World Economic Forum and International Chamber of Commerce

G20 Task Force

Final Report

8 September 2011

Chapter on Green Growth written in collaboration with Accenture
Chapter on Infrastructure Development written in collaboration with PwC
Chapter on the Role of Business in Society written in collaboration with McKinsey & Company

Contents

Introduction

The Korean government's initiative to engage international business leaders in the G20 process last year was received positively by both government and business leaders. In their Seoul Summit declaration, G20 leaders stated that they "look forward to continuing the G20 Business Summit in upcoming summits" in recognition of "the importance of private sector-led growth and job creation".

Business leaders also expressed interest in continuing the process. In his closing remarks on behalf of business participants, SEB Chairman Marcus Wallenberg encouraged the World Economic Forum and the International Chamber of Commerce (ICC) to work together to bring this about. Following consultations earlier this year with the French government, the Forum and ICC formed a joint initiative to develop proposals for leaders on topics corresponding to the priorities President Sarkozy has identified for the G20's work in 2011.

This report contains concrete recommendations to increase economic growth and job creation, in particular in areas such as transparency and anti-corruption, infrastructure development, green growth, commodity price volatility and food security. These recommendations have been developed over the past half-year by seven working groups of the Forum's International Business Council as well as the ICC's G20 Advisory Group.

This initiative has involved a number of positive innovations.

First, as suggested by a number of G20 sherpas in a meeting with the Forum and ICC during the World Economic Forum Annual Meeting 2011 in Davos-Klosters, we are pleased to transmit these interim recommendations at a much earlier stage of the G20's preparations than last year, in order for them to be considered while the Cannes Summit's agenda and decisions are still being formulated. Many of the specific working groups, such as the food security working group, have been working directly with the relevant ministries to maximize their positive impact.

Second, this final report is being transmitted to President Sarkozy and other G20 leaders in September, following a full-day review by CEOs and G20 troika sherpas and ministers during the International Business Council's summer meeting in Geneva, Switzerland, on 25 August. This review helped ensured the rigour, relevance and realism of the proposals being put forward.

Third, this year's report goes beyond broad policy recommendations and focuses on specific, concrete actions. CEOs developed three types of proposals: those requiring government action, those that the private sector could implement directly, and those requiring public-private partnership. For example, the anti-corruption working group recommends G20 government action on fully implementing international anti-corruption commitments, private sector action in developing integrity assurance programmes and public-private cooperation in developing "white lists" to recognize companies that show consistent leadership in anti-corruption. Across the working group recommendations, companies make a number of specific commitments of actions, expertise and resources to support this new, more action-oriented agenda.

Fourth, these recommendations have been developed in a spirit of cooperation and openness to ensure that the best recommendations are put forward, regardless of origin. Working groups have worked closely with other organizations, such as the World Food Programme on food security and the OECD and Transparency International on anti-corruption. We have coordinated our efforts with the French Business Association, MEDEF, with the view that the B20 should reflect the opinions and recommendations coming from all different business task forces and present a consistent and coherent set of conclusions to the G20.

Most of the topics the joint Forum-ICC G20 Task Force has been asked to address are too fundamental and multi-faceted for governments or businesses to successfully address alone. Deeper, sustained cooperation between the public and private sectors encompassing both policy formulation and implementation – advice and action – is required if the G20's ambition of stronger, more sustainable and more balanced global economic growth is to be fully realized.

It is in this spirit that chief executive officers and chairmen of 80 of the world's leading corporations offer the following agenda of smart policy and practical action on some of the most pressing challenges of our time for consideration by leaders of G20 countries. These recommendations of World Economic Forum working groups reflect the views of working group members alone and do not represent an institutional position of the World Economic Forum, nor do they necessarily represent the institutional position of the companies of participating CEOs.

We applaud President Sarkozy and the French government for carrying the G20's engagement with the business community forward from Seoul. We commend these recommendations to the attention of leaders and look forward to having the business community play a constructive role before and during the Cannes Summit.

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Recommendations

World Economic Forum G20 Working Group on Commodity Price Volatility

I. Framing the Issue

Commodity price volatility is justly on policy-makers' radar. While several credible studies[1] contend that volatility today is not higher than that observed in the 1970s and there is nothing extraordinary about today's situation compared to the historic context, some high-profile episodes in key markets stand out (the 2008 oil price spike likely the most prominent example). In addition, well-documented, recent price rises mean that upward fluctuations hit consumers that are already stretched. Volatility also affects investment decisions that can jeopardize future supply security.

Since another working group is examining food security, these recommendations exclusively deal with commodities related to (non-agricultural) energy, metals and minerals. Recommendations related to agricultural commodities can be found in their chapter of this report. The two working groups collaborated closely in creating their respective recommendations, so the results are well aligned.

We think that commodities markets are often not well understood in their intricacies and, therefore, first offer a section that lays out the challenges related to volatility but also give a broader overview of how those markets work from the professionals' perspective.

- Commodity markets exist in two dimensions
  - Physical markets, which are fundamentally dominated by supply, demand and storage, and by present transactions (spot markets)
  - Financial markets, which primarily provide users the means to hedge commodity risk, in other words to deal with uncertainty and time (futures markets)

- Many players operate in both financial and physical markets – as buyers, sellers and hedgers. It is very difficult to separate speculators (players who express a view on future prices for financial gain[2]) from other market participants – and often speculation is needed to create liquidity for hedging strategies.

- Financial markets routinely facilitate goals that are in line with government/society priorities – for example, the hedging of commodity-related risk for industrial or services companies. Financial markets can also help with price discovery and improve allocative efficiency, including better signals for investment and operations. It is worth noting that commodity derivatives are directly linked to physical goods and do not present the characteristics of bond or equity markets.

- Non-agricultural commodities have two important features: 1) new supply typically takes many years (up to a decade) to realize and is capital intensive; and 2) they have low short-run price elasticity of demand (due to limited substitutability, being essential economic inputs and a relatively small part of most final product and service costs) and low-price elasticity of supply (very high fixed to variable cost ratio, physical constraints on production modulation) which are prime drivers of short-run price volatility. It should be noted that similar dynamics, and volatility, are visible in markets where there is no storable commodity, such as in electricity markets.

- Price levels and volatility are primarily the result of fundamentals, structural shifts and resulting imbalances or uncertainty around key drivers. There is a need for clear forward prices that are unencumbered by political or regulatory distortion so that investments and behaviours can follow the right path to guarantee future supply security.

[1] Jacks, O'Rourke, Williamson (NBER WP 14748, Feb 2009); Calvo-Gonzalez, Shankar, Trezzi (World Bank, Oct 2010); Garry Smith (OECD, May 2011)

[2] See glossary for this and other terms used in this paper.

- Long-run prices are set by proven fundamentals of supply and demand. Over short time frames, both estimated supply-demand balance (where there is uncertainty or lack of transparency) and speculation (taking a view on prices) can influence prices and, therefore, introduce financial market volatility in addition to that driven by fundamentals. Storage capacity can mitigate short-term fluctuations, but only up to a point (primarily depending on the available capacity as a fraction of overall markets as well as speed of release). Futures markets per se do not have a conclusive influence on volatility in spot markets, as examined in a 2007 UN study[3]. It is worth noting that speculation normally has no or very little impact on prices in the spot markets (as opposed to futures markets) as spot transactions have to be backed by physical flows of commodities.

- Over the last decade, developments primarily in the physical markets but also in the financial markets have changed their dynamic, contributing to greater uncertainty and thus volatility:
  - Demand profiles in emerging markets (particularly China/India) have changed dramatically, adding to volatility because of the scale of this incremental demand, when related variables (such as economic growth forecasts) change.
  - New sources of supply for many commodities are becoming increasing remote, complex and challenged. There is also a lack of consensus over long-term resource availability, while strong global population growth is putting increased pressure on the world's resources.
  - New and disruptive drivers (e.g. clean technology, regulations on carbon mitigation related to climate change) change supply-demand fundamentals but are still highly uncertain and, therefore, introduce volatility.
  - The political environment of markets themselves has changed – significant uncertainty arises from states' fiscal positions and related tax or regulatory issues.
  - There is an increasing trend towards government interventions when shortages appear (i.e. export taxes, export restrictions, price controls) which disrupt markets and add to uncertainty.
  - In addition to the emergence of specialist investors (e.g. hedge funds), ETFs and index funds have allowed a new class of investors to add commodities to their portfolio.

- Commodity markets are extremely complex – and most "simple fixes" will have unintended consequences in such a dynamic system. Often, local interventions, which seem to work for a limited time, have detrimental effects on the global balance and exacerbate the problem further down the line.

- This is particularly true for some of the more extreme financial regulatory proposals: excessive margin or capital rules related to derivatives which would remove capital for investment in supply, forced clearing for all wholesale transactions which would adversely affect liquidity and the direct transposition of equities market abuse regulation to commodities which would restrict meaningful activities of players that act both in physical and financial markets (ignoring that the spot price already provides a meaningful reference against manipulation). Another notable example would be retail price caps (below full development costs) that jeopardize future production and risk supply shortages in the future.

- With regard to systemic risk, we caution against simplistic analogies between the financial sector and commodities markets. We believe that the concept of "too big to fail" does not apply in the primary markets for non-state actors, as they are backed by production facilities that can be used by others. In the secondary markets, where counterparty risk is an issue, many financial actors are already covered by regulation pertaining to banks and financial market-makers. Of non-financial companies, even the largest players (e.g. Glencore) control less than one-fifth of the market[4] – and appropriate trading repositories for niche markets can improve systemic stability without the need for "too big to fail" regulation similar to the banking system. We note that the spectacular collapse in 2002 of Enron and the near-collapse of Dynegy, both significant market players, did not create systemic market events similar to those in the financial crisis of 2008.

- There is no single measure (or combination thereof) that will solve the volatility issue without significant side effects on producers or consumers. However, some targeted measures can help mitigate or avoid certain aggravating conditions.

- In this spirit, constructive engagement between policy-makers and industry will be key.

[3] "Working Paper – Report of the UNCTAD Study Group on Emerging Commodity Exchanges: Development Impacts of Commodity Futures Exchanges in Emerging Markets", UNCTAD Expert Meeting, 3 September 2007, p. 38
[4] http://www.reuters.com/article/2011/04/14/glencore-marketshare-idUSLDE73D14720110414

II. Key Policy Messages

In putting forward our recommendations, we consider the relevant problem to be damage caused to the economy by excessive price volatility ("spikes" well above the long-term development cost) – not price appreciation driven by fundamentals. We believe such price appreciation can only be solved by appropriate adaptive choices of consumers (or where possible, increased supply by producers) and not by market intervention; while it will cause short-term populist pressures, the economy can ultimately adapt to price appreciation. With regard to volatility, as a guiding principle, we believe that the more transparency and liquidity a market shows, the less risk of excessive volatility occurs. In addition, it is our belief that uncertain and worrisome market conditions (real or expected) are the main trigger of volatility.

Accordingly, G20 leaders should address the role of financial investors in commodity markets by:

- developing more predictable fiscal and regulatory frameworks that can ease volatility and prompt the markets to take a longer term view
- providing more up-to-date information about the fundamentals of the marketplace
- avoiding measures that may increase volatility such as over-regulating OTC deals

In particular, we recommend the following guiding principles for policy-makers seeking to strengthen market resilience against excessive volatility:

1) *Facilitate markets that allow access to the maximum number of players*
In line with our guiding principle, we believe that the more liquidity a market displays, the less volatile it is likely to be. We, therefore, argue against access restrictions for any type of players (unless they are proven to be abusive post-trade on an individual basis) – in particular, against access restrictions for purely financial players as have been mooted in some quarters. Financial players serve key roles as counterparties and in providing market liquidity. We acknowledge the benefits that exchange-based markets can have from a liquidity and transparency perspective, while strongly cautioning against the view that exchanges are the solution for all markets or transactions – existing structures have often developed for sound reasons and should not be changed for ideology's sake. In a similar vein, while trade repositories would generally enhance transparency, provide greater security and global comparability for OTC deals, there might be markets where those benefits would not outweigh the associated cost to set up and maintain the infrastructure.

2) *Remove barriers to investment and production*
We believe that physical markets should allow the maximum number of players for reasons of efficient capital allocation as well as reduction of global imbalances. This should not be read as advocating imposed limitations on the size of any one player, for example where economies of scale create efficiencies in production for the benefit of consumers. We are proponents of removing economic barriers to investment (particularly where cross-border issues are involved) and production (with the obvious exception of where a greater good for society or the environment is threatened).

3) *Avoid "regulatory volatility" that compounds market volatility*
While we appreciate variability in individual countries' fiscal regimes, short-term changes to regulation or taxes on a unilateral basis will increase uncertainty, potentially constrain investment and, therefore, increase volatility. For this reason, we worry about fiscal measures such as windfall taxes (most recently in the United Kingdom), rushed change/introduction of subsidies/incentives (as in several countries related to Climate Change) or retail price caps that are below supply costs.

4) *Coordinate national policy and regulation that affects commodity markets*
Regulatory arbitrage and, in particular, the existence of markets where abuse (e.g. dominant position abuse or hidden counterparty solvency issues) go unchecked, is a major concern for market participants and at the systemic level. We believe the Financial Stability Board should take the lead in coordination – ensuring regulation is targeted at specific risks and does not create unintended consequences (e.g. on capital treatment for certain derivatives which would not lessen volatility and would remove capital available for investment). Rather than directing price movements through market interference, proposals should focus on preventing market abuse.

   Market abuse is a serious consideration and needs to be addressed effectively. By market abuse, we explicitly mean[5] improper disclosure, misuse of information, manipulation of transactions or financial devices/structures, dissemination of misleading/false information, market distortion, misleading

[5] This is consistent with the EU Market Abuse Directive, among other regulatory frameworks.

behaviour and insider trading by non-physical actors. In our opinion, clear, upfront "code of conduct" rules with ex-post enforcement are the best way to regulate a market – as is currently done with good success in stock markets, for example. Ex-ante regulation is harder to define and implement effectively, more costly to administer, and can often carry unintended consequences – thus, potentially being harmful to both public and private interest. As an example, limits on the overall number of outstanding derivatives contracts can affect legitimate inflation hedging (where an energy commodity is used as a proxy for inflation), and thereby increase undesired inflation risk in other parts of the financial system (e.g. pension funds). We also note that, while presumed attempts by speculators to "corner" markets and thereby drive up prices make good headlines in the popular press, historically those attempts have almost always created losses for the speculators in free markets[6]. It therefore seems inappropriate to create regulation specifically for a behaviour that is already punished by markets over time.

