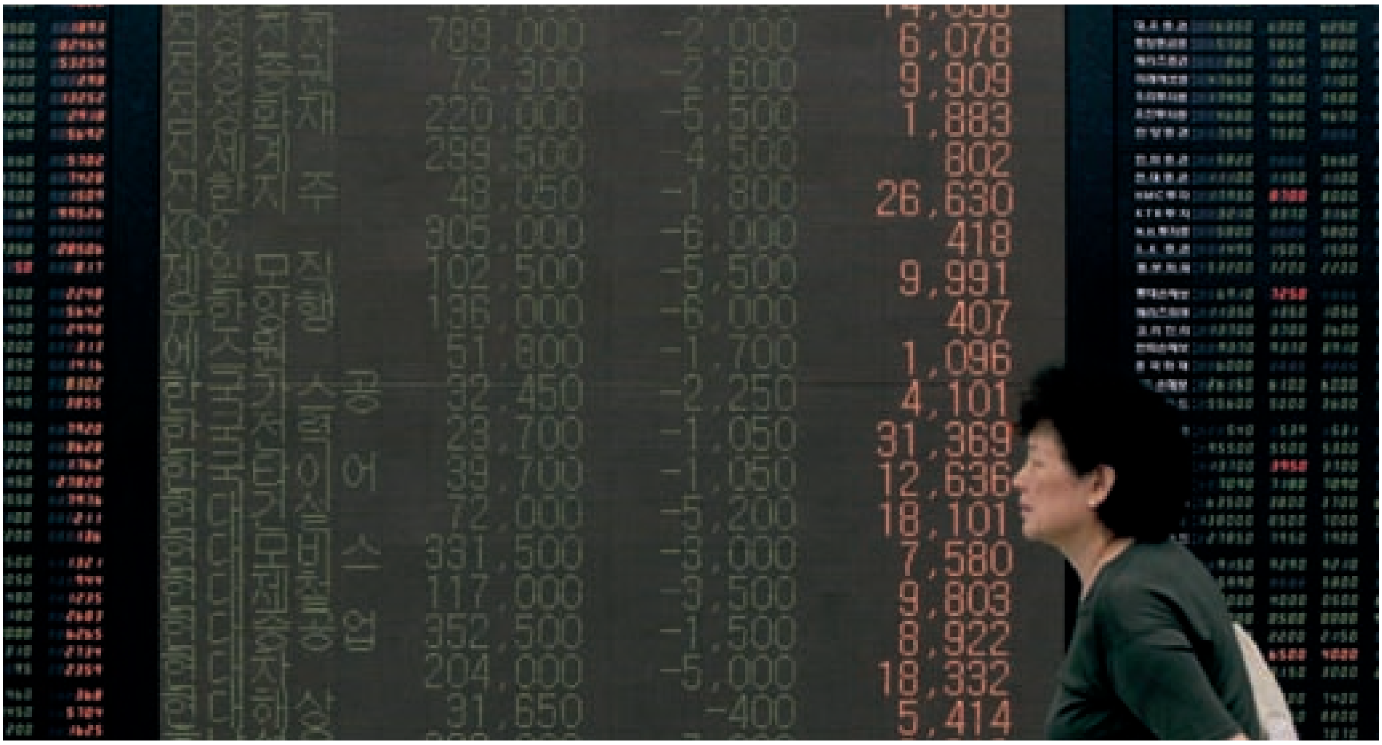
My country today stands for a zero-tolerance policy in the combating of money-laundering, white-collar and financial crimes. The effectiveness of our systems is acknowledged

The Government intends to counter the worldwide problem of tax fraud and tax evasion by a network of tax cooperation treaties and by being a reliable partner for other states. We therefore not only support the justified interests of other states but also meet with such action the needs of the customers of the Liechtenstein financial centre. We are doing this, above all, by promoting the conclusion of comprehensive treaties that provide not only for an exchange of information on request according to the current standard, but also for a mechanism for the regularisation of assets untaxed in the past. At the same time, we want to agree mechanisms by which foreign clients can also in future meet their tax obligations in the state where they live.

An important and inalienable element of the new international Liechtenstein tax policy is to develop and sustain a network of double-taxation treaties. Only in this manner can we take full account of the interests and needs of investors for legal and planning certainty and also create the necessary stable business environment for our many renowned and internationally active industrial companies. Effective regulations, which are of a model character and can therefore also make a contribution to worldwide financial stability, should not only consider the interests of the states concerned but must also take account of the interests of investors, i.e., of the customers, and of the finance institutes. This holistic view is often not yet fully apparent in national and international discussions of the subject. I hope that the Liechtenstein strategy will contribute to the approach taken by the international community for stability and transparency, and help it to be measurably effective and sustainable.

As a small state, Liechtenstein is making its contribution to the safeguarding of global stability by resolutely taking precautionary measures to assure the stability of its economy and financial system. I also undertake personally to make every effort to ensure that Liechtenstein in future is also recognised internationally as a reliable partner, and to support international cooperation in questions of stability.

GOVERNMENT
PRINCIPALITY OF LIECHTENSTEIN



Towards growth and integration in East Asia

The risks to continued economic development in China and Japan cast doubt over the prospects for closer ties between these regional powerhouses and the rest of the East Asian region, unless a new direction is set for the medium to long term

By Naoki Tanaka, Centre for International Public Policy Studies

Stock exchange, Seoul. Korea is one of the three dialogue partners of ASEAN

The 10-member Association of Southeast Asian Nations (ASEAN) and its three dialogue partners of Japan, China and Korea (ASEAN+3) have created a regional mechanism for greater collaboration and calibration of policies, including foreign exchange measures. They seek to clarify their commitment towards a sustainable world economy and complement the role of G20 in managing financial and economic crises.

ASEAN was formed in 1967 by Thailand, Malaysia, Indonesia, Singapore, the Philippines and Brunei, with the aim of stemming the domino effect of successive states turning to communism in South East Asia. At the height of the Vietnam War in the 1960s, the United States increased its military involvement in South Vietnam to contain communist powers in the region, particularly China and North Vietnam.

Given that America's anti-communist strategy was a major factor behind the creation of ASEAN, the organisation's declared objective of achieving regional economic integration would not be a practical goal. Even Japan initially did not expect ASEAN to play a significant role in accelerating regional integration.

But in the late 1990s, the three war-ravaged Indochina countries of Vietnam, Laos and Cambodia joined ASEAN, and Myanmar – long ruled by isolated and authoritarian military regimes – were also admitted, bringing the total number of member states to 10.

In 1997, the leaders of Japan, China and Korea, the three most influential economic powers in East Asia, were invited to the ASEAN summit, which marked the initiation of the ASEAN+3 process.

In its more than 40-year history, ASEAN has undergone considerable transformation and continuously moved forward in its integration efforts. Before their participation in ASEAN, Japan, China and Korea had never worked together to create a formal all-Asian forum for dialogue. It was only after Seoul hosted the Olympic Games in 1988 that it could play its new diplomatic cards against Beijing – Pyongyang's sole major ally and source of economic aid. In the 1990s, Korean firms stepped up expansion into China. At the same time, however, the problem of Pyongyang's nuclear weapons programme came to the fore. The two countries had many issues that needed to be dealt with before their bilateral relations could finally be established.

In reality, Korea could not find even a chance to propose a regional integration initiative. Given its strong economic and military ties with the US, it might have considered that a regional partnership that excluded the US was nothing more than a pipe dream. Another obstacle was the negative response from major political forces within Korea that prioritised the reunification of the Korean peninsula.

Japan, for its part, remained cautious about any regional economic cooperation, owing to Asian antipathy towards its early 20th-century military aggression. As a forum for discussing common economic and security issues regularly, ASEAN+3 proved to be a good opportunity for Japan.

Early ASEAN leaders deftly pretended to know nothing about the complicated and sensitive relationships among Japan, China and Korea when they laid out the broad ASEAN+3 framework. When the external dimension of linking ASEAN with its East Asian partners arose, the principle of inclusiveness was accepted.

However, inclusiveness in East Asia was achieved more effectively through the establishment of supply chain management systems by several companies, rather than through the efforts of the ASEAN countries themselves. East Asian firms needed such a network after the G7's 1985 Plaza Accord led to a steep appreciation of the yen against the US dollar, resulting in an upward revaluation of the Korean won and the New Taiwan dollar.

Japanese firms focused on supply chain development mainly in ASEAN members. The extended supply networks came at a time when China's economic reforms and open-door policy were gathering momentum, which eventually allowed ASEAN to deepen its economic interactions with China. The impetus came just before the start of the 21st century, from those companies that had built their own supply chain networks there.

Regional benefits of membership

ASEAN+3 has obvious advantages compared with the G20, which is part of global economic governance. Thailand, Malaysia, Singapore and the Philippines – four ASEAN members currently enjoying robust economic growth – are not members of the G20.

ASEAN also has a significant meaning in the context of international regimes. Indonesia is home to the world's largest Muslim population. Malaysia positions itself as a premier Islamic financial hub. Indeed, Muslims in the region are steadily moving forward towards democracy, compared with Middle Eastern countries still shaken by uprisings against authoritarian regimes.

There is no question that ASEAN is keenly conscious of the G20's role on the world stage. The ASEAN+3 finance ministers in May invited their central bank governors to their next gathering in 2012. They agreed to strengthen financial safeguards, so the ASEAN+3 Macroeconomic Research Office (AMRO) can prevent a crisis through emergency loans. ASEAN is acting swiftly to institutionalise regional financial cooperation, as exemplified by the recent creation of AMRO for financial surveillance. Meanwhile a secretariat function is unlikely to be added to the G20.

The ASEAN region encompasses more than 500 million people – around 40 per cent of China's population – with a combined nominal gross domestic product (GDP) of $1.8 trillion in 2010, or 40 per cent or so of China's GDP. The economy of ASEAN+3 countries comprises 30 per cent of the world economy.

Unsurprisingly, prospects for ASEAN+3 are clouded by looming risks to the Chinese and Japanese economies. The yawning divide between China's rich and poor may reduce its economic growth, while Japan faces growing uncertainty about its ability to restore fiscal discipline. But the two countries will be able to determine a medium- and long-term direction for their economies by 2015, the target date for ASEAN's fully fledged economic integration.

With regard to East Asia as a whole, the important question is whether the region can correct its global imbalances on its own (see Figures 1 and 2).

The worst scenario would be the failure of a mechanism for redressing global imbalances in East Asia at a time when the social divide within China grows increasingly large. The focus of international debate would then shift towards creating a system to prevent instability in East Asia, with special attention to addressing the region where discipline seems scarce.

The most important problem facing Japan, however, is whether its corporate sector will accelerate its shift away from its domestic focus. The best-case scenario would be for Japan to regain fiscal discipline when East Asia is demonstrating its ability to cure imbalances on a global basis. Japanese firms need to compete to upgrade their supply chain management technology from a global perspective. Japan's worst-case scenario would be the failure to eliminate domestic companies that rely heavily on a partial optimisation approach for their survival, with economic measures taken solely to help manufacturers survive by supplying parts for the world economy.

Economic development in the emerging East Asian region has come closer to a crucial crossroads. ◆

Figure 1: China-centric East Asian economic prospects

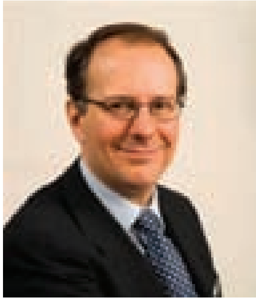
		Economic status in China	
		Progress in China's social integration	China's growing social gap
Options for East Asia	Progress in global economic integration	Formation of large economic bloc involving India, Brazil, Russia, South Africa and so on	Deepening rural-urban dichotomy
	Dysfunctional system for global imbalance corrections	East Asia's lack of absorbing capability, linked to wider global economic imbalances	Proposals for global scheme to reduce instability in East Asia

Figure 2: Japan-centric East Asian economic prospects

		Economic status in Japan	
		Sustainability in Japan with distinctive features	Widening gap between multinational corporations and domestic-oriented Japanese firms
Options for East Asia	Progress in global economic integration	Japan's contribution to building supply chain management systems in East Asia	Negative images of society in Japan, once a model country for modernisation
	Dysfunctional system for global imbalance corrections	Japan's loss of engaging capability owing to weakening leadership in East Asia	Japan's economic measures taken solely to help manufacturers survive as 'suppliers of parts' for the world economy

"The worst scenario would be the failure of a mechanism to redress global balances in East Asia at a time when the social divide in China is growing larger"

Enabling transformation in public sector financial management



Filippo Sabatini, Global Transaction Services Public Sector Head, Citi

Growing competitive pressures and shareholder scrutiny have been a catalyst for many private sector organisations to increase process efficiency, reduce costs, improve transparency and encourage greater accountability. With post-crisis fiscal pressures, changing public expectations, and the need to increase financial inclusion, local and national government entities are now under similar pressure to transform their financial management. In addition, a major focus for both G20 governments and the World Bank is the rollout of effective and transparent governance models, best practices in operational efficiency and centralisation and optimisation of treasury activities. A growing number of local and national governments globally are making huge strides in enhancing efficiency and control, reducing costs, increasing financial transparency and building public confidence. At Citi, we actively support government and public sector bodies through dedicated global and regional teams that deliver skills, expertise and innovative technology across a comprehensive spectrum of banking solutions.

Global financial challenges

While many private sector organisations are already leveraging technology to revolutionise payments and collections, document management and identity verification, government entities and agencies often have less leverage to determine how payments and collections will be made, particularly in countries where financial exclusion is high. Furthermore, the scale of the challenge can be enormous, with huge volumes of often disparate transactions, from taxes and utility payments to social benefits and salaries.

Paper and cash remain the two greatest barriers to achieving efficient financial processes. The time and cost required to transport and issue cash payments is significant, the risk of fraud, error or theft can be high and there is little auditability over payments. Cheque and voucher payments also compromise government agencies' operational efficiency and working capital objectives as they are costly and time-consuming to produce, the value date is unpredictable and auditability is low.

Digitisation for cost and efficiency

As the use of electronic banking systems by citizens and businesses becomes more prevalent, national financial infrastructures are developing, and electronic payment options are improving, public sector bodies are now poised to undertake a similar transformation to their private sector peers. Use of automated payments, particularly when integrated with sophisticated document management and identity management systems, enables governments globally to transform their financial management to improve efficiency, security, convenience, cost control and stakeholder confidence.

For example, prepaid cards and mobile technology offer huge opportunities. Prepaid cards are prefunded cards – either physical or virtual – with the value stored on a server-based electronic account as opposed to being linked to a bank account. Cards can be used for one-off amounts (such as tax rebates, grants or student loan payments) or regular payments (such as employee expenses, pensions, social security or benefit payments).

The payment process is highly efficient, cost-effective, secure and transparent, with complete auditability. Recipients can use the cards to pay for goods or services or to withdraw cash, in the same way as debit or credit cards. Cash is held securely, unlike cash payments; with immediate access to funds, unlike cheques; and cards are supported with telephone assistance, online expenditure tracking, and email and text message alerts.

Automating supplier payments

Other forms of payments can also be managed successfully using cards, such as paying suppliers using procurement cards (also known as purchasing or p-cards). These cards can be used for any value of payment sizes, from petty cash through to large-scale procurement. Payment thresholds, suppliers and spend type can all be defined, ensuring compliance with internal policies and streamlining processes considerably. Payment terms are also predictable, which has a significant advantage for working capital and cash flow forecasting, with the potential to generate rebates. Emergency procurement cards can also bring crucial benefits during crisis situations, enabling governments to respond quickly with rapid procurement of supplies and services without compromising financial transparency or integrity.

For example, Citi implemented a p-card solution with customised reporting and exceptions modelling for a US government department that previously had more than 45,000 supplier accounts that were being paid manually, creating inefficiency, excess costs and a loss of control. Visibility and control over expenditure increased dramatically, while costs were significantly reduced. Suppliers also benefited from timely payment and the ability to integrate collection data into their own systems. As a result of this initiative, the department was awarded the prestigious Alexander Hamilton Award.

Pioneering mobile technology

Increasingly, governments and citizens can leverage mobile telephony as a financial infrastructure. In cities, mobile technology enables low-value payments such as parking charges, public transport costs, and so on, to be automated. In countries with a high unbanked population, the opportunities are even greater. In Kenya, for example, more than 60 per cent of adults have

mobile phones, but fewer than 20 per cent have bank accounts. M-PESA is a mobile money service that delivers mobile electronic payments and mobile wallet capabilities across the country. As the first bank globally to provide mobile payments and store-of-value solutions, we worked with Vodafone's Kenyan affiliate Safaricom to use M-PESA's platform as a payment and collection channel for Citi's corporate and public sector clients in Kenya.

Around 60 per cent of payments nationally are now transacted through M-PESA, and we are rolling out similar solutions in other parts of Africa. Payees benefit from secure, immediate access to cash stored on the card; retailers no longer have to hold cash or wait for cheques to clear; while government agencies can make payments directly through their electronic banking system to mobile phones, in the same way as paying to a bank account.

Efficiency in document processing

One of the advantages of mobile payments is the removal of paper from the payment process. But creating and processing documentation, often linked to a financial transaction or sensitive citizen information, remains an essential government role. Governments and their agencies are the largest creators and processors of documents in the world. Increasingly, governments are seeking support from financial institutions such as Citi to provide comprehensive document management services, to reduce costs, enhance efficiency, security and transparency, and create a highly positive experience for citizens and other stakeholders.

For example, since 2005, Citi has processed all US passport applications, totalling 13 million each year. Advanced technology and automated techniques, such as intelligent character recognition and automated load balancing to remote operators, have resulted in significant efficiency improvements through greater automation and reduction in manual input, and a 50 per cent increase in capacity.

Good governance

Improvements in transaction and document management have operational and cost benefits, but there are also significant advantages in supporting governance objectives. Transparency, data integrity and auditability are intrinsic benefits to automated payment and document management solutions, based on a robust and secure platform. By demonstrating transparent financial processes and decision-making, public sector bodies can build public trust and are in a better position to manage and plan their financial requirements.

While the examples in this article only touch the surface of the opportunities for transformation that are now becoming a reality, they illustrate the huge potential for urban and rural local authorities, national governments and their agencies to revolutionise the way they interact with citizens to deliver universal benefits, by reducing costs, enhancing governance, and increasing efficiency, security and convenience. From cashless hospitals in Mexico to electronic tax and fee payments in Mumbai and state-of-the-art asset management in Minnesota, Citi is helping to create the cities, states and countries of the future, with the transaction, document and identity management tools that benefit citizens and enhance financial transparency.

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China comes to Cannes with an open mind

China is playing an increasing role in the international economy and the financial markets, but it faces challenges following a period of rapid growth. The country needs to rebalance its own economy and become more involved in global reform

By Yu Yongding, Chinese Academy of Social Sciences

Despite the sudden surge in negative comments by foreign pundits, the Chinese economy has continued to forge ahead. In the second of quarter of 2011, it registered a growth rate of 9.5 per cent. Inflation fell from 6.5 per cent in July to 6.2 per cent in August, the first decrease after consecutive increases for 12 months. The consensus among Chinese economists is that, in 2011, the Chinese economy will grow at a rate of more than nine per cent and inflation will fall below six per cent. China is not likely to suffer either a hard landing or runaway inflation in the foreseeable future.

Of course, all is not well. China's growth and economic stability face serious challenges. Any misstep will surely derail the high-speed train that is the Chinese economy. In the short run, the most serious threat is still inflation. The monetary overhang left by the excessive monetary expansion in the wake of the 2008 Lehman Brothers fiasco has yet to run its course. With the ratio of money supply (M2) to gross domestic product (GDP) approaching 190 per cent, the economy remains abundant with liquidity, evident in the ubiquitous speculative fever on houses and antiques, wine and rare stamps.

Rises in commodity prices also contributed significantly to China's inflation in the first half of 2011. Although the pressure of imported inflation has lessened, a rebound in commodity prices caused by the further loosening of monetary policy by the US Federal Reserve still worries China. In recent years, the growth rates of wages and salaries have been accelerating strongly, surpassing income growth. Wage-push inflation will likely become a pertinent feature of the Chinese economy. Moreover, although the government has achieved some success in reining in investment – especially in real-estate development – the growth rate of fixed-asset investments remains high and can return to a higher level, generating inflationary pressure on the economy.

Liquidity shortages for business

It appears that the Chinese government will not reprioritise the objectives of its macroeconomic policy until inflation falls below five per cent. However, as a result of the abrupt monetary tightening since late 2009, small and medium-sized enterprises, which contribute almost half of China's GDP and more than half of its employment, suffer from increasingly acute liquidity shortages and a credit crunch. Consequently, informal financial intermediation by illegal financial institutions has mushroomed, and interest rates in informal financial markets have gone through the roof.