Concrete examples of recommendations are:

- Create a level playing field by harmonizing market abuse regulation for commodities globally via a mandate to the Financial Stability Board
- Reviewing concentration of large positions with single market participants – taking action where either market abuse is suspected or a systemic risk might present itself (but not limit market concentration *a priori*)
- Reviewing trading patterns for conflicts of interest (e.g. between own account and client account trading)
- Improving transparency (e.g. through reporting requirements to regulators for large market-makers). We believe that transparency measures should be applied post-trade, rather than restricting markets pre-trade (and therefore reducing liquidity)
- Reinforcing the integrity of clearing houses
  - Where clearing houses are a beneficial feature of markets (for standardized products only and not for all OTC products) their strengthening can meaningfully contribute to reducing systemic risk
  - This should include portability of transactions (enabling a transfer of positions from one clearing house to another in case of failure) through an appropriate amendment of European (and at a second stage, global) bankruptcy laws
- Resisting the temptation to force clearing for all wholesale transactions, as this would badly affect liquidity
  - There are meaningful differences between purely financial instruments and energy derivatives. Prices of energy derivatives correlate to the spot price and supply-demand fundamentals, they are backed by physical assets, and fewer players are active in the markets
  - Contrary to banks, which have access to deep funding pools (if necessary through the central bank) corporate treasuries cannot deal with the funding/capital impact that mandatory clearing would bring (e.g. by way of margin requirements)
- In principle, it is desirable from a liquidity perspective to exempt certain commercial hedging transactions from requirements that are adequate in other derivative classes (e.g. for clearing or capital). Here, it will be of utmost importance to provide exact definitions and implementation criteria; otherwise, such measures can invite potentially systemically dangerous arbitrage

III. Proposed Actions in Cannes

Specifically, we propose the following agenda to translate these principles into action:

1) *Increase transparency in production, consumption and storage of commodities*
The G20 should actively support the International Energy Forum (IEF) in its drive for greater transparency of markets and market statistics through connecting consumers and producers by **leading in the implementation of the Joint Oil Data Initiative (JODI) and considering a similar approach for other key commodities markets on an ex-post but timely basis**. Storage flows warrant particular attention due to their influence on spot prices. Specifically, we propose that:
    a) **the G20 should engage the IEF and other JODI partner organizations in a dialogue to explore how the JODI initiative could be exported to other commodities beyond energy** (to include data on production, storage and demand) and what would be needed to achieve that in a timely

[6] A logical explanation for this can be gleaned from the fact that absent another trend, the market will be less liquid while the speculator corners it (when he has to buy the commodity) than when he needs to sell it to realize his profits. Particularly with commodities that have a replenishable supply, the market volume will be higher (and therefore prices lower) at the time of selling for the speculator than at the time of buying, creating a net loss.

fashion. The initiative is already expanding into natural gas and is considering expansion into other energy sources[7], but we think the G20 should lend weight and resource to help speed up the process, perhaps initially by organizing a call or meeting involving the French and perhaps other G20 sherpas.

b) **the G20 should foster a direct dialogue among stakeholders to reduce short- and long-term uncertainty by supporting the expert dialogue under the framework of the IEF** with an evaluation of relevant policy proposals. Producers should be encouraged to contribute their views whenever it is felt that (real or perceived) supply shortages are a factor in price spikes. Since demand and supply uncertainty hinders timely investment, and diverging expectations can eventually result in wider imbalances, a regular exchange of views among all stakeholders (notably importing and exporting governments, consuming and producing industries, national and international institutions) is of extreme importance. As a first step, we suggest a call between the IEF and the French G20 sherpa to explore how the envisaged dialogue between expert stakeholders and resulting evaluation of policy proposals could feed into the G20 ministerial meetings on an ongoing basis. This discussion should also cover which stakeholders (e.g. from the private sector) should formally participate in the dialogue.

2) *Improve market access and balance of markets – particularly in raw materials relevant to global challenges*
In line with our policy principles outlined earlier and as a meaningful pilot, we propose that the **G20 member countries commit firstly among themselves to provide markets with optimal access and balance for raw materials that are relevant to global challenges** (e.g., climate change) by

a) Avoiding interventions such as export quotas or taxes that are non-WTO consistent
b) Encouraging greater dialogue (potentially under the IEF framework), including with the private sector on issues related to access to raw materials
c) Committing to avoiding regulatory volatility (e.g., windfall taxes) that would be harmful for natural adjustment of the supply-demand balance

As a second stage within a credible time frame (e.g., a year), we would foresee this framework being expanded beyond the G20 countries

3) *Allow storage to play a smoothing role in the supply-demand dynamic, principally by removing barriers for commercial actors to develop storage.*
Storage buffers can play a crucial role in smoothing price spikes. Unless a commodity is deemed in the national interest and supply failures undermine national security, we believe that the practicalities of second-guessing national demand and establishing “strategic reserves” are not worthwhile because of cost, moral hazard and crowding out investment in substitute products. Storage buffers by commercial actors have the advantage of being smaller in scale, directly related to their economic activity and, therefore, acting directly to avoid economic damage from a price spike. Barriers to storage can be found in planning restrictions, taxation of storage versus production and use restrictions, among others which should be reviewed against the potential benefits of increased storage buffers.

To this end, **G20 leaders should provide a mandate to the IEF secretariat to identify barriers to the expansion of commercial storage capacity and recommend how they could be pragmatically removed over a one to two year time horizon**. A first view of that study might be available for informal discussion among stakeholders at the G20 ministerial meeting in early 2012, and a final draft could be submitted to the G20 summit later in 2012. While this proposal and the preceding one is primarily directed at energy markets, it could also be applied to other commodities (e.g. rare metals) where actors find it useful.

4) *Strengthen international monitoring of market conditions and related policies – focusing on market abuse through ex-post controls*
In addition to the specific initiatives on transparency, liquidity and storage outlined above, **we recommend that international monitoring of market conditions, practices and policies be enhanced**. In particular, we propose that G20 leaders:

a) **potentially under the auspices of the IMF, establish a group that monitors markets (physical and financial) for barriers to participation**, as outlined in our key policy messages 1) and 2). This group would publish an annual report with best practices as well as potential fault lines in commodity

7 http://www.jodidata.org/_resources/files/downloads/reports/jodi_report_to_ief_extraordinary_ministerial_february2011.pdf

markets. It could follow some of the process the IMF has established in assessing economies and financial markets. It would also report suspected abuse to national regulators for investigation.

b) **potentially under the auspices of the FSB, establish a group that oversees coordination of regulatory efforts relating to commodity markets**. This group would be in continuous contact with national regulators, which would include our recommendation on liquidity impact). It would publish its findings on regulation and progress on coordination once a year.

5) *Consider the liquidity impact of new commodity market regulatory measures or changes*
Given the importance that liquidity plays in curbing volatility, **we propose that a liquidity impact assessment be undertaken for every significant proposed regulatory change or new rule in G20 countries**. This assessment should be submitted in public by national regulators to the Financial Stability Board (FSB), which would publish its comments. The proposed change should be implemented only if the assessment process finds that no harmful impact on liquidity is likely to ensue. G20 leaders should provide a mandate to the FSB to develop a process to institutionalize this recommendation on the liquidity impact of regulatory initiatives. In particular, the FSB should be directed to give particular consideration to how national regulators could be incentivized to comply with such a process, which would produce a concrete “quick win” towards the challenge of regulatory coordination.

IV. Contribution from the ICC G20 Advisory Group on Mitigating the Adverse Impacts of Commodity Price Volatility

Issue

Challenge: Commodity markets are inherently volatile, as evidenced by the 2007-2008 rise and fall of prices as well as by recent fluctuations because of global political tensions. Rising commodity prices, particularly for fuel and food, have placed millions at risk of malnutrition and hunger, and are exacerbating social and economic tensions worldwide. During the recent period of global economic expansion – 2002 to 2008 – the factors that drove prices were a combination of strong global demand in emerging markets for global commodities, slow supply responses and low inventories, thus reducing the ability of markets to react to events.

The post-quake humanitarian emergency in Japan and current unrest in the Middle East and North Africa remind us that we operate in a volatile world and must be ready to respond to external events. At the same time, we increasingly feel the effects of a long-term trend of surging global commodity demand, driven mainly by Asia’s vibrant economies. The recent volatility in commodity prices has been largely driven by underlying fundamentals, particularly in an environment of significant shifts in global supply and demand patterns. Much political, social and economic volatility is – by definition – short term. And the impacts are amplified by unprecedented speed of communication and by the increasing interconnectedness of the global economy. In addition, climate change impacts could add to worsening conditions in many areas.

Opportunity: In Cannes, G20 leaders have a historic opportunity to play a role in mitigating the adverse impacts of commodity price volatility. The ICC welcomes the G20 action plan on Food Price Volatility and Agriculture from the 22-23 June Meeting of G20 agriculture ministers in Paris. In particular, we stress the importance of the need for a significant increase in agricultural production and productivity; improved information in particular for agricultural markets; greater policy coordination; and critically brining the Doha Round to a successful conclusion and avoiding trade barriers. This is a step in the right direction but more needs to be done, not only in Cannes, but also in subsequent G20 meetings. The private sector is ready to work in partnership with G20 governments to achieve the recommendations that follow.

Analysis

1. Role of financial investors in commodity markets
Many have pointed to the role of financial investors in commodity markets as a crucial factor driving price volatility. An UNCTAD report on the role of speculation suggested that the acceleration and amplification of price movements can be attributed to commodities as a group[8]. Yet, others have demonstrated that spot prices cannot be influenced by financial investors as they “only participate in futures and related derivative markets; only if they take and hold physical commodities in inventories” will they have an influence on

[8] UNCTAD (2011). Policy actions to mitigate the impact of highly volatile prices and incomes on commodity-dependent countries and to facilitate value addition and greater participation in commodity value chains by commodity-producing countries. Note by UNCTAD Secretariat. 2 February 2011, Geneva

prices[9]. The increase in participation of financial investors in commodity markets deserves proper analysis but, in general, the addition of greater liquidity and product innovation should aid price discovery, provide enhanced risk tools and, with the right regulatory framework, help to reduce price volatility.

However, focusing solely on limiting the role of financial investors could have negative effects on volatility. The commodity markets reflect an understanding of the fundamentals of the marketplace today and tomorrow. It is primarily fiscal and regulatory uncertainty that discourages investment and it is inadequate investment that causes the long-term disjunction between supply and demand that leads to such marked price volatility. Regulating to limit the role of financial investors in the market would do nothing to address this.

G20 leaders should instead focus on ensuring competitive markets with improved levels of aggregate supply and demand information thus providing a strong basis for understanding price formation and thereby attracting additional market liquidity. Fundamentals are the key drivers of price volatility and the mix of rapidly changing demand patterns with long lead time investments in recent years has proved a significant challenge for the private sector.

Over-the-counter derivatives (OTC), which companies use to protect against future movements in the price of commodities, are traded privately between businesses and banks, without being processed through a central clearing house to safeguard against the risk of default. They allow companies to cope with the sector's volatility and increasing complexity.

In the wake of the global financial crisis, policy-makers have indicated their intention to increase the transparency of the derivatives market. One proposal is to push OTC transactions onto the public exchanges, while another is to require mandatory clearing of all trades through regulated central counterparties. While there is a clear need for greater transparency, governments and regulators must be wary of unintended consequences, particularly of limiting the ability of the private sector to hedge risks.

Eliminating OTC deals, or forcing them all to be cleared centrally, would drive down business investment. To meet exchange collateral requirements, companies might have to divert investments in new productive capacity and technology. That would increase, rather than moderate, volatility.

G20 leaders should address the role of financial investors in commodity markets by:

- developing more predictable fiscal and regulatory frameworks to ease volatility and prompt the markets to take a longer term view
- providing more up-to-date information about the fundamentals of the marketplace
- avoiding measures that may increase volatility such as over-regulating OTC deals

2. Food[10]

Historically, achieving food security was based on the expansion of agricultural land and productivity growth. Today, however, additional challenges exist which lead to a new agricultural production context causing increased pressure on both land and resources. Most agricultural commodity markets are characterized by a high degree of volatility. This is normal, as agricultural outputs vary due to natural shocks, demand elasticity relative to price and long production cycles. As in 2007-2008, the main concern today about food price volatility is principally its role in raising prices on basic staples, particularly for the poor. Moreover, in many developing and least developed countries, food security poses enormous challenge where even a marginal food shortage and its consequential adverse impact in terms of surging food prices can pose serious threat. Globally, there are about 1 billion people who are undernourished; every rise in food prices shifts millions of people below the poverty line.

Growing population and income in emerging and developing countries will also add significant demand for food in coming decades – by 2050 world population is expected to have reached at least 9 billion and the demand for food will increase from 70% to 100% – this alone putting significant pressure on commodity prices[11]. In addition, climate change impacts, including water scarcity or droughts, could make conditions worse in many parts of the world.

[9] IBID

[10] This section should be viewed concurrently with more detailed IBC-ICC G20 CEO Task Force – Food Security Working Group Recommendations for G20 Agricultural Action Plan

[11] "Price Volatility in Food and Agricultural Markets: Policy Responses. Policy Report with contributions by FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, WTO, IFPRI and UNHLTF, 2 June 2011

Furthermore, domestic fears of food shortages in many countries are encouraging hoarding and a consequent turning away from the market in many parts of the world. A whole host of bans, quotas, taxes and other restrictions on the export of food, and of other commodities and raw materials, is proliferating. Export restrictions distort an efficient domestic response to changes in food supply, exacerbate both price hikes and shortages and add to overall agricultural inefficiencies that leave hundreds of millions hungry.

G20 leaders have rightly made food security a high priority. The private sector has a key role to play in agricultural systems and is ready to work collaboratively with governments and civil society to address these challenges.

G20 leaders should address volatility in food commodity prices in the short term by:

- opening global markets to food trade by successfully concluding the Doha Round
- avoiding export restrictions, price controls and similar bans, as these will discourage the necessary additional investment required for agricultural production, impede access to agricultural raw materials and threaten food security
- eliminating trade-distorting subsidies to ensure a level playing field in the global marketplace
- avoiding limits on the use of technology which can hinder opportunities and deprive farmers of agricultural tools

Over the longer term, G20 leaders should address volatility in food commodity prices by:

- insuring cost-effective approaches to competition from other sectors for access to land, water, nutrients and energy sources
- boosting innovation, education and capacity building to better mitigate and manage price volatility through improvement in agriculture distribution and storage systems, among others
- focusing efforts on sustainable production and supply involving public-private collaboration and modern technologies integrated with local and traditional knowledge, as well as improving education and capacity building

3. Energy price volatility

Rising energy prices, particularly for oil, are a threat to the recovering global economy and will strengthen inflationary pressures and cause a negative impact on the private sector, especially in developing countries. In addition this impact will be particularly strong on energy suppliers, transport industries, energy-intensive industries and service providers.

Many governments, notably in developing countries, have taken measures such as fossil fuel subsidies to lessen the impact of oil price volatility. A long-term policy goal should be to replace these subsidies with effective social protection programmes leading to both economic and environmental benefits.

The view that speculators are the main force behind fluctuations in energy markets, especially crude oil, has been challenged by recent analysis[12]. Instead market fundamentals – factors that disturb the balance between supply and demand – are the likely primary drivers. High movement in the price of oil for example, is exacerbated by incomplete and obsolete market information. For instance, the International Energy Agency (IEA) can only publish oil statistics with a time lag of more than a year. In the absence of up-to-date information, the price of oil sometimes fails to reflect the underlying fundamentals of the marketplace.

G20 leaders should look to mitigate energy price volatility by:

- taking measures to diversify the energy mix to meet growing demand. No technologies or energy sources should be excluded as innovation may provide solutions to overcoming barriers that limit the use of some technologies today
- creating a policy environment that rewards energy-efficient choices and encourages innovation over the medium and long term; enhancing the interconnectedness of energy systems, both primary and secondary, to reduce risks and increase flexibility
- ending wasteful consumption subsidies while managing the phase out of targeted subsides for the poor – G20 leaders have already committed to phasing out over the "medium term" some of the US$ 557 billion spent annually (2008) on fossil fuel subsidies
- removing trade barriers, improving access to natural resources and opening markets to competition to help minimize potential disruptions
- reducing energy demand and energy needs along the supply chain, as well as extending resource life
- encouraging the International Energy Forum to press on with its Joint Oil Data Initiative

[12] "IEA experts examine fluctuations in Oil Market Report, www.iea.org, 21 March 2011

4. Access to raw materials

Government interventions such as export restrictions for certain critical raw materials (e.g. rare earths, lithium or other metal raw materials) can lead to supply constraints that induce excessive price volatility. As a consequence, increases of raw material prices combined with supply insecurities raise concern for producers and consumers regarding future production and ability to deliver finished goods. This uncertain environment drives consumers to change inventory management practices, thus exaggerating pricing signals, which in turn lead to increased volatility.

Overall government interventions such as export quotas or export taxes for critical raw materials like rare earths, lithium or other metal raw materials might hamper global competition and WTO rules. Trade restrictions enacted in one country risks exacerbating global trade tensions and could have negative consequences for the WTO ruled-based trading system.

Market access to certain raw materials is essential for the future development of innovative technologies to tackle global challenges such as climate change or e-mobility. In addition, research and development of new products based on foreseeable production technologies depend on it. Therefore, if we are to meet global challenges efficiently and create a future with sustainable products and production methods, a stable and secure supply of these raw materials is essential.

Recommendations

Finally G20 leaders should look to improve access to raw materials by:

- avoiding interventions such as export quotas or taxes that are non-WTO consistent
- encouraging greater dialogue, including with the private sector on issues related to access to raw materials
- enhancing market access to raw materials that are, for example, critical to deal with global challenges such as climate change

Annex I – Glossary

Capital intensity	The amount of long-term fixed capital required in relation to shorter term variable factors of production (e.g. labour).
Clearing	The procedure by which an intermediary assumes the role of buyer or seller for transactions to reconcile orders between transacting parties (e.g. for the settlement of accounts or exchange of financial instruments).
Clearing house	A centralized agency or corporation responsible for settling trading accounts, clearing trades, collecting and maintaining margin monies, regulating delivery of contracts and reporting trading data. Usually affiliated with a futures exchange.
Elasticity	The change in demand for a good given a certain price fluctuation (or in supply of a good, given a certain fluctuation in price of its inputs). “Inelastic demand” means that even in the face of a large price rise, there is no change in demand for a good.
ETF (Exchange Traded Fund)	A security that tracks an index, a commodity, or a basket of assets, but trades like a stock on an exchange. Different from mutual funds, an ETF’s price is influenced purely by the balance of buyers and sellers and not a net asset value (NAV) calculation. ETFs can be sold short or traded on margin like stocks. They might or might not be backed by physical assets.
Exchange	A marketplace in which standardized securities, commodities, derivatives and other financial instruments are traded. Exchanges are regulated and need to ensure fair and orderly trading, as well as efficient dissemination of price information.
FSB (Financial Stability Board)	An international body that monitors and makes recommendations about the global financial system, with particular focus on the regulatory aspects. It was established and given its mandate in 2009 by the G20 as the successor to the Financial Stability Forum. The board includes all G20 economies, Financial Stability Forum members and the European Commission. Its secretariat is based in Basel.
Forward price	The agreed-upon price of a commodity in a futures contract. It is closely linked to the spot price through a series of rational pricing assumptions (that among other variables, take into account the economics of storage).
Futures market	A market where futures contracts are traded. A futures contract obliges the buyer to purchase an asset from the seller at predetermined future date and price. Futures are standardized to be traded on exchanges. Some futures contracts stipulate physical delivery of the asset, while others can be settled in cash. Futures can be used for hedging as well as speculative purposes. Futures markets have been in existence for a long time, particularly for agricultural commodities so farmers can get certainty on a price for their produce – the first modern organized exchange began in 1710 at the Dojima Rice Exchange in Japan; in the US the Chicago Board of Trade (CBOT) was formed in 1848.
Hedging	An investment strategy to reduce the risk of adverse price movements in an asset.
IEA (International Energy Agency)	An international agency providing policy advice to its 28 member countries. It was founded as a response to the 1973/1974 oil crisis. Its mandate focuses on energy security, economic development and environmental protection.
IEF (International Energy Forum)	The world’s largest gathering of energy ministers. The 86 IEF countries account for over 90% of global oil and gas supply and demand. Uniquely, its members not only comprise IEA and OPEC countries, but also key players such as Brazil, China, India, Mexico, Russia and South Africa. Its permanent secretariat is based in Saudi Arabia.
Index Fund	A mutual fund that passively tracks the components of a market index.
JODI (Joint Oil Data Initiative)	Launched in 2001, an initiative to provide reliable monthly data on production, refining, trade, demand and stock levels for seven categories of oil and related products. The database (www.jodidata.org) covers over 90% of global supply and demand. The initiative also provides knowledge transfer programmes and events.
Liquidity	The degree to which an asset or security can be bought or sold in a market without materially affecting the price. When selling an asset for cash, the ability to do so quickly and without affecting the price is also known as “marketability”.

Margin requirement	The requirement for an investor to deposit a certain level of collateral (usually cash or highly marketable securities) into an account to cushion against a deterioration in creditworthiness caused by adverse price movements in the account's other securities. A particularly important feature for leveraged accounts involving derivatives.
Margin call	The request for an investor to deposit additional money or securities to restore the minimum maintenance margin for a leveraged account. A margin call is usually brought on by a deterioration in the price of the account's assets, but can also be caused by a reassessment of the investor's creditworthiness.
Market-maker	An intermediary that creates a market in a tradable product (physical or financial). In all but highly liquid markets, market-makers will carry inventory (so they can satisfy demands from buyers at short notice) that might expose them to risk should the price of that inventory change.
Market abuse	Unlawful behaviour, where financial investors have been unreasonably advantaged, directly or indirectly, by others who have disseminated false or misleading information, have distorted the price-setting mechanism (e.g. by way of abusing a dominant position) or have used classified and restricted information (insider dealing). The definition of market abuse and particularly what constitutes insider dealing, can vary significantly between markets depending on their underlying mechanisms and participants.
OTC (Over the Counter)	A security which is not traded on an exchange but through direct interaction between institutional market-makers (dealers). Most securities trading OTC do so because of a lack of the standardization that would allow them to be traded on an exchange (e.g. because they are a bespoke hedge for a client).
Price spike	A large, and quick, rise in price.
Speculator	A market participant that expresses a view on future price movements with the desire to make a financial gain. Usually, this assumes taking on a certain level of risk, for which the speculator hopes to be compensated by a commensurate profit. Speculation and hedging, like buying and selling, can often be complementary activities – for example a counterparty agrees with a farmer on an inflation-linked rise in future wheat prices (providing a hedge for the farmer against a drop in real wheat prices) and in the simplest case the counterparty will have an expectation that the price will rise by more than the inflation rate.
Spot market	A commodities or securities market where goods are sold for cash and delivered immediately. For certain commodities, immediately includes a timeframe of within one month (traded on the short-dated futures market).
Spot price	The price in the spot market, or the short-dated (less than one month) futures market.
Trade repository	A centralized source of detailed transaction data, both "stock" (i.e. inventory of market-makers) and "flow" (i.e. contracts exchanged) with the functionality to provide post-trade aggregation and reporting of data. A trade repository is different from an exchange as it has no listing requirements and less regulatory oversight. Trade repositories, with adequate reporting frequency, are believed to be beneficial for monitoring the build-up of systemic risk.
Volatility	The extent of fluctuation in an asset's return or price over time, usually expressed in statistical terms (e.g. standard deviation of returns in a given time interval).

World Economic Forum G20 Working Group on Food Security

I. Framing the Issue

Under the French Government's leadership, the G20 has established food price volatility as one of its priority issues in 2011, with a specific focus on developing countries. In this context, the Food Security Working Group has worked to develop proposals for G20 leaders that reflect the private sector perspective on issues that must be addressed to ensure global food security. A draft version of the paper was presented at a High-Level Workshop hosted by the French government with Working Group participation on 6 June 2011 in Paris.

In the global economy, the price and availability of food is influenced by a complex set of factors, such as fuel costs, weather patterns, trade policies and changing patterns of consumer demand. In 2007-2008, a confluence of these factors led to prices of food commodities reaching a new peak.[13] As a result, more than 40 countries experienced social unrest caused by food shortages and price increases; and over 100 million additional people were driven into hunger, raising the global total to 1 billion. Three years later the prices of many basic food commodities have spiked again, while stocks-to-use ratios in the developed world are at historic lows. These dynamics have had macroeconomic as well as human impacts. [14] Food price inflation contributes to broader inflation; the uncertainty created by volatility creates a disincentive for investment.

These developments have raised questions with regard to the global food security situation:

- Can we produce enough food of good nutritional quality to feed the growing population?
- Can we ensure access to food for all who need it, even in times of acutely high prices?
- Can we do this in an environmentally, socially and economically sustainable way?
- Have we entered a period of consistently higher prices for food staples?

The fluctuations seen in recent years are likely to continue if the underlying factors that drive them are not addressed. For example, by 2030, water scarcity may significantly increase the volatility of staple food supplies and lead to a structural loss of 30% of global crop production.

The private sector plays a central role in agriculture systems. In response to the ongoing challenges, companies are collaborating to develop innovative solutions and share best practices to mitigate the impact of price volatility across the supply chain, while working to address broader issues of supply chain sustainability. In some countries, the private sector has been supported or incentivized by government policies and instruments.

Currently, the strongest private sector operations and public sector enabling environments are largely found in developed markets. Emerging markets have greater challenges including poor infrastructure, underinvestment and inadequate functioning of the markets. This weakens productivity and particularly affects the situation of smallholder farmers. Some of these issues can be addressed through the greater availability of innovative financing across the entire value chain, including cost-effective insurance models. In addition to developing specific tools to better manage volatility and risk, we believe that underlying supply and demand factors must be addressed by structural and environmentally, socially and economically sustainable measures to improve global food security.

The Food Security Working Group has identified priorities for action by the private sector and public authorities, and proposals for their implementation, focusing largely on the underlying factors and structural solutions. In this report, we do not deal with financial instruments which could play a role with regard to food price volatility. In addition, while we recognize the need to address the challenges and opportunities posed by biofuels in view of global needs for food security, energy and sustainable development, this topic is not addressed here.

Our recommendations reflect the following "core principles" of our approach.

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[13] FAO

[14] See OECD-FAO Agricultural Outlook 2011-2020.

Core Principles

- We share an overarching goal with the public sector which is to **feed the world in an environmentally sustainable and socially beneficial manner**
- Implementing **market-based strategies** to strengthen the productivity and sustainability of food systems, engaging a full range of private sector actors (from entrepreneurs/SMEs to large firms) and market mechanisms to address the needs of both producers and consumers
- Taking an integrated approach to improving **whole value chains**
- Encouraging **multistakeholder collaboration** and innovation to optimize sustainability and impact
- Meeting **nutritional needs** through integrated strategies of agriculture and food production
- Focusing on **medium- and long-term solutions** for food system sustainability
- We believe agriculture can be a vital **engine of economic growth** in the developing world
- Many of the most **effective solutions are locally led and targeted**. Global partners must be willing to embrace the specificity and complexity required

II. Key Policy Messages

The Food Security Working Group believes that commitment to action, investment and innovative new models of collaboration are required from both public and private sectors in particular in the developing world. The Working Group has, therefore, developed recommendations for action through increased commitment among the public and private sectors in the following five priority areas. By November 2011, we will provide a time frame for the short- and medium-term actions, based on our consultations with public sector leaders and other stakeholders.

Summary of Key Policy Messages

The proposed actions outlined in Section III are summarized briefly below.

1. Increasing investment

a) **Prioritize specific value chains or regions** for increased public-private investment
b) Remove barriers to investment, particularly through **innovative financing** mechanisms (catalytic finance, patient capital, credit guarantees and insurance) and property rights
c) Develop **intellectual property protection** policies, where they are currently lacking
d) Strengthen the capacity of **smallholder farmers** (particularly women) through extension, financing, information access, organizing support and property rights

2. Improving markets

a) **Improve trade policies at global and national level**, including finalizing the WTO Doha Round and prohibiting export bans
b) **Establish emergency reserves** to reduce volatility and ensure availability for the most vulnerable
c) **Establish transparent monitoring and data sharing** on availability, stocks, demand, price and quality of agricultural commodities
d) **Improve access to markets for smallholder farmers** through investments in transport and storage infrastructure, training programmes as well as information access

3. Accelerating R&D investment and expanding technology access

a) **Develop public-private partnerships** for technology R&D and for expanding technology access
b) **Encourage consistent, well-formulated government policies** to incentivize on technology approvals, regulation, R&D and safety
c) **Strengthen agriculture and nutrition science** in institutions of developing countries

4. Ensuring environmental sustainability

a) **Encourage sharing of best practices** and technologies for environmentally sustainable agriculture
b) **Improve water resource management** through increased public-private collaboration and incentives to strengthen water management strategies and technologies
c) **Scale up sustainable supply chain management** for specific commodities, through effective policies
d) **Reduce post-harvest losses and food waste** by improving transport, storage, energy efficiency and waste recycling along the value chain, and reduce consumer food waste
e) **Reduce greenhouse gas emissions** from agriculture, through policy and financing incentives including the Clean Development Mechanism (CDM)

5. **Meeting nutritional needs**
   a) **Increase availability of nutritional foods** through R&D, improved distribution and integrated production strategies linking agriculture, nutrition and health goals
   b) **Support the Scaling Up Nutrition** (SUN) programme
   c) **Encourage consumers to choose diets** that offer a healthy nutritional balance as well as environmental efficiency, based on an integrated approach

Establishing Effective Mechanisms for Public-Private Coordination
- Establish **national partnerships** that engage government, the private sector, civil society and other key actors to develop and implement sustainable, market-based solutions to improved food security
- Establish a **global-level multistakeholder dialogue**, supported by the G20, to coordinate and strengthen public-private collaboration on agreed priority action areas

1) Increasing Investment

Goals
- Significant increases in both public and private sector investment are needed to raise agricultural productivity and food output in a sustainable manner, and to increase crop diversity. We propose that for the developing world, decades of chronic underinvestment be reversed through the adoption of a **50% increase in investments in agriculture and agri-food supply chains** by 2015 and implemented by the combined efforts of the public and private sectors.[15]
- Enabling significant increases in private sector investment will require, in many cases, improvements in the **business enabling environment** of individual countries. These include policies (including laws, regulatory requirements and customs regulations) that channel benefits back to the farmer. Such policies should include provisions to increase investment in transport, agricultural storage and other physical infrastructure, and to assist smallholder farmers with risk management through accessible agriculture statistics or innovative financing and information technology that results in greater price transparency and stronger domestic development programmes. Ensuring adequate property rights is an important enabler of investment.
- Improved natural resource management is urgently needed to enable increases in agricultural productivity over the long term. In particular a focus on improved water use efficiency and management of **water supplies** used in agriculture is an urgent priority. We believe this focus will require increased investments in infrastructure for improved water capture, irrigation and other water-saving technologies.
- Increasing **productivity, market access and opportunities for smallholder farmers** is critical in developing countries, where smallholders produce 80% of domestic consumption. Globally there are approximately 470 million smallholder farmers, supporting 1.2 billion people, largely living in poverty[16]. Improving training through better extension services, financing, property rights and access to modern technologies (including no-till technology) particularly for women is key to empowering and expanding the productivity of these producers.[17] The private sector acknowledges the important and unique role of civil society in these endeavours.