The recent collapse of some informal financial institutions have cast a shadow on the stability of China's financial system. To make the situation worse, thanks to the European sovereign debt crisis and the faltering US

Checking on stock prices in Shanghai. China's economy faces challenges following its recent boom

economy, China's exports may take a hard hit, which in turn will pull down China's growth substantially. The government has been walking a tightrope in its effort to control housing prices. For many years, investment in real-estate development accounted for a quarter of total fixed-asset investment and more than 10 per cent of GDP. The consequences of a collapse in real-estate investment on growth will surely be serious.

However, due to China's strong fiscal position, whatever happens, China should still be able to reignite the economy, although on a smaller scale than in 2008-09.

In short, unless the government shoots itself in foot by over-tightening its monetary policy and allowing the renminbi to be fully convertible too early, there is no reason for the economy not to maintain its growth momentum while bringing inflation under control in the next few years.

Facing enduring problems

The real challenges facing China are medium- and long-term structural problems. The long list of those problems includes overdependence on investment and exports for growth, lack of innovation and creativity, the widening gaps in income distribution, serious pollution and a reckless use of resources. More fundamentally, progress in institutional reform is lacklustre, attributable to China's gradualist approach to reform.

China has been accused of running a large current-account surplus. But while it has exported large amounts of capital via a current-account surplus – mostly invested in US government securities – it has imported an equally large amount of capital, mainly in foreign direct investment (FDI). Instead of investing savings in domestic projects with high returns, China invests heavily in low-return US government securities.

Due to its highly concessional FDI-attraction policy over the past 30 years, as a result of the fierce competition among local governments, local investments are crowded out from high-return projects and must settle for less profitable ones. Facilitated by China's export-promotion policy, the excess resources – thanks to FDI crowding-out, as well as low consumption – translate into a current-account surplus, which is invested in US government securities.

Rebalancing the Chinese economy is not just a simple matter of exchange-rate policy. It involves a comprehensive adjustment of a policy regime consolidated over the past three decades. The adjustment will inevitably encounter fierce resistance from various interest groups that have established themselves during the drawn-out process of gradual reforms over 30 years. But China must make the necessary adjustment and shift its growth paradigm from dependence on investment and exports to balanced growth based on innovation and creativity.

> “Rebalancing the Chinese economy involves a comprehensive adjustment of a policy regime consolidated over the past three decades”

As the world's second largest economy, the largest trading country and the largest reserve-holding country in the world, China plays an important role in reviving the growth momentum of the global economy and stabilising international financial markets. First, China should put its house in order and lay a solid foundation for sustainable growth.

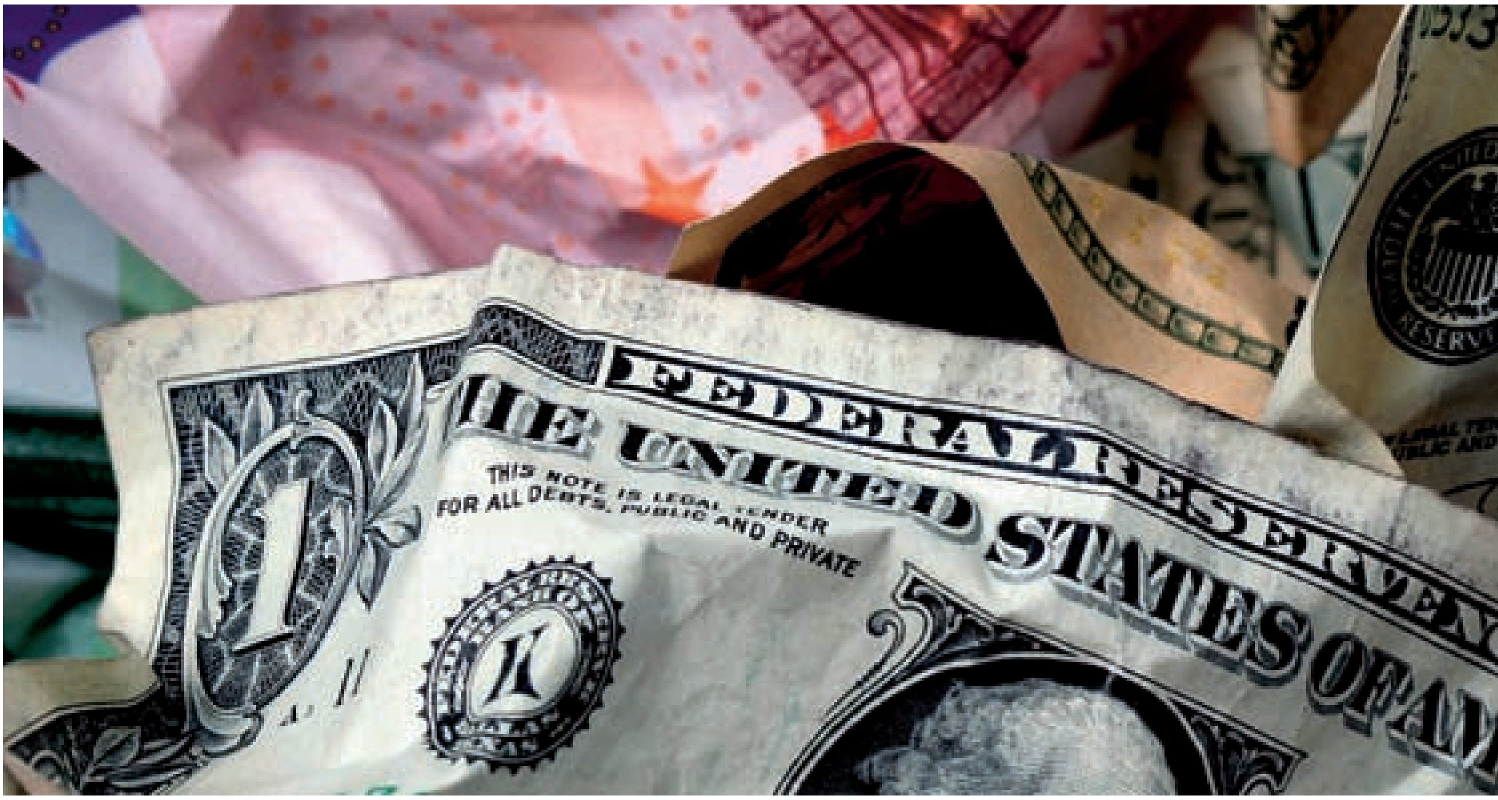
Second, China should redouble its efforts in rebalancing its economy. It should dismantle its trade-promotion and FDI-attraction policies, including making the exchange rate more flexible and further liberalising the financial services sector – although China still has far to go in order to make the renminbi fully convertible.

Third, China is keen on lending a helping hand to European countries. The European Union is China's largest trade partner. It is in China's self-interests to assist the EU in overcoming its sovereign debt crisis. However, the squabbling within the eurozone makes China hesitant to get involved.

Reshaping the monetary system

Fourth, China should be more active in the reform of the international monetary system. The current system is flawed by a fundamental contradiction: a national currency – the US dollar – serves as the key international reserve currency. It is one of the most important conditions for the global imbalances. The dramatic deterioration of the US fiscal position and the faltering recovery of the US economy may make the temptation for the United States to print more money irresistible. Retaliatory measures by emerging markets may prove inevitable, escalating political and trade tensions. The G20 and the International Monetary Fund must prevent this nightmare scenario from coming true. A supranational currency along the lines of the special drawing rights should be contemplated.

In a globalised world, while conflicts of interest among countries or groups of countries are unavoidable, common interests dominate. Therefore, politicians and technocrats from different countries should sit at the table to negotiate bargains both bilaterally and multilaterally. The G20 has provided a good platform for multilateral bargains. Surely, in Cannes this coming November, China will come to listen and to be heard with an open mind. ◆



What's next?

The future of the global economy rests with appropriate and decisive steps being taken to improve stability and confidence, not least in the United States and the eurozone, where domestic politics are proving a hindrance to concerted action

By David Hale, chair, David Hale Global Economics; co-editor, *What's Next? Unconventional Wisdom on the Future of the World Economy*

Political decisions play an increasingly large role in determining the economic prospects of countries and regions across the world. This trend was one of the primary themes explored recently in *What's Next? Unconventional Wisdom on the Future of the World Economy*, which I co-edited with Lyric Hughes Hale, and, if anything, this trend has become more pronounced since the book was published. One of the major risks now confronting the global economy is political uncertainty. There are major decisions pending in the United States, Europe and China that will determine whether 2012 will be a year of modest growth or of renewed recession.

The big uncertainties in the US centre on fiscal policy. The budgets published by the Obama administration this year project significant fiscal drag for 2012. There could be tax increases equal to 2.2 per cent of gross domestic product (GDP) as the reductions in payroll and business taxes enacted last December expire. The stimulus programme enacted in 2009 is also unravelling, and there could be spending cuts equal to 1.7 per cent of GDP.

One of the biggest declines will be in federal aid to state and local governments. It will fall from $59 billion in the fiscal year that ended in July 2011 to only $6 billion. As most states still run large fiscal deficits, the reduced federal aid could force them to lay off additional workers. States shed over 150,000 jobs during the first half of 2011, and could easily shed another 250,000 during the year ahead.

Proposals for US fiscal relief

The Obama administration recognises the dangers posed by fiscal drag. In September, the US president asked Congress to approve a $447 billion fiscal relief programme for 2012. He asked Congress to extend the payroll tax cuts, offer a plan to target small businesses, provide $35 billion of new aid to state and local governments, extend unemployment benefits for another year, and undertake up to $90 billion of infrastructure spending.

The White House is hopeful that the Republicans will agree to extend the payroll tax cuts and unemployment benefits, but it is sceptical that they will accept the proposals for aid to subfederal governments and infrastructure spending. If the White House is correct, there will be nearly $300 billion of fiscal relief next year. Such an adjustment could help to sustain growth at two per cent or higher during the first half of 2012. Without relief, the tax increases could drive the economy's growth rate to one per cent or less.

Europe is preoccupied with the problems of highly indebted countries such as Greece, Portugal, Ireland, Italy and Spain. It has offered a rescue programme to Greece to avoid default, but the markets are discounting the possibility that Greece will pursue debt restructuring equal to as much as 70 per cent of the value of the bonds. There is now much debate over how Europe can prevent a Greek default from producing contagion that would drive bond yields significantly higher in other vulnerable countries.

The eurozone created the European Financial Stability Facility (EFSF) at the time of the first Greek rescue in 2010. It helped to finance the rescue programmes for Ireland and Portugal earlier this year. The eurozone countries recently agreed to increase the EFSF to €440 billion and to give the facility new powers, such as intervening in bond markets and recapitalising troubled banks. The International Monetary Fund (IMF) has speculated that eurozone banks may need more than €150 billion of new capital.