Proposed Actions
a) Actively support pilot projects that demonstrate the effectiveness of increased investment and can lead to best practices applicable in a variety of growing regions. The public and private sectors can work together in individual countries to **prioritize specific food value chains or regions for increased investment**. Examples include the SAGCOT initiative in Tanzania, the Malawi Agricultural Partnership, the Agricultural Transformation Agency in Ethiopia, the Beira Corridor and broader emerging efforts to engage private sector investment in alignment with African nations' CAADP plans, and the Public-Private Task Force on Sustainable Agricultural Development in Vietnam, focusing on five priority commodities.
b) **Remove barriers to investment** and establish investment enablers through joint action by public and private sectors. These could include catalytic financing measures (such as targeted low-cost loans, specific guarantee funds and matched grant facilities) to attract and leverage mainstream financing; development of "patient capital" to support demand-driven agricultural infrastructure needs; and credit guarantees and insurance programmes that reduce risk and promote investment across the entire agriculture value chain. Multilateral institutions are particularly well-suited to working with both public and private sector actors to increase the speed of implementation.

[15] FAO
[16] FAO 2005
[17] IFAD

c) Encourage governments to work with industry to develop **intellectual property protection policies** to enable private sector investments and innovations in markets currently lacking such frameworks.
d) **Strengthen the capacity of smallholder farmers** by expanding dedicated extension services and financing programmes, enhancing access to reliable and transparent market price information, and supporting the formation and effective management of producers' organizations and property rights through expanded public programmes, government incentives and public-private partnerships. These actions should be especially targeted to women smallholders in those countries or regions where they have a dominant role in agricultural production. We will consult with smallholder representatives as part of the stakeholder consultations at local level.

2) Improving Markets

Goals

- **Well-functioning markets** create the right incentives to expand production levels in a sustainable manner and to motivate improvements in supply chain efficiency. The public and private sectors play distinct and complementary roles. Governments establish the framework for transparent, competitive, efficient and well-regulated markets – in terms of standards and safety, and for market-oriented price identification. Within this framework, the private sector is the key driver of investment, business activity, innovation and productivity.
- **Trade** is a key market enabler, contributing to improved access to food supplies. Improving global and intra-regional trade is an important priority for improving market functions.
- Extreme price fluctuations can be reduced through **adequate stock levels and storage facilities** to ensure availability during price surges and **improved transparency** of market information to reduce hoarding and speculation. A global framework for market information would facilitate a rapid response system and improved policy coordination. Public sector actions, such as restrictive export quotas, tariffs or embargoes, should be discouraged, as these measures often lead to serious market distortions.
- The movement of food is a determinant of food costs and food waste, which could be reduced through **infrastructure improvements**, including roads, bridges and storage facilities to better enable availability and movement of food.

Proposed Actions

a) **Improve trade policies at global and national level**. Strongly encourage G20 leaders to **finalize the WTO Doha Round** and eliminate market barriers, including import and export restrictions and allow both consumers and farmers access to the global market. **Prohibit export bans** of agricultural commodities to enable the effective functioning of global markets, particularly ensuring that humanitarian shipments are not affected by export restrictions to enable access to food for the most vulnerable in times of crisis.
b) **Establish emergency reserves**, supported by targeted financing and potentially managed under the auspices of the World Food Programme (WFP) to help reduce volatility and the impact of price spikes on the most vulnerable.
c) **Establish transparent monitoring and data sharing** services through public-private collaboration to provide accurate and timely information on availability, stocks, demand, price and quality criteria. The private sector will contribute to the initiative to set up a global framework for food security data by providing expertise.
d) **Improve the access to markets of smallholder farmers** through investments in public infrastructure (particularly for transport and warehousing) as well as information access through cost-effective information technology. We will develop risk-reducing solutions and training for smallholders through public and private partnerships at local level.

3) Expanding Technology Access and R&D

Goals

- New technology, including modern biotechnology, has an important role to play in ensuring adequate food supplies for the world. Increased investment in technology **research and development**, particularly for crops native to developing countries, is needed as are public sector efforts to assure consumers of the safety of biotech products. We share the objective to identify and communicate the benefits of new technology for civil society.
- Protection of existing stocks of **seed varieties and in germ plasm banks** is essential for future food security in the face of unpredictable climate change and diminishing natural resources.
- Significant progress can be generated just by improving **access to and use of existing technologies**, many of which are not currently available to, or employed by, smallholder farmers.

- We will benefit from **effective monitoring systems and data sharing** on food security indicators. Best practice initiatives to improve nutritional security should be rolled out by public-private collaboration. Public sector efforts to assure consumers of the safety of nutritional enhancement of food products should be further supported. Civil society has an important and unique role to play in this effort as well.

Proposed Actions

a) **Develop public-private partnerships** for technology R&D and to expand technology access, enabling the private sector and public institutions to share technology and implement best practices, with a goal of addressing food security needs. They will remove existing hurdles with regard to the application of R&D and to support initiatives to encourage R&D investments which offer sustainable solutions.
b) **Encourage consistent, well-formulated government policies** to incentivize and manage technology development and the application of adequate food safety standards. Such effective policies are needed to manage new technology approvals, provide a clear and efficient regulatory environment, incentivize and support effective R&D and to assure consumers of the safety of the products.
c) **Strengthen agriculture and nutrition science** in institutions of developing countries through public-private partnerships

4) Ensuring Environmental Sustainability

Goals

- **Ensuring the sustainability of food production systems** for future generations (soil, air, water quality and quantity, climate, land use and biodiversity) through strong commitment from all stakeholders. The private sector is engaged in sustainability initiatives and remains committed to invest in the sustainable sourcing of raw material. Internal standards and targets will help reduce the environmental impact of increased production levels.
- **Addressing water scarcity** is a particularly urgent priority. Significant improvements are needed in infrastructure, demand efficiency and R&D for drought-resistant crops.
- **Reducing losses and waste** of agricultural and food supplies can help expand food supplies without additional production. Post-harvest waste is estimated to exceed 30% of production worldwide, totalling approximately 1.3 billion tons.[18]
- **Enabling carbon sequestration and climate-change resilience through agriculture**, through improved water, soil and land management using science-based lifecycle assessments. At the same time, producers must strive to reduce greenhouse gas emissions from agriculture in a sector that both contributes to and is highly affected by climate change.

Proposed Actions

a) **Scale up sustainable supply chain management** for specific commodities. This can be accomplished through public policies such as standards, rules and preferential market access, without undermining overall competitiveness. Crops and commodities relevant for long-term nutritional security can be recognized and prioritized in public-private partnerships at national level based on an adequate market-based approach.
b) **Encourage sharing of non-competitive best practices and technologies** for environmentally sustainable agricultural practices, among private sector actors.
c) **Encourage public-private collaboration to improve water resource management**. This can include promoting **fact-based, cost-effective water management** (such as the World Economic Forum's Water Resources Group) and increasing investment in water capture, storage, distribution, and reuse, particularly in farming communities of developing countries. Economic incentives developed by the public sector can encourage the development of **technologies** and practices which improve the efficiency of water use in food production. These can include establishing investment funds and, where appropriate and well-studied, water pricing schemes. Multilateral institutions can play an important role in jump-starting these efforts across regional boundaries.
d) **Significantly reduce post-harvest losses and food waste** by investing in agricultural infrastructure and technology, and exchanging best practices for waste and loss reduction.[19] Such efforts should engage both public and private sectors, taking a value chain approach to improving transport and distribution, storage, cold chain technology, energy efficiency, and waste recycling along the chain. Consumer food waste must be reduced through consumer outreach, improved technology, and incentives.

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[18] FAO, Global Food Losses and Food Waste, May 2011
[19] An example is the ADM Institute for the Prevention of Postharvest Loss at the University of Illinois, USA

e) **Reduce greenhouse gas emissions from agriculture,** leveraging incentives such as the Clean Development Mechanism (CDM) to include agricultural projects, and providing innovative financing for sustainable land use.

5) Meeting Nutritional Needs

Goals

- **Reducing nutritional deficiencies and imbalances** is urgently needed to address the needs of 1 billion undernourished people; 1 billion overweight or obese people; and those affected by micronutrient deficiencies and nutrition-related health issues such as diabetes and heart disease.
- **Improving nutritional status** is an essential component of food security. Nutritional interventions are widely recognized as some of the most high-impact, cost-effective interventions in the development arena.[20] This is particularly true of children under two years of age, for whom inadequate nutrition can have lifelong impacts on their health and their intellectual and economic opportunity. Improving the availability, access and affordability of appropriate high-quality nutritional foods is a key strategy.
- **Integrating agriculture and nutrition strategies** can help ensure access to good quality, affordable diets that contribute to the ultimate goal of strengthening human health and well-being. Such integrated approaches can simultaneously address hunger, micronutrient deficiencies and obesity/overweight. For example, increasing crop diversity can improve nutrition and provide environmental benefits such as enhanced biodiversity, soil fertility and water quality.
- Ensuring the application of adequate food safety standards throughout the supply chains.

Proposed Actions

a) **Increase availability of nutritional foods** through consumer-oriented strategies including research and development; improved distribution strategies to increase access (especially in poor communities); and integrated production strategies linking agriculture, food safety, nutrition and health goals.
b) **Support the Scaling Up Nutrition (SUN) programme**, led by the Special UN representative on Food Security and Nutrition, and invest in the core elements of the "1,000 critical days" strategy.
c) **Encourage consumers to choose diets that offer a healthy nutritional balance as well as environmental efficiency**, based on an integrated approach. This will have positive benefits on both human health and the environment.

III. Proposed Actions in Cannes

Key highlights of our recommendations are:

1. **A 50% increase of investments in <u>food value chains</u>, totalling US$ 80 billion from both public and private sectors, is critical to achieve by 2015.** This can be achieved by incentivizing private investment through improved risk management and policy solutions; and fulfilling public-sector funding commitments.
   <u>Proposed public-private actions:</u>
   - **National and regional partnerships to accelerate public-private investment in sustainable agriculture:** Vietnam, Indonesia, Mexico, Tanzania and pan-African partnerships are being facilitated by the New Vision for Agriculture initiative.
   - **Scale up effective risk management tools to accelerate responsible investment:** A public-private working group should immediately start work to expand and apply risk management solutions (including innovative finance and affordable index-based insurance) in target countries.

2. **Improving the functioning of <u>agricultural markets</u>** is a vital and immediate priority. This requires extensive improvement to policy and infrastructure, as well as increased transparency through improved data collection, sharing and monitoring.

3. **<u>Technology</u> innovation and distribution should be accelerated** through partnerships and policy reforms, to address local needs for improved productivity, sustainability and nutrition.

4. **Environmental <u>sustainability</u> must be integrated as a core objective into all agricultural activity,** addressing climate, water, land and waste issues through policy incentives, technology innovation, partnerships and best practices.

[20] See for example the recommendations of the International Food & Beverage Alliance.

Proposed public-private actions:

- **Public-private collaboration for improved water resource management:** the Water Resource Group is working in India, Jordan, Mexico, Mongolia and South Africa to meet economic, social and environmental needs sustainably.
- **Launch an ambitious expansion of sustainable sourcing practices** by leveraging public-private capacities to scale up best practices for sourcing agricultural products from smallholder farmers.

5. **A major shift to improve nutrition should be undertaken**, engaging private-sector technology, communications and distribution capacities also in partnership with other stakeholders.

Many of the policies recommended above will require deeper public-private cooperation to shape and execute them successfully. We propose that G20 leaders provide a mandate in Cannes for the following processes aimed at accelerating and scaling implementation of such policies:

- To effectively develop and coordinate public and private sector action on these priorities, we support the idea of a **multistakeholder dialogue** and partnership on food security and agricultural development that would meet and report annually to the G20. The World Economic Forum and other organizations can share best practices on multistakeholder dialogues and provide support for this effort.

- Building on initial models piloted by the World Economic Forum and others, we encourage governments, companies and local stakeholders to establish **country-level partnerships** in developing countries to accelerate sustainable, market-based growth in the agriculture sector. Actions and investments can be focused on mutually-agreed priorities, whether regionally focused (such as the growth corridors in Tanzania and Mozambique) or commodity-focused (seen in partnerships in Vietnam and Mexico). Such partnerships would benefit from the support of multilateral institutions, as well as investment and technical support from the global private sector. The industry is willing to take an active role in defining and implementing these programmes, in partnership with governments, farmers, civil society and other key stakeholders.

The Food Security Working Group stands ready to engage in further dialogue and coordination with G20 leaders to develop and implement the proposals outlined here.

World Economic Forum G20 Working Group on Improving Transparency and Eliminating Corruption

I. Framing the Issue

Where do we stand in the fight against corruption?

The glass is half full – The global fight against corruption has made significant progress over the last 10 years. The adoption of the United Nations Convention against Corruption (UNCAC) in 2003, together with sustained efforts by the world's major trading nations to meet their new obligations under the OECD Anti-Bribery Convention, has helped shape a legal and institutional response to the problem of corruption. Business engagement has been strong, as attested by the introduction of a 10th principle against corruption in the United Nations Global Compact, the proliferation of business-driven initiatives against corruption, and the growing number of companies that have established anti-corruption policies and compliance programmes.