Concerns over euro stability funding

Many analysts are concerned that the EFSF will not have adequate resources to protect Italy and Spain if they suffer further large interest-rate increases. The US has proposed that Europe vastly expands the size of the EFSF to enhance its credibility with investors, but there is no consensus about how to finance such an expansion. Some think tanks have proposed that the EFSF establishes a 'bank and borrow' from the European Central Bank (ECB). Others would simply have the EFSF borrow in the market.

The Germans are concerned that a large increase would increase their own debt-to-GDP ratio and jeopardise their triple-A credit rating. ECB governor Jean-Claude Trichet has opposed the bank taking on the role of lender of last resort, despite the fact that it has purchased more than €50 billion of Italian and Spanish debt since early August. This impasse may not be resolved until market events make it necessary for the EFSF to intervene on a large scale. The Germans want to preserve the monetary union, so they will be flexible when there is no alternative. But their unwillingness to lead the markets has left everyone apprehensive and has adversely affected business confidence in the eurozone.

The prospects for major currencies are uncertain while the scope and scale of coordinated rescue measures are still being considered

"The G20 members will not be able to change the political dynamics that stand in the way of positive action"

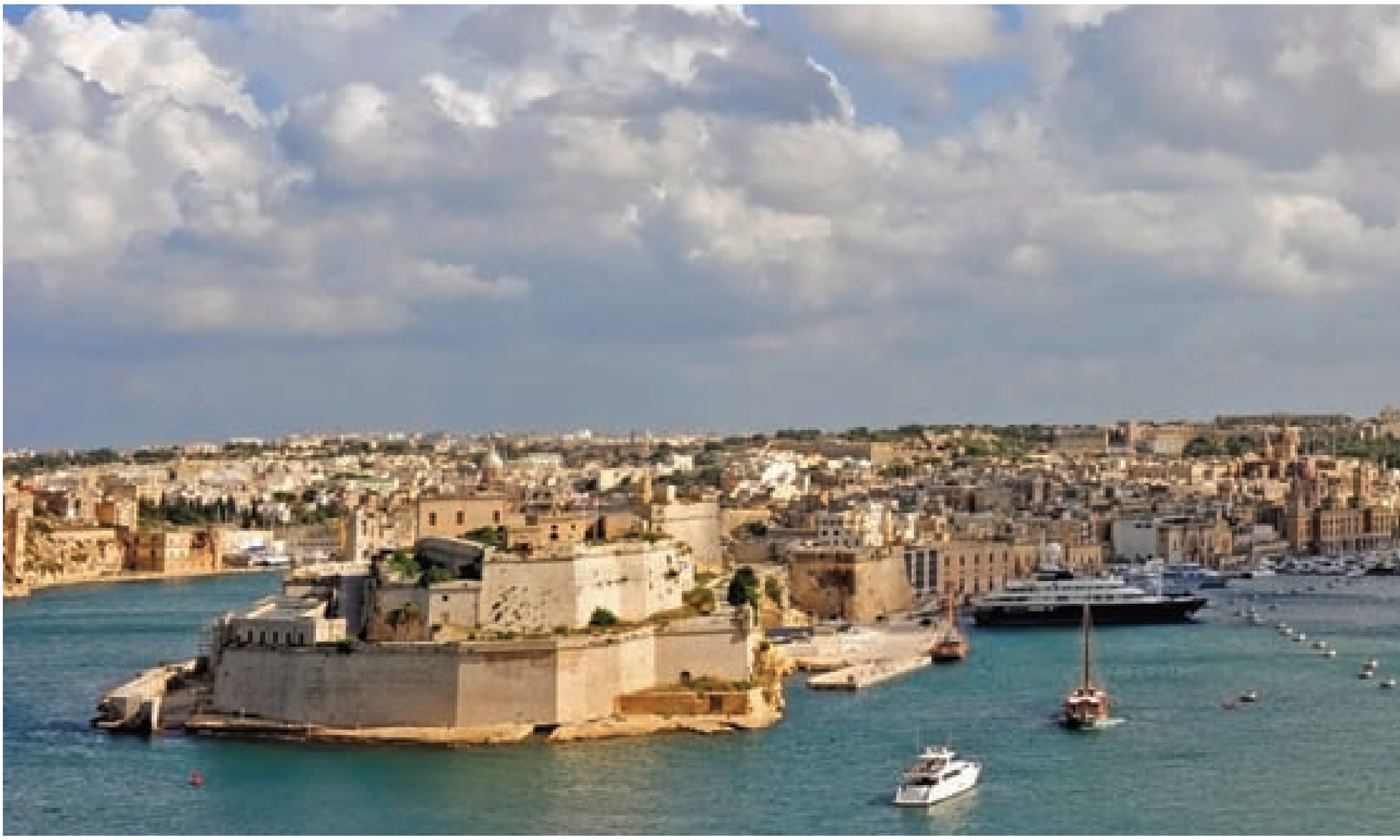
There have recently been sharp declines in eurozone purchasing-agent surveys, suggesting a possible mini-recession during the next two quarters. The eurozone finance ministers would be able to bolster confidence if they could agree on a programme to protect Europe's banks and financial markets from a full Greek default.

China has been pursuing a tighter monetary policy in the past year in order to resist higher inflation and rising property values. It has raised interest rates five times and bank-reserve requirements 11 times. It also has imposed numerous restrictions on property lending. The policy has not prevented inflation from rising to 6.5 per cent, but it has created a credit crunch for small and medium-sized enterprises while depressing property values and sales.

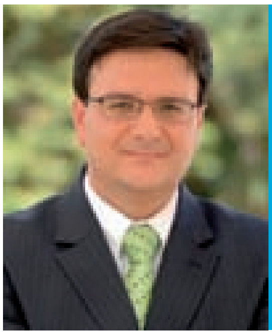
China will be reluctant to ease monetary policy until inflation declines, but the economy will be vulnerable to a downturn in global trade. If the US and Europe have a recession, falling exports could reduce China's growth rate to six per cent from 9.5 per cent this year. China should therefore prepare contingency plans for fiscal and monetary stimulus in the event that a recession occurs in its two major export markets. It contributed significantly to the global recovery from the 2008-09 recession. As its ratios of government and private-sector debt to GDP are very modest, China has the potential to play this role again.

Lingering uncertainties

There will be no simple way to resolve the policy uncertainties now gripping the US and Europe. The American political system has deep partisan divisions that are causing policy gridlock, which may not be resolved until the 2012 presidential election. The Germans are reluctant to create a European fiscal union to support the monetary union. There is a broad awareness of the policy changes that will have to occur, but a natural reluctance to accept them. The G20 members can attempt to address these issues at their summit in Cannes, but they will not be able to change the political dynamics in the United States and Germany that stand in the way of positive action. The uncertainties will therefore linger, inhibiting business decision-making and reinforcing the downturn occurring in the largest G20 economies. ◆



Malta: a centre of excellence and stability



Tonio Fenech, Minister of Finance, the Economy and Investment

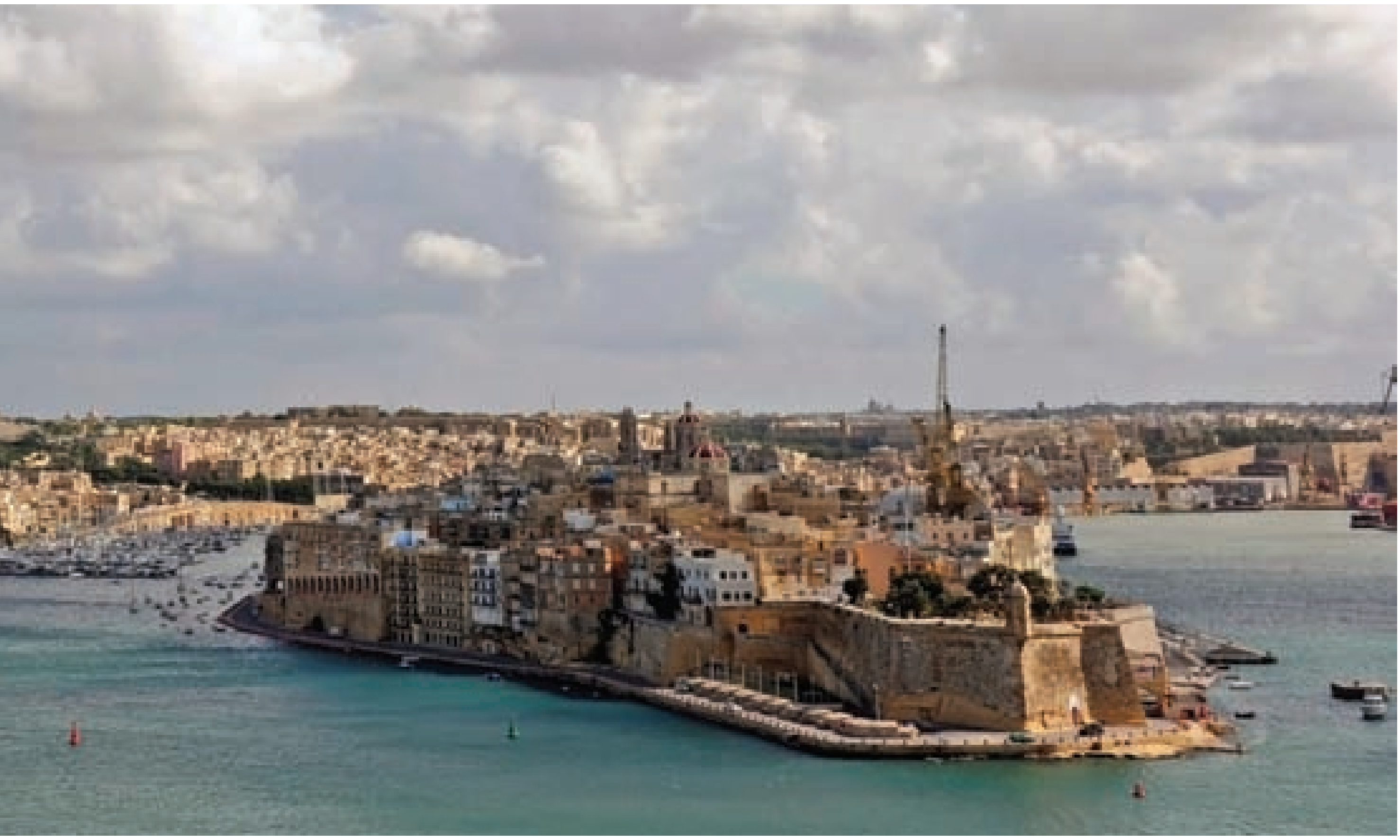
Striving for excellence and achieving stability have been the two key growth factors that have supported Malta's development over the past years.

Strategically located in the centre of the Mediterranean, 93km from Sicily and 288km from North Africa, Malta has over recent years transformed itself into an innovation-driven economy that seeks to compete amongst the world's best in a number of areas where it benefits from a significant comparative advantage. Malta is indeed the smallest European Union and eurozone member and, perhaps, best known as a popular tourist destination with lots of history and culture to offer. However, over the past few years it has developed its economy into a vibrant, varied economy, hosting financial, IT, gaming, high-value-added manufacturing and logistics-related companies of international repute.

Despite the international crisis, Malta and its economy have demonstrated resilience and soundness, managing to continue to sustain above EU-average growth rates and significantly lower levels of unemployment. Indeed, our economy kept growing, registering a gross domestic product (GDP) increase of 3.2 per cent last year, a momentum which was sustained this year with growth rates reaching 2.3 per cent and 2.8 per cent in the first two quarters. The reason behind this success is the ability and willingness to transform ourselves and branch into new areas, a direct effect of the restructuring and transformation process that the economy has undergone in the past few years.

Vision 2015 – Vision for Excellence

We believe that the Maltese economy can retain and improve its position in the face of the ongoing challenges by attracting and supporting niches of activities that have the potential to create high-value-added activities. Our long-term strategy – embodied in our Vision for 2015 and beyond – is built on the sound principle of aspiring towards excellence. We see and position ourselves as your partner to expand your operations. This Vision highlights diverse sectors, from the innovative sector of creative industries, the pillars of financial services and tourism, high-value-added manufacturing, the provision of international educational services, life sciences and health-related services, as well as transport and logistics. These sectors form the basis of our long-term vision, which is built around the potential of the



island and on the results registered so far by our economy. They are the areas in which we believe that we do have a competitive advantage and thus have the potential to excel in.

Some have questioned the motivation behind the decision to identify and invest not in one or two key sectors to achieve growth and excellence, but rather seven. Indeed, we believe that the recent experience of the international crisis has taught us the benefits of diversification – a decision that has made the country less prone to sector-specific shocks and the benefits of diversification.

Beyond the Vision, we offer resources. Most importantly, the human resource. We have invested enthusiastically in our educational and training system, which churns out qualified professionals targeted to address industry's needs. Our workforce is highly educated, productive, adaptable and multilingual. These attributes are regularly highlighted by foreign investors as the main reasons driving their decision to invest in Malta.

Indeed, foreign direct investment (FDI) has supported Malta's positive economic performance. FDI flows amounted to €792.1 million in 2010, an increase of €250.6 million over the previous year. A number of foreign businesses have not only expanded their operations on the island, but have brought over vertical aspects of their businesses, including pension management, call centres and other back-office work. Excellent IT systems – as well frequent air and sea links to major locations in Europe, North Africa, Middle East and Asia – put Malta closer to the needs of businesses.

Malta offers a proactive business environment, and the legal structure in Malta is based on the civil-law pattern of continental Europe, with an administrative and fiscal legislation based on British laws. EU, eurozone and Schengen membership, relatively competitive costs, a highly efficient OECD-approved tax model and an advanced telecoms infrastructure have also helped Malta to secure further investment and international recognition.

Despite this strong sense of affinity with its European neighbours, Malta's location allows it to serve as a bridge to the emerging economies in the Mediterranean region. Malta's humanitarian and logistical role during the crisis in Libya has been hailed as a success worldwide. The potential there is unlimited. Investment from Europe in the Mediterranean region has gone up from €2.5 billion in 1995 to over €7 billion in 2010. Imports and exports in Mediterranean countries have increased by 39 per cent and 52 per cent respectively during last five years. Despite this growth, the market size of the Mediterranean is set to expand by over 50 per cent by the year 2025. Adding to this, trade and investment liberalisation are under way in many North African and other Mediterranean states. Malta is perfectly located to assist in your growth.

On top of all this, Malta is a great place to be. Its history is vast and spans more than 10,000 years, while its culture is diverse, with influences inherited from foreign rulers of the country. The beauty of its natural scenery is complemented by almost year-round sunshine. No wonder our climate was ranked first in the International Living survey.

With this in mind, we invite you to be part of our success, because your success is the basis of our country's success, as our economic history has shown.

Connecting to people: tackling the massive global jobs deficit

As unemployment rates rise around the globe, especially among young people, and wages continue to stagnate, the world is looking towards the G20 leaders to cooperate on ways to address these problems and their effects on society

By Juan Somavía, director general, International Labour Organization

The G20 leaders will meet in Cannes at a time of great uncertainty and high risks, for people, jobs and the world economy. Expectations of the G20 are running high.

Around the world, some 200 million people are unemployed. Youth unemployment is around 20 per cent, two to three times the adult rate. Long-term unemployment is on the rise in many countries, destroying skills and motivation. In many economies, workers' real wages were stagnant before the crisis and are now falling. Vulnerable employment and informality have not receded and make up a large share of total employment.

Sixty-one million people, less than one per cent of the world's population, have the same income as 3.5 billion people, 50 per cent of the world's population. In most advanced and emerging countries, income inequalities are widening, with a disproportionate share of income going to the top 10 per cent of income earners. This is challenging the foundations of social cohesion in many countries. It is weakening aggregate demand and the financing of growth, and leading countries to an over-reliance on export-led development, further widening internal imbalances.

At the end of 2010 and in early 2011, the world economy was growing at a pace that was sustaining a rate of growth of employment of around one per cent, roughly the growth in the working-age population. This halted the increase in the number of unemployed, but was not sufficient to reverse the trend and bring unemployment down by any significant measure. A rate of growth in world employment of 1.3 per cent is required in order to recover by 2015 the ratio of pre-crisis employment to working-age population, closing the current jobs gap and absorbing new entrants into the labour market.

However, the current global economic slowdown now implies employment is growing at only 0.8 per cent, less than the increase in the labour force. This can only worsen the chances of young women and men finding decent employment. The world is not on track to generate the 400 million new jobs needed in the next decade just to keep up with the increase in the working-age population.

Restoring people's confidence in governments

G20 leaders have a tremendous responsibility. Levels of anxiety, anguish and anger are running high in many countries. Many people are looking to the leaders to turn around the drift back into crisis.

There is much talk of restoring the confidence of financial markets. It is even more important and urgent to regain the trust of citizens in governments' ability to make public policies for the benefit of working families and their communities, and for business and entrepreneurs of the real economy.

Emerging and developing countries have weathered the crisis better than the developed world. Most resisted the advice to lighten regulation of the finance sector and kept in place rules that prevented some of the worst excesses experienced in advanced economies. The absence of a debilitating private- and public-debt hangover in most of the largest developing countries has enabled recovery to take hold more strongly. But a slowdown in the developed world will inevitably affect the pace of this pick-up, together with inflationary and exchange-rate pressures.

Under these conditions, decisive global cooperation is urgently required in order to agree on a convergence of macroeconomic, employment and labour market policies that promote, in the near term, high levels of productive investment and job creation in sustainable enterprises of the real economy.

I strongly endorse the conclusions drawn by the G20 employment and labour ministers at their meeting on 26-27 September in Paris. The G20 committed "to promoting policies and institutions that enhance the job content of economic growth and contribute to create the quality jobs our people need".

Coordinated action for jobs-rich growth

The Cannes Summit must mark a decisive breakthrough in coordinated action for jobs-rich growth across several interconnected policy fields. Full employment should be a central target of economic policies. Today, inflation rates, balanced budgets and public-debt levels are targeted – but not job creation. There should be action taken to achieve high levels of employment.

Multilateral agreements to reform and repair the financial sector, as called for by the G20 three years ago, must be accelerated and deepened in order to restore stability and confidence in financial markets. A reconstructed financial system servicing the real economy is vital.

Mobilising domestic and international development finance is critical for increasing investment in the economic and social capital of the least-developed countries.

Investment in the real economy to grow enterprises and employment is a priority: infrastructure, green energy and

Young jobseekers in the Philippines look for vacancies as they queue during a job fair. Youth unemployment has become a widespread global problem

the greening of production and transport are needed to create and sustain jobs.

The easing of credit conditions for small enterprises is an urgent requirement and a direct way to sustain investment and jobs. Credit facilities can take the form of guarantees, with some or all of a loan backed by government support. Part of the liquidity provided to banks could be earmarked for support to small businesses. Credit mediators to examine the requests of small businesses could be introduced.

Productivity increases have outstripped wages in many countries, contributing to income inequality and a falling wage share, thus widening internal and external imbalances. Labour standards, collective bargaining and minimum-wage systems should be strengthened to better align wages with productivity gains and sustain demand and income-led growth.

Public policies are needed to help businesses to resume hiring or to retain workers. Temporary reductions in payroll taxes paid by employers and workers have proven to be effective in this regard.

A strategy of socially responsible fiscal consolidation is needed to ensure that measures to introduce more stability in financial markets are not at the cost of social instability. Social protection for the vulnerable should be guaranteed; unemployed persons should have access to unemployment benefits, as well as orientation and training to facilitate job search. Tax reforms should ensure that the burdens of medium-term fiscal consolidation are shared fairly. Loopholes and boltholes to tax havens must be closed. Governments should actively consider a financial activities or transactions tax.

Emerging and developing countries will want to continue to rebalance their economies away from excessive reliance on exports and towards domestic consumption. An important focus is more evenly distributed wage earnings and the gradual establishment of a social protection floor. The social protection floor approach is advocated by Michelle Bachelet, former president of Chile, in her report to the United Nations and the G20, showing the feasibility of measures to protect and empower the most vulnerable while sustaining demand.

> “The Cannes Summit must mark a decisive breakthrough in coordinated action for jobs-rich growth across several interconnected policy fields”

These policy choices are the building blocks for patterns of growth that can yield social justice through the realisation of decent work for all: action to promote enterprise development and employment creation, to extend social protection, to engage in social dialogue, and to respect fundamental principles and rights at work. There is no better way to restore people's confidence and connect with them than by responding to the universal aspiration for a decent job. ◆

INTESA SANPAOLO

Intesa Sanpaolo is among the top banking groups in the euro zone and the leading banking group in Italy with over **19.6 million clients** served by **7,700 branches** and present in over **40 countries**.