… and half empty – Over half of the respondents to Transparency International's 2010 Global Corruption Barometer survey think that corruption has actually increased in their country over the past three years. The OECD has repeatedly warned about the wide disparities in the levels of enforcement activity across countries that are parties to the OECD Anti-Bribery Convention. Private sector engagement against corruption remains uneven and companies that have demonstrated leadership continue to operate in contexts where they are exposed to undue solicitations and unfair practices by their competitors.

A watershed moment – The launch of the G20 Anti-Corruption Action Plan at the last G20 Summit in Seoul marks a new phase in the global fight against corruption. The adoption in 2009 of a review mechanism to monitor the implementation of the UNCAC, and recent moves by China, Russia, Turkey and the United Kingdom to strengthen their legal framework against corruption, are all positive signs of a renewed commitment to action. The pressure from citizens around the world is mounting. From the Arab spring to the massive protests that took place in India, Mexico and Spain in recent months, the public outcry against corruption has been loud and clear.

Looking ahead – Governments, business and society have a joint interest in eliminating corruption. The G20 is uniquely placed to demonstrate leadership and take bold, collective action in support of a global economy based on common integrity rules and fair competition. The G20, together with business and other key stakeholders, has a significant opportunity – and a shared responsibility – to develop and implement new initiatives that will further improve the effectiveness of the global anti-corruption regime.

II. Key Policy Messages

Recognizing that poor governance, corruption and lack of transparency are among the greatest obstacles to social and economic developments, critical action is required from G20 governments to:

1) **Strengthen existing institutions and initiatives** to combat corruption by providing the political will and financial support that they need to effectively fulfil their mandate. In particular, G20 governments must secure adequate funding and operational support for ongoing efforts by the **United Nations Office on Drugs and Crime (UNODC)** and the **OECD Working Group on Bribery** to monitor the implementation and enforcement of the United Nations Convention against Corruption (UNCAC) and the OECD Anti-Bribery Convention. Governments of G20 countries must firmly establish anti-corruption as a core part of their **bilateral and multilateral aid programmes** and further support capacity building efforts to help developing countries establish a minimum legal and institutional framework to prevent corruption and foster collective action initiatives.

2) **Develop new innovative approaches** to substantially scale business engagement against corruption and develop practical solutions in support of a clean business environment. In particular, G20 governments should **introduce positive incentives** to recognize companies and high-level public officials who take the lead in the fight against corruption; support the establishment of a **high-level reporting mechanism** to assist and provide solutions to companies that are confronted with a solicitation for a bribe or extortion; and **initiate multistakeholder dialogues and collective action projects** to address the root causes of corruption and eliminate lingering problems of corruption related to specific country contexts and industry sectors.

III. Proposed Actions in Cannes

To drive this agenda forward, the G20 should consider launching, at its summit in Cannes, **a new global anticorruption partnership bringing together governments from the G20 and beyond, and drawing in the active involvement of business and the main organizations and initiatives addressing the "supply side" of corruption** (i.e. the World Economic Forum Partnering Against Corruption Initiative, the International Chamber of Commerce, Transparency International, the United Nations Global Compact and the OECD Working Group on Bribery).

Through this Global Anti-Corruption Partnership, the G20 would create an operational mechanism to:

- Agree on concrete steps to advance the G20 Anti-Corruption Action Plan and further develop the practical and innovative solutions which have been highlighted in this document in support of a clean business environment
- Continue the dialogue between governments and business on a regular and systematic basis, and identify policy gaps and opportunities to further advance the fight against corruption
- Encourage the use by companies from all over the world of the existing rules, principles and implementation tools for establishing and reporting on corporate anti-corruption policies and programmes
- Assess and report progress at future G20 business summits
- Cooperate on sustained public and business community advocacy to change mindsets and business cultures around the world

Four areas that require priority action from G20 governments and business, and which should constitute core pillars of the Global Anti-Corruption Partnership, have been identified. For each area, key recommendations and high-level policy objectives are followed by concrete implementation proposals for action by G20 governments and business on an individual and collective basis.

These foregoing policy recommendations and the following implementation proposals are interconnected and mutually supportive. To achieve lasting and effective results, it is essential that G20 governments adopt a comprehensive approach to the proposed actions, rather than picking and choosing among them.

A. Securing fair competition and common integrity rules across countries and between companies

Key Recommendations and Objectives

Implement the UNCAC and OECD Anti-Bribery Convention: All G20 countries should ratify and implement the United Nations Convention against Corruption (UNCAC) and become parties to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. In addition, G20 governments should advocate and strongly pursue the adoption and implementation of the UNCAC by non-G20 countries. To this end, G20 governments should provide further financial and technical support to help developing countries meet their obligations under the UNCAC and by firmly establishing anti-corruption as a core part and required component of their bilateral and multilateral aid programmes. A special effort should be made to assist countries from North Africa and the Middle East who have recently engaged in political reform and have a strong interest in fighting corruption.

Enhance the review mechanism for the UNCAC: Governments of G20 countries whose implementation of the UNCAC is under review should ensure non-governmental participation (including business) in the preparation of their individual country reviews and allow business input to be channelled through national and international business representative bodies to the reviewing teams (i.e. the UNODC and reviewing countries).

Trace the proceeds of corruption: Governments from the G20 should fully support ongoing efforts by the OECD's Financial Action Task Force and the UNODC to promote the global implementation of minimum global standards for tracing and detecting suspicious transfers of funds across countries. In line with Chapter V of UNCAC, G20 governments should also adopt and implement measures aimed at the return of funds obtained through corrupt activities.

Support corporate anti-corruption programmes: Companies headquartered or listed in G20 countries and beyond (and their subsidiaries) must play by the same set of rules when competing in international markets. To facilitate compliance and benchmarking efforts, G20 governments and businesses should support the emergence of common global principles on the key elements of adequate corporate anti-corruption programmes based on the OECD 2009 Recommendation for Further Combating Bribery and its Annex II on Good Practice Guidance on Internal Control, Ethics and Compliance.

Implementation Proposals

Government actions

1) Every year, as part of its **annual monitoring reports** on the G20 Anti-Corruption Action Plan, the G20 should publish the status of each G20 country's adoption and implementation of the UNCAC and the OECD Anti-Bribery Convention, and identify issues that remain to be resolved by individual G20 countries.

2) G20 governments should agree to **increase their funding and operational support** for the UNODC and OECD's ongoing efforts to review the implementation and enforcement of the UNCAC and OECD Anti-Bribery Convention and assist signatory countries with their implementation and enforcement efforts.

Business action

3) The business community should establish **a CEO business pledge** for companies of all sizes, industry sectors and countries, whereby CEOs and their companies commit to a number of specific actions, including:
   - Clear prohibition of corruption in company policies, including business-to-business corruption
   - Establishment of an effective anti-corruption programme, in line with the UN Global Compact's 10th Principle against Corruption, the "Principles for Combating Bribery" developed by the World Economic Forum Partnering Against Corruption Initiative (PACI), the "Rules of Conduct to Combat Extortion and Bribery" developed by the International Chamber of Commerce, the "Business Principles for Combating Bribery" developed by Transparency International and the "Good Practice Guidance on Internal Control, Ethics and Compliance" developed by the OECD in its 2009 Recommendation for Further Combating Bribery
   - Action to increase transparency in their own procurement systems
   - Annual corporate disclosure of their anti-corruption policies and implementation measures (e.g. based on the "Reporting Guidance on the 10th Principle against Corruption" developed by the UN Global Compact and Transparency International).
   - Independent assessment of their anti-corruption programme through third-party verification

4) Larger companies, such as those participating in PACI, should offer capacity-building assistance to small and medium-sized enterprises (SMEs) to help them strengthen their anti-corruption policies and practices. Such capacity-building efforts may also take the form of public-private joint action through the organization of collective action initiatives aimed at scaling business engagement against corruption (see section D below).

B. Recognize those who play by the rules; penalize those who do not

Key Recommendations and Objectives

Create positive incentives: Governments and international development banks should introduce new measures to recognize companies, countries and high-level public officials who demonstrate leadership in the fight against corruption and create positive incentives that will boost public and business efforts to prevent corruption. Examples of positive incentives for business include the establishment of a "white list" mechanism (e.g. to be applied in the context of public procurement, government-funded programmes and project financing), and the institution of a compliance defence to liability to be made available for companies that can demonstrate that they have adequate compliance procedures to prevent corruption.

Penalize foul play: Active enforcement of existing anti-corruption laws remains the most effective way to deter illicit behaviour by public and private sector entities and their employees. G20 governments should lead by example, sustaining and, in some cases, substantially increasing their efforts to enforce existing national laws and measures to fight corruption, in particular those that prohibit the bribery of foreign public officials, the solicitation of bribes by public officials and corruption in the context of private commercial transactions.

Implementation Proposals

Government actions

5) G20 governments should develop and implement a **globally accepted assessment framework** to monitor the robustness of a company's anti-corruption programme (e.g. along the lines of the Draft TI

Framework for Voluntary Independent Assurance of Corporate Anti-Bribery Programmes) and introduce **white list mechanisms** to recognize companies that take the lead in the fight against corruption.

Such **white list mechanisms** should be used by:
- National and local governments in their public procurement and public bidding procedures
- Export credit agencies in their application procedures for the granting of export financing and insurance
- National and international development banks in their application procedures for project financing

To be eligible for white listing or preferred supplier status, **companies should meet the following requirements**:
- Existence of an effective anti-corruption programme, based on common global principles, subject to annual corporate disclosure, and verified through a globally accepted assurance mechanism
- Participation in collective action initiatives and projects with industry peers and other stakeholders in government and civil society
- Absence of company management previously convicted for corruption

Another positive incentive that governments should introduce on the basis of similar requirements is the institution of a compliance defence to liability based on the notion of "adequate procedures" recognized by Annex I of the OECD 2009 Recommendation for Further Combating Bribery and established by the UK Bribery Act and other similar laws.

Governments should also establish leniency policies to encourage voluntary disclosure and give credit and possible amnesty to companies that disclose misconduct themselves before an investigation begins.

6) G20 governments should introduce positive incentives **in their appointment, compensation and promotion policies** to recognize and reward high-level public officials, including government ministers and senior civil servants, who have demonstrated leadership in fighting corruption. The aid community, including bilateral and multilateral donors, should commit to provide **additional development assistance** to low-income countries that are taking action and have demonstrated results against corruption as a way to reward them and incentivize others.

7) G20 governments should demonstrate their political will to increase their level of enforcement activity by **providing adequate resources for corruption investigation and prosecution efforts**. Such enforcement efforts should equally punish the supply and demand side of corruption. In particular, G20 governments must demonstrate zero tolerance for the solicitation or acceptance of bribes by their public officials. As a preventive measure, governments should as far as possible remove opportunities for their public officials to exercise discretion in the course of their duties.

C. Make it safe to report acts of corruption

Key Recommendations and Objectives

Reporting solicitation and extortion of bribes: Governments should provide mechanisms that will facilitate the voluntary disclosure by companies of risky situations that they may encounter. In particular, governments should provide assistance and solutions to companies that are confronted with a solicitation and/or extortion of a bribe (whether by a public official or a company executive), and resolve other concerns on corruption that might arise in the context of public procurement, international projects and private commercial transactions between companies.

Whistle-blowing: Governments, intergovernmental organizations and companies should create effective and protective policy frameworks for whistle-blowing that protect individuals:
- Exclude those who report suspected acts of corruption in good faith from any form of retaliation
- Disclose whose behaviour has been reported, through the respect of the principle of presumption of innocence and other legal rights

Implementation Proposals

Government action

8) As part of their implementation efforts of UNCAC and the OECD Anti-Bribery Convention, G20 governments should demonstrate leadership by endorsing the idea of a **high-level reporting**

mechanism as proposed by the chief legal officers of four leading companies in power and supported by the Secretary-General of the OECD. The purpose of such a reporting mechanism, which could take the form of a "help line", should be to investigate and resolve allegations of irregularities through speedy, informal and extrajudicial channels. To work smoothly, such a mechanism should:

- Be implemented at country level in accordance with national legal frameworks
- Operate in harmony with companies' internal reporting systems
- Protect confidentiality so as not to harm individuals and companies that may be accused wrongly
- Provide adequate guarantees of independence
- Be subject to annual reviews of effectiveness

The business community stands ready to work with governments and relevant intergovernmental organizations to flesh out this idea over the coming year, with a view to formally present it to the G20 as part of proposals offered for the next G20 Summit, in Mexico in 2012.

Business action

9) Companies that have not already done so should introduce **practical channels** for their employees to internally report in good faith any suspected act of corruption without any fear of retaliation.

D. Promote public-private partnerships

Key Recommendations and Objectives

Address the root causes of corruption: G20 governments and business should work together to identify and develop solutions to overcome the root causes of corruption. A practical objective should be to help governments and intergovernmental organizations identify and work to eliminate policies and practices that unintentionally create the conditions for corruption. Working on the root causes of corruption requires addressing the underlying socio-economic factors that lead to the proliferation of bribery and abuse of power. To promote a culture of integrity around the world, G20 governments should also instil the teaching of ethics into educational systems, beginning at the elementary school level.

Promote collective action: G20 governments and business should join forces to develop practical solutions to problems of corruption affecting specific country contexts or industry sectors through collective action initiatives that combine and leverage the competencies and capacities of public, private and civil society actors.

Implementation Proposals

Public-private joint actions

10) G20 governments should mobilize their embassies and development assistance channels to **initiate and co-fund multistakeholder dialogues in specific countries** with a view to identifying and developing solutions to overcome the root causes of corruption. Such multistakeholder dialogues should have a strong business component and seek the participation and support of local business actors, including domestic and foreign companies as well as national and local business associations. The local chapters and networks of the UN Global Compact, the World Economic Forum and the International Chamber of Commerce can serve as important partners to facilitate business participation in such dialogues.

11) G20 governments and business, and other key players in the fight against corruption should **identify and launch new collective action initiatives** to address corruption problems linked to specific country contexts and industry sectors.

The establishment of such multistakeholder dialogues and collective action initiatives should draw on the experience of recent and ongoing programmes and projects involving government, business and civil society actors, for example:

- The World Bank Institute's Working Group on Collective Action
- The Extractive Industries Transparency Initiative (EITI) and other similar programmes based on the "publish-what-you-pay" concept
- The "Clean Games Inside and Outside of the Stadium" project launched by the Ethos Institute and the UN Global Compact to monitor public spending and potential irregularities in connection with the 2014 FIFA World Cup in Brazil and the 2016 Olympic Games in Rio de Janeiro

- The Korean Pact on Anti-Corruption and Transparency (K-Pact), a principle-based initiative that was signed by public and private sector leaders and led to the conclusion of sector-specific pacts in the fields of construction, health social welfare, finance and education
- The Anti-Corruption Collective Action project launched by the Global Compact India Network and the UN Global Compact Office to mobilize Indian businesses to engage in collective action in support of the Central Vigilance Commission's anti-corruption strategy as well as the Government of India's policy on green economy.
- The Anti-Corruption Collective Action project launched by the National Business Initiative, South Africa, and the UN Global Compact Office to mobilize South African businesses to engage in the development of an integrity pact around major government procurement projects
- The Multi-Industry Customs Transparency Project, conducted by the PACI in Vietnam with the support of the Vietnamese Government and the World Customs Organization to address the issue of improper payment requests by customs officials
- The Multi-Industry Corporate Anti-Corruption Project, also conducted by the PACI in Mongolia with the support of the Mongolian president and the Mongolian business community to strengthen private sector engagement against corruption in the country

IV. Contribution from the ICC G20 Advisory Group on Fighting Corruption

Issue

As noted by G20 leaders, corruption threatens the integrity of markets, undermines fair competition, distorts resource allocation, destroys public trust and undermines the rule of law.

For decades, the International Chamber of Commerce (ICC) has taken the lead in denouncing corruption and in developing measures to combat it. World business welcomed the G20 leaders' recognition at the Seoul Summit of their special responsibility to prevent corruption and hailed the G20 leaders' call for public-private partnerships in countering corruption. Indeed, it is only through a combination of concrete action by governments, business both working together through public-private partnerships that effective progress can be made.

Analysis

The next G20 Summit will take place after the years of global economic turmoil that followed the financial crisis in late 2008 and following recent uprisings taking place in a number of countries. While the causes and consequences of these developments are still being assessed, it is clear that there is greater attention worldwide to the need for more transparency and accountability, and the desire of citizens to fight corruption.

In 1977, the ICC led the way in producing the first edition of the ICC Rules of Conduct to Combat Extortion and Bribery, which contained strong measures to end both bribery and extortion. These rules have been updated regularly since then and continue to be the leading private sector tool for fighting corruption today. The ICC has long been at the forefront of the drive for integrity in business, because only a corruption-free system makes it possible for all participants to compete on a level playing field.

It is estimated that corruption adds up to 10% to the total cost of doing business globally and up to 25% to the cost of procurement contracts in developing countries. Moving business from a country with a low level of corruption to a country with medium or high levels of corruption is found to be equivalent to a 20% tax on foreign business. Inversely, countries that tackle corruption and improve their rule of law can increase their national incomes by as much as four times in the long term *(source: World Bank).*

A recent study of 400 companies worldwide revealed that an increasing number of companies recognize their vulnerability to corruption. Among survey respondents, 63% indicate that they have experienced some form of actual or attempted corruption. This study reveals that there is a strong business case for having an anti-corruption strategy that goes beyond avoiding potential enforcement penalties. Almost 45% of respondents say they have not entered a specific market or pursued a particular opportunity because of corruption risks; 39% say their company has lost a bid because of corrupt officials; and 42% say their competitors pay bribes. In addition, 55% of respondents say that if corruption was discovered, the most severe impact would be to corporate reputation. More than 70% believe that a better understanding of corruption will help them compete more effectively, make better decisions, improve corporate social responsibility and enter new markets. *(Source: PricewaterhouseCoopers International)*

The ICC welcomed two major legal instruments for fighting corruption – the United Nations Convention against Corruption and the OECD Convention on Combating Corruption of Foreign Officials, which have strengthened the international legal framework. More effective enforcement in a growing number of jurisdictions has meant that companies find themselves increasingly liable for employees and agents engaged in corruption. This prompts more and more companies to implement complete corruption prevention systems.

Fighting corruption requires a robust, international legal framework with effective review mechanisms involving the largest number of countries, as well as effective legislation against corruption implemented on a national basis.

G20 leaders have rightly pointed to the importance of the UNCAC for ensuring the principles of an effective global anti-corruption regime. For business the UNCAC is essential because it has the potential for a global scope and, therefore, the promise for curbing corruption and creating a level playing field for all participants in the global economy.

In 2009, the ICC led a global business initiative joined by the World Economic Forum, TI and UNGC, rallying CEOs from around the world to write a letter to UN Secretary-General Ban Ki-moon urging the adoption of an effective monitoring mechanism for the UN Convention. This "CEO letter" initiative has been credited with helping to bring about the adoption of a monitoring mechanism at a UN conference of more than 140 UNCAC parties in Doha in November 2009. This represented significant progress but more can be done by governments, especially with the leadership of G20 governments, to ensure full and consistent implementation of the UNCAC.

The OECD is also a key forum for anti-corruption reforms. The private sector commends the achievements made by the OECD Working Group on Corruption and also notes the importance for business of the OECD Good Practice Guidance on Internal Controls, Ethics and Compliance (Annex II) of February 2010 for the shaping of genuine corporate anti-corruption systems.

World business recognizes that doing business with integrity is the only right way of doing business. Companies seen to be doing business with integrity are more likely to attract and retain highly principled and motivated employees as well as ethically oriented investors. In contrast, companies confronted with corruption cases have faced reputational damage.

The risk of corruption faced by businesses varies according to a number of parameters, including their size, their international exposure and the nature, scale and diversity of their activities. More needs to be done for SMEs in particular, which are especially vulnerable and lacking in adequate resources to fully comply with anti-corruption requirements.

Fighting corruption within the private sector, among both MNEs and SMEs, is a progressive and incremental process. Combating corruption requires strong commitment from top management and high-quality, systematic organization to ensure that anti-corruption becomes part of the corporate culture at all levels. From a business perspective, what is needed now is thorough and pragmatic implementation of ethics and anti-corruption standards in business. This requires the building of real integrity awareness in all segments of society and in business in particular.

What international business has accomplished so far

World business appreciates the approach of the French presidency of the G20 to seek concrete and precise progress for the Summit in Cannes.

The ICC and other business organizations have taken a number of concrete actions already towards achieving greater integrity in business. Indeed, the private sector has a proven track record in fighting corruption and has developed a number of practical tools and initiatives that need to be known further, scaled up and implemented with the support of G20 governments. These include:

- **ICC Rules for Combating Extortion and Bribery** – As noted above, these ICC rules, first published in 1977, outline the basic measures companies should take to prevent corruption and constitute what is considered good commercial practice. They are presently being revised to integrate the latest anti-corruption developments in the UN and OECD. *(http://www.iccwbo.org/policy/anticorruption/id870/index.html)*

- **ICC Fighting Corruption Handbook** – These ICC rules are complemented by a corporate practice manual that provides practical advice on key areas such as corporate gifts, political contributions, accounting and facilitation payments. It is a handbook for all companies wishing to put into place an efficient and well-run integrity programme. *(http://www.iccbooks.com/Home/Home.aspx)*

- **RESIST** – This practical tool aims to train company employees on how to prevent solicitation of a bribe and/or how to respond in a safe, ethical and efficient way to a demand for a bribe. RESIST is the result of successful collective action among the leading stakeholders representing the private sector in the fight against corruption – the ICC, the World Economic Forum, Transparency International (TI) and the UN Global Compact (UNGC) *(http://www.iccwbo.org/policy/society/index.html?id=42784).*

- **Nine steps to responsible business conduct** – The ICC issued this concrete advice for companies to develop policies and practices for responsible business conduct. *(http://www.iccwbo.org/policy/society/id1188/index.html)*

- **Whistle-blowing Guidelines** – These ICC guidelines enable companies to put whistle-blowing systems in place, which make it possible for employees to report incidents without fear of retaliation, discrimination or disciplinary action. *(http://www.iccwbo.org/uploadedFiles/ICC%20Guidelines%20Whistleblowing%20%20as%20adopted%204_08(2).pdf)*

- **Business Case against Corruption** – The ICC, along with the World Economic Forum, TI and UN GC, has sought to demonstrate convincingly why it makes sense for business to fight corruption not just for moral reasons, but from a business point of view. *(http://www.iccwbo.org/uploadedFiles/The%20Business%20Case%20Against%20Currption19June08.pdf)*

- **Third-party guidelines** – Agents, intermediaries or third parties can present the "weak link in the chain" in terms of an enterprise's anti-corruption policies and practices. This is why the ICC developed and issued in 2010 the ICC Guidelines on Use of Agents, Intermediaries and Third Parties, which provide companies with essential advice on good commercial practice on how to select, remunerate and monitor third parties so as to obtain the best possible result without harm to the enterprise's reputation. *(http://www.iccwbo.org/uploadedFiles/ICC/policy/business_in_society/Statements/195-11%20Rev2%20ICC%20Third%20Parties%20FINAL%20EN%2022-11-10.pdf).*

Recommendations

What international business expects from governments and intergovernmental organizations

- All G20 governments should ratify and implement the UNCAC. G20 governments should also encourage work with non-G20 states towards a universal adoption and implementation of the UNCAC.

- All G20 governments should become parties to the OECD Convention on Combating Bribery of Foreign Public Officials.

- High-level reporting mechanism: Each national government should consider creating a reporting mechanism to provide assistance to companies that are confronted with a solicitation of a bribe and/or extortion, and to resolve other concerns that might arise in the context of public procurement and international projects. To be effective, such a mechanism, which could take the form of an "ombudsman" function, should provide adequate guarantees of independence and be subject to annual reviews of effectiveness.

What more can business do

- World business calls for the development of effective ethics and compliance training to embed best practices for fighting corruption among all levels within companies big and small. The ICC is committed to actively contribute to the development and implementation of such training.

- World business recommends extending sectoral initiatives that offer collective guidance and support targeted to the specific challenges of different industries and that share anti-corruption best practices.

What more can business do in partnership with governments

- World business calls for the further development of external certification, verification or assurance of the effectiveness of company anti-bribery procedures, as called for by the UNCAC and the UK Guidance to the Bribery Bill.

- World business further calls for public-private partnerships on the development of the "self-cleaning process", as a positive anti-corruption incentive for business, wherein procurement rules are amended to allow for the re-entry into the market of companies debarred under public procurement rules if these companies can do an internal company "self-cleaning" exercise.

World Economic Forum G20 Working Group on Green Growth

I. Framing the Issue

A number of related challenges have accelerated during the last decade: the 2008-2009 economic crisis, precipitated by the financial sector; stresses on food and water supplies; and increasingly evident changes in the climate. These crises share a common thread – the misallocation of resources into non-sustainable assets. Existing policies and markets contributed to this situation, and also offer a path to a solution. With a concerted effort, governments and industry can work together to design a set of strategic policies and market-based approaches that direct limited public capital in such a way as to free up substantial private sector investment that is financially and environmentally sustainable. Sustainable economic growth, also called "green growth", facilitates the generation of new jobs and improves national competitiveness from the bottom up, while also addressing the challenges of climate change and food/water security.

Greening the world economy is a long-term effort involving all aspects of the economy. In the power sector, existing infrastructure requires major change, and emerging economies need to invest in new systems that facilitate larger shares of low-carbon resources. Technological breakthroughs are needed to accelerate the shift to cleaner manufacturing and transportation options. Traditional and modern agricultural methods need radical overhauls to meet changing needs at manageable environmental and social cost.

With sufficient time, such challenges might eventually be overcome under business-as-usual conditions. However, time is not on our side. The International Energy Agency (IEA) reported in 2011 that over 30 gigatonnes of CO_2 equivalent was emitted in 2010.[21] According to IEA scenarios, to stay below the 2 degree Celsius increase that is targeted by the international community, global emissions must not exceed 32 gigatonnes by 2020. Even with a global economic slowdown in the West, it seems that this barrier might be breached in the very near future. Further, agricultural stocks and water resources are increasingly stressed.

Strategies to achieve greener growth are needed and particularly ones that are attractive to business. We must deal with increasing environmental impacts, while also delivering business value and commercially viable products and services. As the Organisation for Economic Co-operation and Development (OECD) states in its recent report on green growth:[22]

> "...we have to find new ways of producing and consuming things, and even redefine what we mean by progress and how we measure it .... Non-technological changes and innovation such as new business models, work patterns, city planning or transportation arrangements will also be instrumental in driving green growth. No government has all of the technological, scientific, financial and other resources needed to implement green growth alone. The challenges are global ..."

The United Nations Environment Programme has also endorsed this view in its recent *Towards a Green Economy*, which stresses that private sector innovation and technology development are at the heart of greening economies.[23]

II. Key Policy Messages

The private sector has already taken concrete actions in all sectors towards green growth, from reducing environmental impacts across value chains to increasing energy and resource efficiency, investing in low-carbon and renewable energy and reducing waste. To provide guidance for governments on key lessons learned, last year's G20 CEO Working Group on Creating Green Jobs undertook extensive analysis on green growth. The group made four important economy-wide recommendations to G20 leaders:

- Set a robust price on carbon
- Dramatically scale up research and development
- End fossil fuel subsidies
- Allow free trade in environmental goods and services

[21] See www.iea.org/index_info.asp?id=1959.
[22] OECD (2011), *Towards Green Growth: A Summary for Policymakers,* OECD, Paris.
[23] UNEP (2011), *Towards a Green Economy: Pathways to Sustainable Development and Poverty Eradication*, Nairobi.

The 2010 Working Group also made specific recommendations for buildings, the power sector, the industrial sector and the transport sector:

- Buildings: promote energy efficiency, creating publicly funded fiscal incentives for green building investments
- Power: implement policies to accelerate renewables and clean energy uptake; streamline and expedite administrative processes such as planning and permitting; and expand and upgrade grids
- Industry: devise targeted incentives for energy efficiency; broker sector agreements for energy- and carbon-intensive industrial sectors; and foster market-based technology transfer (technology centres of excellence)
- Transport: introduce fuel efficiency standards that ratchet up over time; provide supply and demand side support for new technologies such as electric vehicles; and invest in energy-efficient public transport

This year's Working Group strongly endorses and builds on these recommendations. The aim now is to shift the debate from analysis and broad policy guidance to action, building on existing examples that G20 leaders can help to replicate and scale through the Cannes Green Growth Action Plan proposed below.

To render economies more resilient in the face of an increasingly variable climate and mitigate further increases in emissions, it will be necessary to catalyse a new pattern of economic growth – green growth – across G20 countries and elsewhere in the world economy. Since this transformation of economic activity must occur primarily in the private sector, it cannot be financed mainly through taxes or other public levies. G20 leaders have a unique opportunity to mobilize the necessary private finance by taking the initiative to coordinate the creation of a set of stable regulatory frameworks and targeted incentives that reduce investment risk and enlarge green growth market opportunities across their economies. By doing so, they can catalyse change from the bottom up – through the everyday decisions of investors, corporate managers and consumers behaving as rational economic actors – even in the absence of a formal multilateral treaty or national economy-wide cap-and-trade or carbon tax system.