Corrado Passera
Chief Executive Officer
Intesa Sanpaolo

"**To create and sustain prosperity in Europe, we need to work together to harness innovation, boost growth, and create jobs.** Working for years on an international scale, we strongly believe in innovation as a key strategic factor, and in technology as an enabler of economic development. That's why we decided to establish ourselves as a European catalyst, connecting the dots of innovation scattered throughout the ecosystem. That's why we created the **Intesa Sanpaolo Start-Up Initiative**."

INTESA SANPAOLO START UP INITIATIVE

Think Big Start Small Scale Fast

OUR COMMITMENT TO JOB CREATION

Innovation is a key source of new jobs. Our key commitments include seed and later-stage VC funds, preferred loan facilities for R&D, advisory functions to accessing EU support funds, and various other activities.

THE INTESA SANPAOLO START-UP INITIATIVE is one of our projects for the creation of jobs by identifying and coaching promising start-ups and connecting them, at key global events, to potential investors and other players in order to meet, obtain support and make deals. Over the last two years, we accomplished the following:

1,000+ START-UPS SCREENED to identify the most suitable candidates for coaching and for investors to meet

200+ START-UPS COACHED to strengthen their management and presentation skills

160+ FINALISTS PITCHED their ideas at international roadshows

25 INTERNATIONAL EVENTS held in Italy, in other European countries and in the United States of America

7 TECHNOLOGIES COVERED: BIOTECH, CLEANTECH, ICT AND WEB, NANOTECH AND MATERIALS, SOCIAL VENTURES, ELECTROMECHANICS, HEALTHCARE

A UNIQUE ECOSYSTEM UNDER ONE ROOF: start-ups, investors, companies and other partners such as universities and incubators meet for deals, services, tech transfers and other forms of cooperation

HUNDREDS OF LEADS FACILITATED: the Start-Up Initiative enables key stakeholders to meet and to develop commercial, service and investment deals

How can we create growth and jobs together?

Act Now
Do Better
Grow Together

A PROVEN MODEL

The Intesa Sanpaolo Start-Up Initiative has facilitated investments in entrepreneurs to reduce investors' risk exposure, and to act as a platform from which to work with other players.

A SCALABLE PLATFORM

To reinforce the impact of innovation, we continue to scale our commitment and strengthen the Intesa Sanpaolo Start-Up Initiative network both at existing and new locations in Europe and beyond.

SOLUTIONS NEED THE CONTRIBUTION OF MANY

As we face the challenge of building lasting prosperity, we become humbly aware that just as the challenge is not the result of the actions of a selected few, the right solutions will also need the contribution of many. If you wish to help building the prosperity of future generations, we would like to hear from you.

To know more about the Start-Up Initiative, visit **www.startupinitiative.com**

To join forces or discuss working on similar growth and job-creation partnerships, email **startup@intesasanpaolo.com**

Young entrepreneurs should be a G20 priority as drivers of global growth

While large companies have been shedding jobs during the global downturn, many young entrepreneurs have taken the risk of launching their own businesses to create employment. Such enterprise needs to spread worldwide to aid recovery

By Vivian Prokop, founding chair, G20 Young Entrepreneur Alliance, and CEO, Canadian Youth Business Foundation; Grégoire Senhilhes, president, Les Journées de l'entrepreneur, France; and Francisco Ruiz, president, Coparmex Young Entrepreneurs, Mexico

As the G20 leaders grapple with the continuing aftershocks of the 2008 financial crisis, entrepreneurship has proven to be vital for building a stronger economy globally, rather than simply a topic for theoretical reflection.

Issues of youth unemployment and entrepreneurship are destined to grow urgent on the global economic agenda. Even in good times, young people face relatively high unemployment and are the first and worst to be hit during any downturn. Those without jobs or prospects represent more than a loss of economic potential. They remain trapped in poor value-adding jobs, become easy targets for recruitment into criminal activity and the underground economy, and see no hope or reason to believe in society. Job creation strategies aimed at younger generations should be central to any economic recovery strategy.

Economic recovery will only happen thanks to a long-term vision and political will to place entrepreneurship at the heart of 21st-century capitalism.

Youth entrepreneurship must be a priority for world leaders because its importance in fostering growth is undeniable. In France alone, where this year's G20 summit takes place, small and medium-sized enterprises have created 1.8 million jobs over the past 15 years; over the same period, the country's 500 largest companies have cut 300,000 jobs. As average youth unemployment across the members of the Organisation for Economic Co-operation and Development (OECD) is expected to hit 18 per cent in 2011 and will drop only slightly next year, enabling more young people to launch new businesses is essential.

Need for a worldwide plan

A successful strategy requires a sound appreciation of the issues that matter to young entrepreneurs, a coordinated plan to reinforce optimism, and initiatives that support entrepreneurial attitudes and activities. In order to enable large numbers of entrepreneurs to create jobs, innovate, invest, grow their businesses and contribute to stronger economies, a global entrepreneurial ecosystem is needed.

A major step in this process was the inaugural G20 Young Entrepreneur summit (G20 YES) in 2010, which started in Canada following the financial crisis. Despite the recession, young people were willing to take risks in creating employment for themselves and others. Demands for support from the Canadian Youth Business Foundation (CYBF) began to surge. The Canadian government moved to reinforce CYBF's capacity, contributing $10 million (an amount that has since grown to $40 million). This enabled CYBF to fund a record number of start-ups (more than 600 in 2010) while maintaining an impressive 94 per cent success rate throughout the recession. In the same year, CYBF was inundated with requests for advice from overseas.

Since Canada was hosting the 2010 G20 summit, CYBF seized the opportunity to give entrepreneurship a higher profile in the global discussion about how to reinforce economic recovery. The first G20 YES was born, bringing more than 200 young entrepreneurs and supporters to Toronto in the days preceding the leaders' meeting.

The 2010 G20 YES produced a resounding consensus on five key issues: improving access to financing for people

with little experience and few assets, coordinating support for young entrepreneurs across the public and private sectors, fostering a more entrepreneurial culture, shaping regulation and tax policy in ways that encourage business start-up and growth, and enabling young people to acquire the knowledge and skills to succeed as entrepreneurs. A resulting communiqué was presented to Canada's minister of industry, Tony Clement, on behalf of the G20 leaders, and again a day later to top business leaders and finance ministers from across the G20 at the B20 summit.

> "Youth entrepreneurship must be a priority because its importance in fostering growth is undeniable"

The second important outcome of this inaugural G20 YES was the decision to create a continuing vehicle for addressing entrepreneurship issues within the context of the G20. The G20 Young Entrepreneurs' Alliance (G20 YEA) was formed to create a worldwide movement with the aim of highlighting to young people the vital role played by entrepreneurs in countries' growth, innovation, job creation and competitiveness. The G20 YEA is a collective of leading entrepreneurially minded organizations representing the G20 countries. The G20 YEA Incheon Charter, formulated in November 2010 in Korea, declared a joint commitment to work within the official G20 process to raise awareness and drive policies that will help young people start and grow businesses.

The G20 YEA is organising the 2011 G20 YES in the south of France under the theme 'Entrepreneur = growth = new jobs'. It is hosted by French G20 YEA member Les Journées de l'Entrepreneur and will take place from 31 October to 2 November. More than 400 emblematic entrepreneurs from the world's leading 20 economies will gather in Nice, near Cannes, where the G20 leaders will congregate the day after the G20 YES ends. Together, the entrepreneurs will finalise proposals for positive solutions to the crisis based on the most effective policies and practices to ignite entrepreneurship, developed on an international level with the support of Ernst & Young and McKinsey and Company. The G20 YEA will then present the resulting recommendations to the G20 leaders.

Looking ahead to Mexico

Next year, the G20 leaders will meet in Mexico, where eight million people between the ages of 15 and 29 are neither in school nor working, and where 3.6 million households – 15 per cent of the total – are headed by people between 15 and 29, of whom only one in eight has a university degree. Mexico's economy has seen a short-term recovery of the jobs lost in 2009, but it needs to create one million jobs a year just to absorb labour market entrants. Even this, however, will do nothing to reduce the number of people out of work today.

With Mexican G20 YEA member Comisión Nacional de Empresarios Jóvenes de COPARMEX at the helm, the 2012 G20 YES will build upon the previous summits by championing the growth of a sustainable entrepreneurial ecosystem in developed and developing economies. It will mark the third time that the YEA will bring international recognition to the critical role that young entrepreneurs play in economic growth, and will engage world leaders in providing greater support for these business owners, who create jobs for themselves and others.

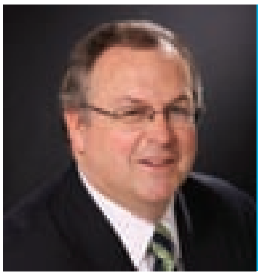
For members of the G20 Young Entrepreneurs' Alliance and others, the G20 Young Entrepreneur summits are linked by one common, passionate belief – that entrepreneurship can become the cornerstone of global economic dynamism, competitiveness and prosperity.

For more information about the G20 Young Entrepreneurs' Alliance, visit www.g20yea.com ◆

During the 2010 G20 Young Entrepreneur Summit in Toronto, key policy actions were identified for G20 leaders to undertake in support of young entrepreneurs

Financial reform through the G20

Establishing the right balance between risk and opportunity for future prosperity



Kent Andrews, Senior Vice-President, Regulatory and Government Affairs
TD Bank Group

Craig Alexander, Senior Vice-President & Chief Economist
TD Bank Group

The 2008 financial crisis revealed fundamental weaknesses in the global financial system. The ensuing world recession also highlighted how financial problems are rapidly transmitted to the real economy and across countries. These recent experiences underscore that healthy economies require healthy financial systems, and that the latter require prudential regulatory oversight.

Ideal forum for financial reform

A concerted effort is now under way to address the identified financial system shortfalls. Given that financial activity is global in nature, it is essential that the reforms are coordinated across countries and across financial sectors. Thus, the G20 is an ideal forum in which to shape the financial reform agenda.

Progress is already under way in a number of areas. Basel III effectively addresses the issues of excess leverage and inadequate capital. It also ensures that the underlying capital is of high quality.

The decision to require identified global systemically-important financial institutions to hold more capital is an effort to address the moral hazard dimension of 'too big to fail'. Moral hazard has also been tackled through the concept of living wills, which requires that financial firms identify how they would unwind operations if solvency became an issue. Stress testing has also been embraced as a manner to identify financial vulnerabilities. It also helps financial institutions to appreciate unanticipated economic and financial environments.