The level of investment required to grow the global economy in a sustainable manner is considerable. Bloomberg New Energy Finance suggests that the global clean energy market will need to sustain about US$ 500 billion a year in private sector finance to mobilize the required scale of investment; this is over and above the estimated US$ 1 trillion needed in a business-as-usual case. The World Bank puts the annual incremental financing needs of developing countries for climate mitigation at US$ 140-175 billion over the next 20 years and an additional annual US$ 30-100 billion for adaptation over the same period.[24] These estimates exceed the US$ 100 billion a year in public finance that the Green Climate Fund (GCF) hopes to mobilize by 2020 for developing countries, and these funds have been slow to materialize.

While the trend of private finance in clean energy investment is upward (30% up in 2010 compared to 2009, against a growth trend of about 30% from 2000 to 2008), it is also clear that most developed countries face a protracted period of fiscal consolidation and slower economic growth. Further, although they are an efficient solution, political realities suggest that market-based greenhouse gas reduction approaches are not likely to proliferate greatly in the near future. An international climate (or green growth) strategy that relies too heavily on the appropriation of public monies and/or carbon finance is likely to encounter difficulty in gaining implementation within individual national legislatures, let alone on an internationally coordinated basis. National governments need to continue to pursue greenhouse gas market creation, but we believe there is a need to find other approaches to mobilizing the necessary finance to ensure green growth.

G20 governments can stimulate major, new momentum in this direction by working with the private sector in a structured manner to identify practical, replicable ways of attracting private capital into clean technology investment in different national and sectoral contexts around the world, and then mobilizing a public-private network to scale these models rapidly. In fact, most low-carbon or resource-efficient infrastructure and industrial projects are literally investments – i.e. they enhance economic productivity and generate potentially attractive streams of revenue. They, therefore, are natural candidates for private investment if the means can be found to manage the attendant risks and produce an acceptable return on investment. This is where governments and international financial institutions have a crucial role to play. They alone have the capacity to create incentive frameworks and target public resources as necessary to scale the "crowding in" of private investment into new and retrofitted resource-efficient infrastructure and industrial plant and equipment, learning from and replicating successful examples along the way.

[24] To put these figures into context, the total value of private finance deals in the global clean energy investment in 2010 market was US$ 247 billion (of which US$ 54 billion, or 22%, was invested in China).

Similarly, a sustainable green economy ultimately must be demanded by consumers themselves. Sustainable consumption patterns can be enabled by the creation of reliable, transparent methods to measure, compare and communicate the footprint of products and services over the value chain for easy reference by consumers. Here too, government has a crucial, arguably indispensable, role to play.

In this way, green investments, consumer markets and economic growth can work together, and a green economic growth agenda can be activated from the bottom up. For this reason, we propose a new leadership agenda for the G20 on green growth and climate change. G20 governments have an opportunity to demonstrate, in very practical terms, how limited public resources can be structured to attract private capital in a way that mobilizes the greatest possible amount of investment as quickly and efficiently as possible. An action plan to scale up workable case studies on this basis, covering key sectors such as clean energy, energy efficiency, land use and transportation, would shift discussion towards a set of practical public-private green growth investment discussions at the national level, helping governments to deploy their funds in the most strategic manner.

III. Proposed Actions in Cannes

We propose that G20 leaders commit to develop an **Action Plan on Green Growth** at their 2011 Summit, including, but not necessarily limited to, the following elements:

1. G20 leaders should formally acknowledge that shifting incentive structures to drive investors and consumers towards a new model of economic growth – green growth – is an important priority for both advanced and emerging economies that merits a central place in the agenda of international economic cooperation. As such, **G20 leaders should commit to making green growth a standing item on their agenda**, building on the strong base established by the Korean and French presidencies in 2010 and 2011.

2. G20 leaders should **direct their finance, energy, environment, trade and industry ministers to develop a Green Growth Action Plan for the Mexico G20 Summit.** This Action Plan should include case studies and policy recommendations addressing all the key elements that can be tailored by countries as they develop their national green growth plans, including research and development and innovation; key industrial sectors (transport, energy, industry, agriculture); and consumer engagement.

3. G20 leaders should also **establish a separate public-private G20 Green Growth Partnership Network** to support the action plan's G20 Working Groups by documenting and sharing successful national, plurilateral or sectoral case studies that involve significant public-private collaboration on green growth. The network will provide an intellectual commons for sharing practical experiences and public-private partnership opportunities that could support the realization of green growth. Private sector investors and project developers could leverage the network to offer practical support to governments seeking to develop and implement their national green growth strategies, helping them to mobilize the investment and technology necessary to realize their plans.

To help catalyse this process, we ask the World Economic Forum, ICC and Medef to convene companies, governments and international organizations (including the OECD, International Energy Agency, United Nations Environment Programme and the multilateral development banks, among others) to identify, catalogue and develop a set of green growth case studies.

IV. Contribution from the ICC G20 Advisory Group on Encouraging Green Growth

Issue

Challenge: The prospect of critical, interlocking crises for climate, energy, food and water presents the G20 with a significant challenge to secure and expand economic opportunities for a growing population, while ensuring that economic growth and environmental and social responsibility work together in a mutually reinforcing fashion. This challenge is exacerbated by increasing levels of government debt in some countries and international financial insecurity that is severely limiting investment resources.

Opportunity: While there has been some encouraging action in response to promises made in Seoul and Cancun, no meaningful progress has been achieved on green growth and climate change, and, for many countries, political rhetoric remains non-binding. In Cannes, G20 leaders have an opportunity to encourage green growth and accelerate a transition towards a green economy. Business will have a key role to play as there are, for example, between US$ 2.1 trillion and US$ 6.3 trillion of potential commercial opportunities related to environmental sustainability in natural resource sectors alone by 2050 (OECD, 2011).

Analysis

Context: Greening the world economy is a long-term effort involving all aspects of the economy. This process must deal with increasing environmental impacts, while delivering business value and commercially viable products and services. Thus, innovation, technology development and deployment are at the heart of greening economies as well as dealing with resource shortages.

For example, the International Energy Agency (IEA) estimates that the 17% (US$ 46 trillion) increase in energy investment required globally between 2010 and 2050 to deliver low-carbon energy systems would yield cumulative fuel savings equal to US$ 112 trillion (IEA, 2010). The private sector has already taken concrete actions in all sectors towards green growth, from reducing environmental impacts across value chains to increasing energy and resource efficiency, investing in low-carbon and renewable energy, and using ICTs to limit energy use, manage scarce resources and reduce waste.

Clarity: In business, activities must be measured and accounted for. Many companies have made commitments to further reduce their global environment footprints through corporate sustainability programmes with measurable goals, targets and deliverables to reduce their resource use and increase the efficiency of their production systems and design of their products. Consumers must ultimately lead, but governments have a critical role in establishing enabling frameworks.

Moving forward, green growth is a concept that ultimately needs to function in a self-sustaining way and become integrated in international and global markets, and in business balance sheets (taking into account individual company requirements), management systems and practices.

Business has already contributed to developing a range of tools and applications to measure environmental impacts and help assess response measures. A few examples include the World Business Council for Sustainable Development (WBCSD) greenhouse gas (GhG) protocol and water footprint tool, as well as other tools such as those of the Global Reporting Initiative (GRI) or the International Organization for Standardization (ISO).

The ICC and its partners will continue to deliver on the challenge of green growth across the global business community by providing frameworks for business action, such as:

- ICC's Business Charter for Sustainable Development – which provides companies (large and small) with the basis for sound environmental management
- Voluntary sustainability principles such as those of the United Nations Global Compact
- Sectoral approaches like the chemical industry's "Responsible Care"
- Long-term visions such as the World Business Council for Sustainable Development (WBCSD) Vision 2050
- ICC business principles to achieving a green economy
- Capacity-building activities for small and medium-sized enterprises via the ICC World Chambers Federation (WCF) network

Recommendations

From the G20 and government leaders, business needs a comprehensive green growth framework that is clear, stable and predictable. The G20 has a significant role to play, working with other intergovernmental organizations and processes (WTO, UNFCCC, Rio+20 conferences) to make this a reality.

Below is a series of critical objectives G20 leaders should aim for with concrete steps to achieve them.

G*20 leaders should strengthen multilateral rules-based trade and investment by:*
- Avoiding potential competitive distortions in international trade in the transition to greener economies
- Successfully completing the Doha development round and eliminating tariff and non-tariff trade barriers on all goods and services, including on environmental goods and services
- Providing a stable economic environment governed by the rule of law, including effective intellectual property rights protection (IPR), strong contractual arrangements and open, rules-based trade – all strong prerequisites to driving green growth

G20 leaders should promote effective enabling frameworks by:

- Coordinating domestic regulatory frameworks and incentive programmes to reduce investment risk and scale up green growth
- Encouraging the implementation of UNFCCC Cancun agreements at COP 17 in Durban and work towards a truly global agreement on climate change, but not let delays in such agreements slow establishment of effective domestic policies
- Continuing the fight against corruption, thus saving scarce resources

G20 leaders should support resource-efficient choices over the medium and long term by:

- Ending wasteful consumption subsidies while managing the phasing out of targeted subsides for the poor. G20 leaders have already committed to phasing out over the “medium term” some of the US$ 557 billion spent annually (2008) on fossil fuel subsidies
- Providing new financing solutions and clear market directions to help overcome funding barriers for high investments and/or long-payback periods
- Establishing clear and consistent standards to better measure environmental footprints and support benchmarking efforts and use of these standards in policy setting
- Promoting the harmonization of energy-efficiency standards to avoid market fragmentation and achieve economies of scale
- Developing energy and natural resource policies that reduce uncertainty in long-term investment

G*20 leaders should encourage the development of indicators that account for environmental externalities by:*

- Working with the private sector to develop common and non-discriminatory measurements and indicators
- Taking into account other dimensions, including economic growth and employment
- Pursuing market-based carbon pricing (either through a market-based, cap-and-trade approach or through taxation approaches) within the context of each country’s national circumstances

G20 leaders should promote innovation and creativity by:

- Increasing research and development spending to provide for the faster uptake of advanced technologies, leading to lower costs and increased efficiency
- Encouraging the utilization of market-based technology sharing agreements that respect IPR and maximize impact of R&D spending (e.g. ICC Model Contract on Technology Transfer)
- Providing effective public funding to encourage the private sector to commercialize risky but potentially viable and scalable pre-commercial technologies, though any subsidies must be time-bound and eventually phased out
- Striving to meet clear policy objectives (i.e. emissions reduction) and improving technological performance across the board (all technologies) – while avoiding picking “winners and losers” among technologies

G20 leaders should promote the shift to sustainable consumption by:

- Promoting education campaigns to raise consumer awareness about the transition towards a green economy
- Allowing an expanding global population to consume sustainably – sustainable consumption need not be a matter of consuming less but consuming differently
- Looking beyond short-term pressures and focusing on the development of long-term shared value

Collectively, the G20 is well placed to play a key role in catalysing action and proving a global framework for green growth. In Cannes, G20 leaders should make the following commitments:

1. Establish a platform to ensure the coordination of national measures and approaches to “green” economies and share best practices
2. Commit to holding regular, collective meetings of environment, energy, trade and finance ministers at the G20 level to deal with (integrated) green growth related issues

World Economic Forum G20 Working Group on Infrastructure Development

I. Framing the Issue

There is a clear requirement for increased investment in cost-effective, efficient and sustainable infrastructure (land, sea and air transportation, and Internet, telecommunications, energy and water networks) to support economic growth and address other challenges such as climate change and access to basic services. The private sector can and should provide most of this infrastructure (for example, utilities controlled by appropriate regulatory regimes) and is ready to support governments, many of whom are under tight fiscal constraints. However, in some sectors, new projects need to be promoted by governments.

The G20 Summit in Seoul in November 2010 identified a need for private sector input and help on how governments can optimize and prioritize their infrastructure expenditure across ***all*** types of infrastructure, and then deliver the selected projects as effectively and efficiently as possible. Green growth was one of the four themes particularly emphasized. Leaders called for such findings to be consolidated into a concise set of proposals that could be used by all governments to help spur growth.

The following recommendations seek to respond to this appeal, building on the recommendations presented in Seoul last year.

II. Key Policy Messages

To maximize societal returns from infrastructure, two key questions need to be addressed:

- How should governments prioritize which infrastructure projects create the greatest impact in terms of economic growth, social uplift and sustainability?
- How should they enable and, if necessary, (co-)fund, procure and monitor the building of assets most efficiently and effectively?

Following are three groups of recommendations: a general recommendation on the need for multistakeholder involvement; three recommendations on prioritizing infrastructure investments; and five recommendations on delivering infrastructure efficiently and effectively. Due to the prominence the G20 Summit in Seoul placed on green growth, encouraging substantial use of renewable and low-carbon energy, and closing the infrastructure funding gap, examples are given on how some of these more generalized recommendations can be applied to the energy sector (see footnotes).

Overall recommendation – the need for multistakeholder involvement

Decisions made today on infrastructure investments will have major implications on society, the environment and economic growth for decades to come. To create a path for cost-effective, efficient and sustainable infrastructure development, a multistakeholder approach is needed to align the partners and closely define, plan and execute an infrastructure plan. The evidence is that early engagement with stakeholders sets up a partnership that allows projects to be delivered more effectively and efficiently, and, in so doing, creates a "*win-win"* in which infrastructure truly benefits society and boosts economic growth. If not already engaged, it is recommended the three main stakeholders – government, the private sector and civil society/non-governmental organizations (NGOs) – have the following contributions to make, with the backing of the G20.

Government: Primary role is to provide the vision and then set up the enabling environment to encourage competition and attract investment.

Private sector: The private sector's role is typically to build and operate the infrastructure. While many countries have fiscal challenges, the private sector has the money, resources and keenness to invest, seeing infrastructure as both a great business opportunity and essential for economic growth. The private sector is also a potential partner for capacity building.

Civil society/NGOs: The role of civil society and NGOs, particularly environmental NGOs and NGOs representing marginalized groups of society, is to act as advisers and watchdogs to ensure investment is built and maintained to high standards. NGOs can also act as a potential partner for capacity building.

G20: The G20 should encourage governments to engage in multistakeholder dialogue with the private sector and civil society/NGOs in all phases of infrastructure planning, development and implementation to enable more cost-effective and efficient development of infrastructure that also addresses environmental and societal concerns.

Recommendations to help governments prioritize infrastructure investments

1) ***Governments need to provide national/transnational visions and strategies on infrastructure investment priorities to develop affordable, well-conceived and coordinated Infrastructure Plans that address economic, social and sustainability concerns.***

All too often, high-profile infrastructure projects are conceived but are never implemented due to regulatory hurdles, or they run out of money during the construction process. For investments in low-carbon infrastructure, it has been shown that policy uncertainty can increase risk by more than 10%. To avoid delivery problems and increase the investment attractiveness of a country, it is recommended that:

- Countries, supported by relevant stakeholders (the private sector, civil society and NGOs) should prepare National Infrastructure Plans (or, if the infrastructure development spans national boundaries, a Transnational Infrastructure Plan) underpinned by a needs assessment of the investments that are most economically effective. The scale of this task should not be underestimated, as the plan needs to encompass economic, social and sustainability drivers, be fully integrated and coordinated with other government priorities (for example, plans to move towards a low-carbon economy) and be incorporated into government budgets.