Recent experience shows us that oversight of individual institutions can miss broader or aggregate risks to national financial systems. This calls for macroprudential regulation, and many nations have initiated new programmes by their domestic regulators to provide such oversight. The concept of countercyclical capital buffers, which are part of Basel III, also helps to address macroprudential risk, by having regulators lean against excessive overall credit growth.

Transparency is also improving as traditional creditors are required to provide greater details on financial activities and exposures. Progress in providing oversight to non-traditional sources of credit is proceeding more slowly.

There is concern among many financial institutions that new regulatory oversight will place greater demand on their resources. However, cost should not be a determinant when it comes to establishing control functions for legal requirements. Moreover, financial institutions should appreciate that they, too, benefit from improved oversight. It reduces the risk of major imbalances developing that will hurt financial institutions. It also reduces counter-party risk. No one wants a repeat of 2008, including financial institutions, their shareholders, or the customers and clients that they serve.

Achieving balance and flexibility

However, the ultimate goal of regulators is challenging. Policymakers must strike the right balance. It is critical that the financial reforms do not undermine access to credit, make the cost of credit excessive or deeply reduce the incentive to innovate. The law of unintended consequences should also be considered. For example, restricting risk in one area could inadvertently incentivise inappropriate risk-taking elsewhere to maintain return on equity.

As mentioned, international coordination is key. However, this does not mean blanket treatment for every financial institution, because national supervisory judgment must be present in a domestic context, and international cooperation and coordination must be present in a cross-border context. All regulatory bodies must recognise the difference between low- and high-risk business models in their supervisory assessments, and align capital levels accordingly.

It is likely that financial reform will not be done perfectly the first time around. There must be scope to reassess regulatory changes to evaluate whether they are achieving the desired outcome, and there needs to be the flexibility to alter rules if they are not. Financial system reform is not a sprint; it is a marathon that will take years to get the right mix. Moreover, financial regulation will need to respond and adapt to future financial innovation.

Financial institutions, too, benefit from improved oversight – it reduces the risk of major imbalances developing

The bottom line

We commend the action of G20 nations on creating a stronger, more stable, global financial sector. The financial ills have been correctly diagnosed. Proposals for the traditional financial lenders have now been put in place to address the majority of issues.

Implementation and enforcement are now the challenge, with international coordination needed to ensure the desired outcome. This requires constructive and frequent communication between the regulators and the regulated, as well as between the regulators across countries. We are headed in the right direction, but the journey continues.

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The case for a coordinated macroeconomic solution

The G20 members need to rediscover their sense of urgency if they are to prevent further deepening of the global financial crisis, and cooperation among countries is crucial if the debt issues that brought about the downturn are to be resolved

By William R White, former economic adviser and head of the Monetary and Economic Department, Bank for International Settlements

Over the past year, the G20 has been living under a dangerous misapprehension about the health of the global economy. As recently as April, G20 finance ministers and central bank governors stated that "the global recovery is broadening and becoming more self-sustained". The global crisis that began in 2007 was declared over. A closer look at economic and financial data, however, reveals the continuing influence of the headwinds of debt that built up to the crisis.

The "imbalances" – both internal and external – that precipitated the crisis persist. The process of deleveraging in heavily indebted countries has barely begun, while the solvency of lenders is increasingly in question. This situation is reminiscent of the late 1920s and, in some respects, worse. The accumulation of large debts in the private and public sectors in some advanced economies is unprecedented in peacetime, as is the low level of interest rates. In effect, for many countries the limits of macroeconomic policies for stimulating demand have now been reached.

What does this mean for the G20? First, the sense of urgency that characterised the meetings of the G20 in 2008 and 2009 must be re-established. This is all the more important since slow growth or recession threatens to unleash the social and political tensions built up over recent decades in which income inequality has increased enormously. There is evidence of this in the Arab Spring uprisings and street demonstrations and unrest in Europe, China, India and elsewhere – while governments everywhere show high turnover rates. An increasing recourse to protectionism could well follow.

Second, the G20 must focus more on crisis management than crisis prevention. There are clear and pressing problems that threaten to affect all the G20 participants, creditors as well as debtors. These problems must be urgently addressed in a cooperative way.

This is not to deny the significance of the accomplishments of the G20's Mutual Assessment Process (MAP), especially given the extent to which important countries still pursue different objectives and also have different views on how market economies operate. The focus of the MAP on imbalances is a big step forward, since most analytical models ignore such concepts.

A further sign of progress is that these imbalances include not only external imbalances, but also the underlying domestic imbalances that drive them. Finally, the emphasis placed by the G20 on maintaining stability within the financial sector is welcome, given the central role attributed to financial dysfunction in recent years.

It is regrettable, however, that the indicators used to identify external imbalances do not include measures of competitiveness – as is the case internally in Europe. Hard targets to motivate a policy response and an enforcement mechanism are absent – the process suggests restraint rather than urgency in the face of known problems. Yet the welcome emphasis on the pursuit of financial stability by the G20 must not be allowed to divert attention from imbalances amassing in the non-financial sector. Severe economic downturns can occur even in an initially robust financial sector. The Great Depression kicked off in 1929 but the collapse of the US banking system only began two years later.

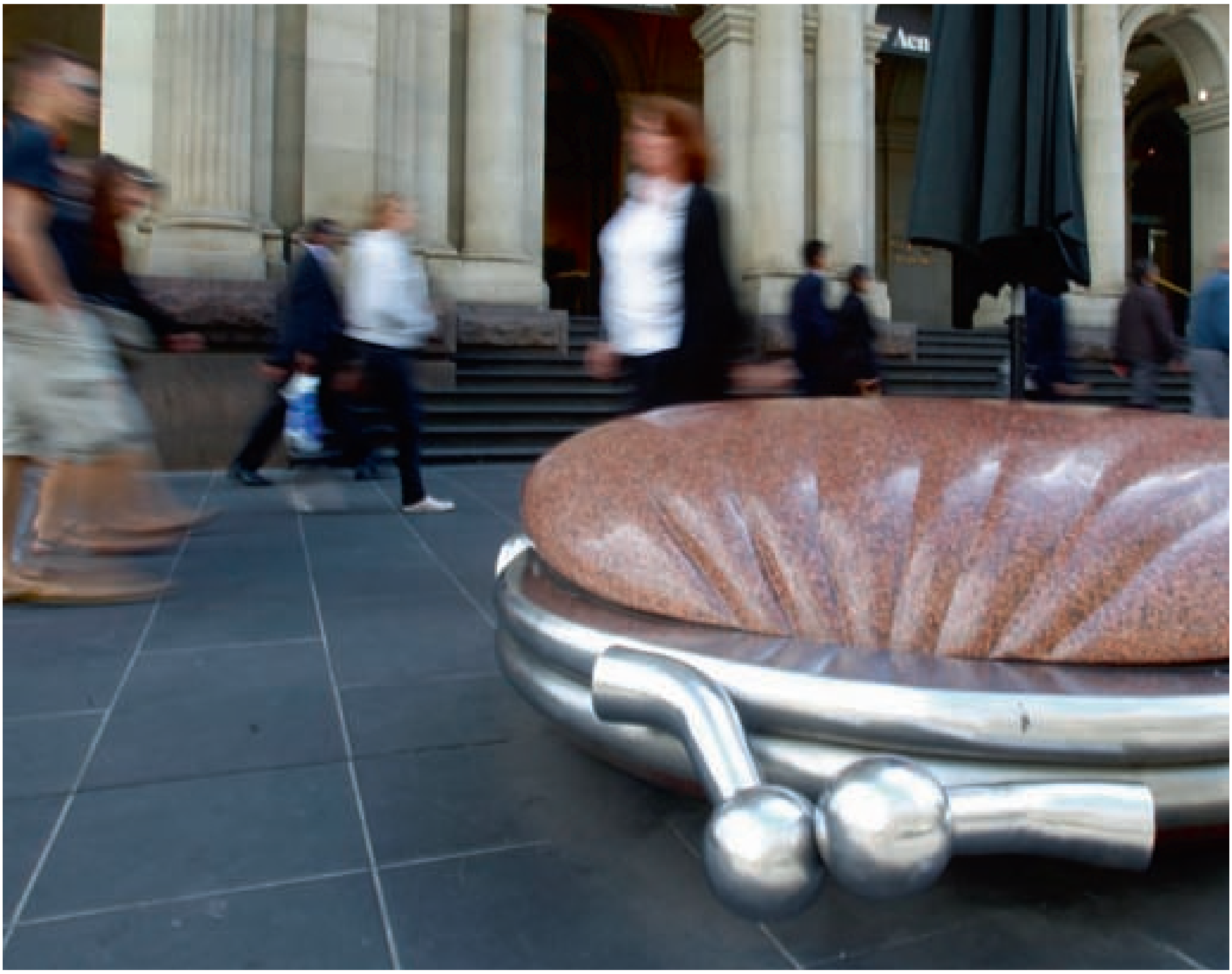
Correcting past mistakes

What should the G20 do? Its first task is the most difficult. It must forge an agreement on the need for enhanced attention to crisis management and on the need for cooperative solutions to the continuing problems posed by the overhang of debt. Creditors and debtors both made errors in allowing debt levels to grow so high and both bear the responsibility for trying to find a solution to this problem.

Put more dramatically, creditors must see the threat of a further descent into crisis as a material threat to their own wellbeing. After all, it was the intransigence of creditors, and those seeking impossibly large war reparations during the 1920s, that contributed materially to the problems of the 1930s and all that followed. On the assumption that agreement can be reached on the character of the problem, what cooperative solutions suggest themselves? Existing imbalances constrain the use of stimulative macroeconomic policies in many advanced economies facing slow growth.

At the same time, many emerging market countries face resurgent inflationary pressures. Nevertheless, considerable room to manoeuvre remains, given the possibility of both nominal exchange-rate movements and supporting structural reforms.

Consumption spending in many emerging economies is too low, and fixed investment too high, while the very opposite is the case in many advanced economies. China and the US are a case in point. So further exchange-rate appreciation in rapidly growing creditor countries would appear to benefit everyone. Not only would substitution effects help achieve the desired real rebalancing, but the direct effects on prices would also be welcome. Inflation would be reduced in countries where this is a problem, but deflationary fears in debtor countries would also be reduced. As for supportive macroeconomic policies, more government spending on



The Public Purse – a sculpture in Melbourne, Australia, by Simon Perry – alludes to the power of government over financial affairs

infrastructure in advanced economies would provide an earning asset, as well as a liability.

Credible promises to reduce future deficits, even if current ones were allowed to rise, would provide further solace to financial markets worried about high levels of sovereign debt. In emerging economies, a more restrictive monetary policy might dampen inflation while leaving more room for improved government safety nets and spending on health and education. Such developments would help to bring down high household saving rates and encourage domestic consumption.

Easing the debt burden

Structural reforms would also help. In many highly indebted countries, these reforms would spur growth and help to make the burden of debt more bearable. In creditor countries, faster growth due to structural reform would also be welcome in itself, but reforms also could help to ease the problem of external imbalances.

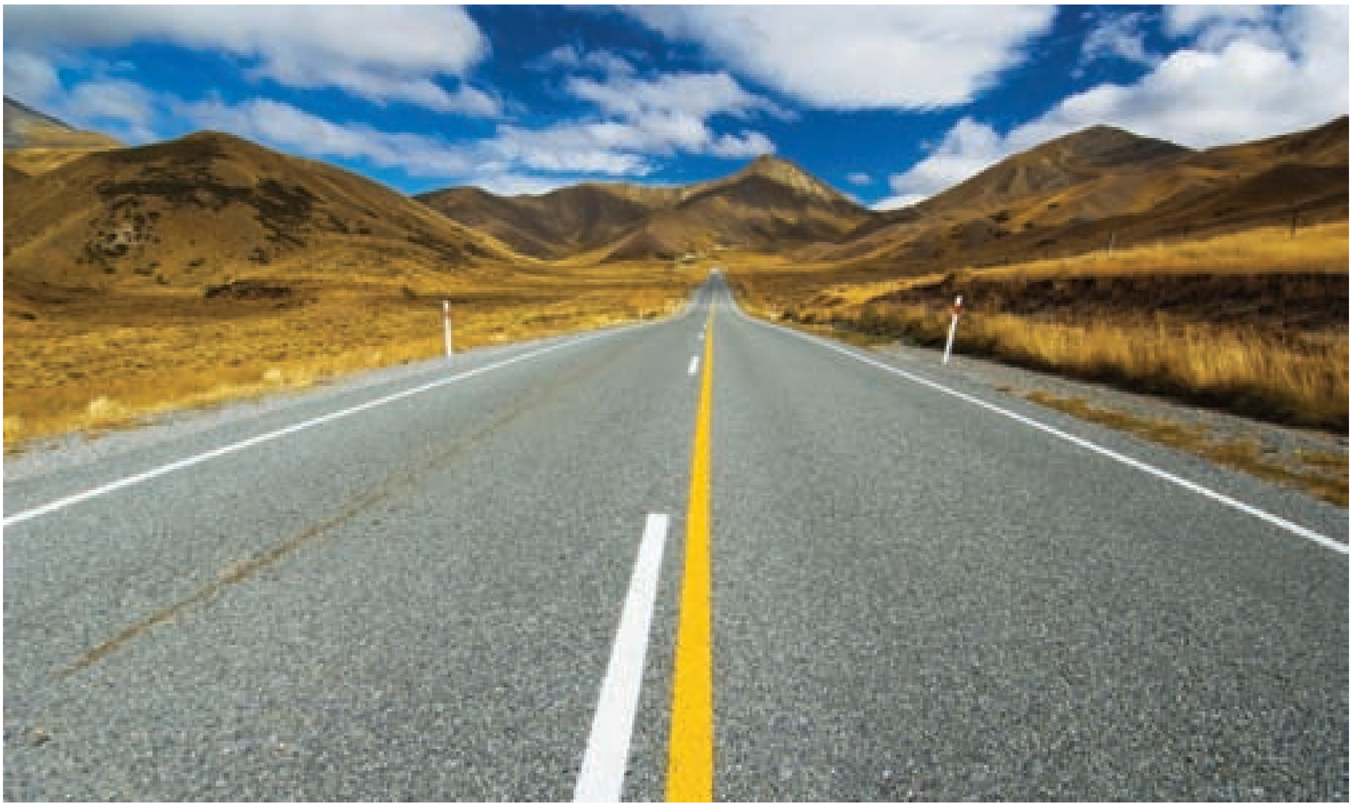
In important creditor countries, such as Germany, Japan, China and Korea, the domestic services sector remains very highly regulated. Deregulation, with all of the associated opportunities for increased profits, would decrease the production of tradeable goods and increase import penetration as well.

Two other sets of policies suggest themselves. First, if debt overhang is a fundamental problem, then an orderly means of debt reduction needs much more serious attention. This applies to many households, to a number of sovereigns and to the resolution of systemically important financial institutions. Prospective future declines in the value of the US dollar – which reduces debts denominated in that currency – must also be carefully managed to avoid disorder.

> “If debt overhang is a serious problem, then an orderly means of debt reduction needs much more serious attention”

Second, the one sector not constrained by debt, but still reluctant to invest, is the private corporate sector in the advanced economies. For investment to accelerate, given uncertainty about the robustness of domestic consumption, protectionism must be ruled out. Businesses will be encouraged to make risky investments by a more certain domestic policy environment and by policies that generally support business. Recent political developments in the US and Europe have not been helpful in this regard. Credible policy statements, forged in the MAP, could go a long way towards establishing such a supportive environment. ◆

Global Accounting Standards post 2011 – a way forward



The International Accounting Standards Board issued a request for views on the strategic direction and overall balance of its standard-setting agenda. Comments are requested by 30 November 2011. In the midst of the ongoing global financial crisis, we provide our views on the role that the IASB can play in setting relevant and useful standards for global financial reporting

Christian Mouillon, Ernst & Young
Global Vice Chair – Assurance

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Background

During and as a result of the financial crisis of 2008, the IASB focused much of its attention on topics related to the crisis, such as financial instruments and off-balance sheet entities. Now, as the IASB moves closer to finalising the remaining projects from its current work plan, it is looking forward to the next three years of standard-setting. On 26 July 2011, the Board issued a request for views ("The Report") on the strategic direction and overall balance of its future agenda. This will be the first of an ongoing three-yearly public consultation process.

In the Report, the IASB has proposed the following strategic foundation for setting its future agenda:

- A more diverse IFRS community, potentially leading to new issues;
- A more complex market environment, creating new challenges in financial reporting;
- A number of new and amended IFRS have been issued or are expected to be issued in 2012 placing pressure on preparers to implement these changes and users to understand the key differences.

The Report highlights that the strategy of the future agenda should not only focus on the development of new IFRS, but should also emphasise the need to maintain existing IFRS. The Board has specifically asked very open-ended questions in the Report to encourage diversity in constituents' responses.

Ernst & Young's views

Overall, we support the agenda consultation as it allows the IASB to receive views from a wide range of constituents, in addition to creating further transparency of the IASB's agenda-setting process. However, rather than prioritising specific projects, we believe that the agenda should focus on the following key strategic areas:

1. **The IASB should take the opportunity to step back and focus on the long-term goals of IFRS**
    - The IASB has the unique ability at this point in time to take a step back and re-assess the strategic direction of IFRS as a valuable tool for financial reporting. The three-year agenda should be set based on intermediate steps that help achieve its key strategic goals;
    - The most important project would be a long-term analysis of the future of performance reporting. This project would focus on the decision-usefulness of IFRS that steps back from individual areas of accounting and considers IFRS financial statements as a whole. This will help to enhance confidence in the relevance of IFRS financial statements for both users and preparers. This confidence has been challenged as a result of the recent financial crisis and continued uncertainty in the global markets. Ideally, we would encourage the Board to find a way for IFRS to be seen as valuable by preparers as a means of 'telling the story of the business' to users, while at the same time meeting the needs of users for transparent, decision-useful financial information;
    - As part of this performance reporting project, a comprehensive review of financial statement disclosures should be made. This includes emphasis on determining clear principles and objectives for streamlined financial statement disclosures to ensure that financial statements remain meaningful and relevant to their primary users;
    - A high-level review of IFRS should also focus on the Conceptual Framework project. Once the Conceptual Framework and performance-reporting projects are completed, these can be used to 'road test' existing IFRS to identify areas of inconsistency or where further guidance is required;
    - These are very in-depth projects aimed at the future state of IFRS. However, this should not preclude the IASB from taking short-term measures to achieve these goals (such as starting outreach activities, reviewing research and initial discussions of these projects).

2. **A period of calm is needed**
    - Preparers and users need time to implement and digest the raft of new standards that will have been completed by late 2011/early 2012. These include new standards on financial instruments, consolidation, joint arrangements, fair value measurement, revenue and leases;
    - However, this period of calm does not mean that IFRS should remain stagnant or unresponsive to changes in the environment for the next three years;
    - There is an opportunity to consider if there are any projects that would be relatively simple for financial statement preparers to implement (and users to understand), but would require greater effort on the part of the IASB to resolve (for example, the distinction between debt and equity). Completing projects that meet these criteria in the next three years would allow for minimal disruption while IFRS preparers focus on other, more significant new accounting changes;
    - Many of the new standards represent implementation challenges and it is likely that the IASB will be asked to provide more application guidance. We would encourage the Board to do so;
    - One example is the new standard on Fair Value Measurement – IFRS 13. This standard, while it does not change *when* fair value is used, provides detailed guidance on *how* to measure fair value. Many of the issues faced during the financial crisis, such as determining how to measure fair value in volatile markets, are now addressed in IFRS 13. However, there is likely to be an increased need for the involvement of valuations experts in applying this new standard. Accordingly, we support and encourage continued co-operation between the IASB and valuation bodies such as the IVSC.[1]

3. **Focus on consistency of application for the benefit of all stakeholders and users of financial statements**
    - As noted in the Report, there is an opportunity to focus on Post-Implementation Reviews and ensuring standards are consistently applied and interpreted. However, there are further efforts outside of post-implementation reviews needed to ensure the continued value, usefulness and consistency of IFRS for all stakeholders into the future. These key steps include providing interpretations (or application guidance where needed) at a global level and engaging regulators in the standard-setting process;
    - The current lack of coordinated global regulation is an environmental threat to the consistent application of IFRS throughout the world. The IASB and its governing body, the IFRS Foundation, should consider what actions can be taken to mitigate these concerns;
    - The goal of one set of high-quality global standards requires consistent application and interpretation across many jurisdictions. Engagement with local regulators is an essential part of this process, in order to avoid a proliferation of local interpretations. In our view, the Monitoring Board of the IASB has an important role to play in this respect, since it represents the securities regulators as a group.

Conclusion

The IASB stands at a pivotal point in time. With a new Chair and Vice-Chair and much of its existing work programme near completion, there is a momentous opportunity to continue to shape IFRS to benefit all stakeholders and users of financial statements into the future. Now is the time to take big strategic decisions, rather than simply prioritising a list of separate projects. We encourage the IASB to be bold to benefit all.

Footnote

1. International Valuation Standards Council