- A challenge in publishing and committing to a National Infrastructure Plan is that different political administrations might have other priorities. Frequent changing of the Infrastructure Plan creates significant investor uncertainty. Therefore, fostering wide political support for the plan and formulating an unbiased project evaluation methodology creates more confidence, and indirectly reduces the overall cost of infrastructure.

- The Infrastructure Plan should reflect the specific needs of the country concerned and focus on desired outcomes (e.g. sustainable water access or less congestion) rather than single projects or facilities. This allows countries to remain open-minded when considering solutions, for example a similar outcome may be achieved by just rebuilding a few network bottlenecks or charging users to use existing infrastructure. The plan should incorporate clear programmes for each infrastructure sector, for example transport, utilities, waste management and telecommunications.

Many governments seek assistance in making these difficult decisions during the project feasibility and preparation phase[25]. The World Economic Forum is developing guidance on how governments could approach this prioritization process. The report will draw on best practice and is due to be launched in the Forum's Annual Meeting in Davos-Klosters in January 2012.

The following stakeholders have roles and actions to perform:

Government: Responsible for catalysing the process of preparing an Infrastructure Plan and setting up multistakeholder dialogue.

Private sector: Role to fully engage in the dialogue process, identifying drivers for economic growth, and offering practical evidence-based guidance on ways to prioritize and manage risks, and accommodate other environmental and societal concerns.

Civil society/NGOs: Any infrastructure investment might generate some resentment from some individuals in society. Civil society and NGOs should understand the need for infrastructure, and be willing to engage in an open dialogue, remaining pragmatic in presenting their views and suggestions.

[25] In many countries, for example, there is a lack of a clear energy policy. Without clear government direction on the appropriate balance of energy supplies and uncertainty about government's commitment to renewable energy subsidies, investors will be reluctant to make the long-term investments in capacity and the supporting infrastructure. However, to formulate a National Infrastructure Plan means reviewing and updating the country's energy policy. By rigorously examining what the most efficient energy mix is, the distribution grid network infrastructure can be defined. Due to the intermittent nature of many renewable energy sources, there is ultimately a need for grids to extend beyond national boundaries and for transnational energy network plans to be formulated. For example, coordinated progress is being made within Europe for mid- and long-term plans for electricity grids.

2) ***Governments should prioritize infrastructure investment on a whole life-cycle performance basis***

Governments, NGOs and multilateral development banks (MDBs) sometimes base investment decisions on whether there are sufficient funds to build the assets. Once the infrastructure is built, there is often the realization that ongoing maintenance costs have not been provided for. Instead, projects should be evaluated on a whole life-cycle basis, i.e. considering all costs over the asset's life including repairs, renewals, decommissioning costs and their environmental and sustainability impacts[26]. In this way, there will be more reassurance that projects can be maintained over the longer term (for example, by including maintenance and life-cycle reserves in budgets), and different technological solutions may emerge.

A further benefit of basing investment decisions on whole-life costs is that solutions are often more sustainable. For example, trains that can recover braking energy are more expensive to build than conventional trains, but they generate significant cost and environmental savings during their operation.

Appropriately structured public-private partnerships (PPPs), where contractors build and then operate the assets, encourage the private sector to automatically consider whole life costs. In general, the lower the whole life costs, the lower the overall price the private sector will be able to charge the public sector, and, all else being equal, the more likely the tendering company is to win.

The following stakeholders have roles and actions to perform:

Government: Responsible for incorporating whole life-cycle performance analysis in evaluating and prioritizing infrastructure projects.

Private sector: Share methodologies for the evaluation of whole life-cycle scenarios and their financial interpretation, such as investments with longer payback periods but higher net present values. For example, the private sector is constantly developing new technologies and methodologies to reduce risks and costs to achieve greater operational efficiencies.

Civil society/NGOs: Should contribute advice on how to measure environmental impacts, e.g. impacts on ecosystems and the negative effects of congestion.

G20: Due to the challenges of evaluating the whole life costs and environmental impacts of infrastructure, it is recommended that the G20 set up a working group to consider the formulation or adoption of a recognized evaluation standard, seeking advice from the MDBs and select environmental NGOs and universities. The standard would provide a guideline for governments and contractors to prioritize the execution of projects.

3) ***Better risk allocation between the public and private sectors should enable projects to be built more efficiently and cost-effectively***

Given the fiscal constraints many countries face, creating more consistent and transparent procurement methodologies that allocate risks (both financial and environmental) to the party best able to manage that risk will reduce the overall costs of infrastructure and result in more effective contractual solutions. This might require changing regulations and tax incentives in the country to create more investor stability[27]. The methodology and guidelines should be prescriptive, to enable countries to undertake a multistakeholder project risk assessment, including how to price and allocate construction and operational risks of infrastructure.

Different procurement approaches include management contracts, concessions or opening the service up to the market. Costs are reduced (or quality improved) for two main reasons:

- Optimal risk allocation (including shared risks and rewards) can speed up the procurement process, lowering risk premiums, due diligence costs and therefore the overall cost of infrastructure.

[26] Because of the high costs of building new generation capacity and high voltage electricity grids, governments need to take a very long-term view when designing their national plant and grid infrastructure. For example, when strengthening a connection between regions, it might be better to accommodate sufficient capacity for the next 10 or even 50 years.

[27] Having an energy plan with clear risk allocation and a sensible pricing structure should incentivize energy supplies and demand to be more balanced. Many renewable energy technologies involve technology not previously deployed in the country. New UN mechanisms – the Green Climate Fund, the Technology Mechanism and Nationally Appropriate Mitigation Activities (NAMAs) – offer key channels for pooling and targeting public and private sector resources into infrastructure investments.

- By attracting more investors and major construction companies, there will be greater competition that will drive costs down and improve quality. Greater competition should also help reduce the equity and debt costs as more banks will be prepared to lend to the sector and hold loans (i.e. the project finance syndication market should re-emerge, allowing banks to more effectively diversify their risks).

Designing projects with a risk/return profile that is compatible with market requirements and stimulates enough competition can be challenging, and in some countries there is a need for risk management and project planning capacity to be enhanced to achieve an optimal solution. The private sector would welcome the opportunity to engage with government to explain its concerns and proactively propose solutions to develop the risk framework. For example, in cases where PPPs are the appropriate procurement route, governments and MDBs will typically retain *"political and regulatory*", currency and interest rate risks, with the private sector retaining the design, construction, operational and some of the financing risks.

As indicated, the outcome of the risk evaluation exercise may well entail the need for governments to change regulations and tax incentives in the country. Combining the risk assessment and allocation processes with the whole life-cycle performance analysis might also highlight the need for some government or MDB "*pump priming"* in a sector, for example increasing use of government and MDB guarantees, loans or subsidies. Many countries have national development banks to provide this support. For example, in the next three years, the Brazilian Development Bank is planning to invest an additional US$ 340 billion in national infrastructure projects and infrastructure related to the upcoming World Cup and Olympics. For certain untried technologies, governments also are considering jointly investing equity to reduce investor exposure.

It is also important for all parties concerned, including the private sector, to adopt clear risk mitigation strategies, e.g. designing modular networks, allowing extra space for expansion, designing infrastructure that is robust to potential climate change and securing performance guarantees from subcontractors.

The following stakeholders have roles and actions to perform:

Government: Responsible for engaging with stakeholders in identifying ways to allocate risks that make projects more viable and bankable for investors and preparing risk mitigation strategies for the risks government is retaining. For example:
- In projects involving traffic/demand risks, government can assume the macroeconomic risks and uncertainties that the private sector cannot easily price or insure
- Where necessary, certain catastrophic natural hazards can be assumed by government
- Changing necessary regulations and tax incentives in the country to create more stability for investors

Private sector: Responsible for developing innovative solutions to reduce the cost of projects and advice on preparing risk frameworks. For example:
- New financial products are being launched where a single financial company will undertake detailed due diligence of a project, and package the debt to achieve a better credit rating and hence lower the cost of debt
- New technological, process and risk assessment and mitigation approaches

G20: It is recommended that the G20 create a task force to consider appropriate project risk frameworks and risk management/mitigation strategies and guidelines for governments and the private sector. The guidance should include the project management techniques required to manage the construction and operation of infrastructure.

Recommendations to help deliver infrastructure more effectively and efficiently

4) ***Governments need to provide the enabling environment and the necessary mechanisms to help execute the selected projects***

Even when an Infrastructure Plan has been agreed, the amount of effort to execute infrastructure projects is considerable. For example, regulations and policies may need to be changed, disputed resolution procedures codified, cross-departmental agreements sought, *"right of way"* and planning permissions gained, output specifications defined, procurement routes finalized, risk mitigation strategies adopted, engagement with interested stakeholders undertaken, any financial support or guarantees provided and building progress monitored. These actions will strengthen the enabling environment and offer the private sector greater certainty.

Directing resources to effective project management and control generates significant cost and time savings, but building this capability and capacity is often not treated as a priority. It is recommended that:

- To save time, maintain project momentum and avoid cost inflationary pressures, relevant public sector bodies (for example, those responsible for planning decisions) should have clear lines of swift delegation, not only within their ministry, but also between ministries. One solution is for countries to set up a government ministry or implementation unit that has power conferred by the prime minister/president to drive the process.
- Clear dispute resolution processes are formulated to cover the cases where contractual issues arise.
- In developing countries lacking the necessary institutional and legal systems, NGOs and the private sector can partner with governments to help them achieve their goals.
- If the public sector does not have requisite project management and other technical skills such as the ability to manage PPPs, it should put in place intensive training courses and/or employ highly trained external project managers and consultants. For example, the South African Treasury Department established a PPP unit to provide technical assistance and staff to local governments and municipalities. Money spent on running a well-managed procurement is probably the biggest "*quick win"* governments can make to reduce costs. The private sector would welcome the opportunity to assist, recognizing that well-managed procurements benefit all concerned.

The following stakeholders have roles and actions to perform:

Government: Ensure that projects are properly managed and implemented, which may involve enacting new regulations.

Private sector: Offer expertise and resources in project management and procurement, and assistance in capacity building within government and strengthening the rule of law.

Civil society/NGOs: Possibility of assisting with capacity building of governments.

G20: The G20 should sponsor an information dissemination unit or rely on a recognized project management professional association to provide project management information and details about best practice project management. For example, governments should have and use indicators for monitoring and evaluating infrastructure projects.

5) ***Multilateral development banks should focus on accelerating project delivery***

MDBs have different approval criteria than commercial banks. These approval processes can often be very lengthy, slowing project implementation and adding costs. In some cases the delays are understandable, for example due to the additional environmental and social due diligence criteria that MDBs require, but often the delays are due to internal approval processes. Approval processes in MDBs should be streamlined and made more commercial.

While different MDBs have different investment priorities, if two MDBs are prepared to invest in a project, then one MDB should be appointed the lead arranger and conduct all the due diligence and negotiate terms. If the project passes the lead arranger's credit committee/board, then the other MDB should "*rubber stamp"* the authorization. For example, the Asian Development Bank is piloting a project design facility that aims to harmonize the World Bank and its own approaches. It is intended that the facility will speed up the project formulation and design phases of projects and provide more realistic project cost estimates, thereby reducing the need for loans with large contingencies. There are other cases during the financial crisis where individual MDBs transferred some of their risk appraisal practices and knowledge to commercial banks.

The following stakeholder has roles and actions to perform:

G20: The G20, as partial owners and funders of MDBs, should encourage national-level governments to engage with MDBs to discuss how MDB processes can be accelerated.

6) **Multilateral development banks should increase the use of guarantees (as opposed to loans) to increase market liquidity**

If an MDB lends or provides a guarantee to a project, this sends a strong signal to the market that significant due diligence has been performed. The investment is then regarded by the financing market as having lower risk. By providing a loan, the MDB may well be providing funding liquidity that could just as easily have been provided by a commercial bank. Structuring guarantees in innovative ways to leverage commercial lending is a valuable alternative way of participating.

The following stakeholder has roles and actions to perform:

G20: The G20, as partial owners and funders of MDBs, should encourage increased use of innovative MDB guarantees to increase market liquidity and help re-establish a thriving infrastructure investment market.

7) ***Governments should focus on smaller "quick-win" infrastructure projects within their country while being pragmatic and engaging in realistic, trans-border projects***

Trans-border projects (e.g. rail networks) often get delayed by complexities and the need for multiple approvals, for example by planning authorities in each country and by government departments responsible for technical designs and details. For countries with little experience in procuring infrastructure, it is recommended that local capacity and expertise is nurtured and fostered by focusing on relatively small quick-win projects – that is, infrastructure projects that are not technically complex and are deliverable within shorter timeframes.

As a country develops a track record in infrastructure, or already has a track record, it should retain the principle of keeping infrastructure ambitions manageable. Where new technologies or new procurement methodologies are required, pilot projects should be built before scaling up the project. Where trans-border infrastructure is a national priority (e.g. a road upgrade), countries should engage with one or two other neighbouring countries that also have a history of project success. For example, by creating the necessary infrastructure and subsequently importing gas from Mozambique, South Africa generated economic growth for both countries.

The following stakeholders have roles and actions to perform:

Government: Depending on the economic circumstances in the country, it is recommended that governments focus initially on the quick wins within the country. Then, with procurement experience and capacity in the country, governments would be advised to keep projects manageable and scalable when considering larger projects and cross-border projects.

Private sector: Timeliness of execution is essential in delivering quick wins. The private sector should be able to distinguish this class of projects from other, larger and more complex infrastructure investments and apply strict cost and schedule controls.

8) ***Governments should undertake a country-level infrastructure readiness/attractiveness self assessment***

To allow governments and stakeholders to reliably assess their country's infrastructure attractiveness, the use of an agreed multidimensional measurement methodology should be encouraged. The proposed approach is to provide a methodology for governments to gather subjective (or perceptual) views from key stakeholders (e.g. NGOs, civil society and construction companies). The methodology would enable a rigorous evidence-based understanding of the institutional, legal and financial environment for a country's infrastructure, and will then assist the country prioritize the steps needed to meet its infrastructure requirements over the coming years.

The results would provide value to all stakeholders: for investors, a measurement of investment attractiveness and project opportunities; for other private sector partners, a measurement of technical and operational capacity; for civil society, a measurement of societal readiness; and for government, a diagnostic to focus on improvement and how to attract infrastructure developers/investors.

Several methodologies have already been developed that could serve as a basis for discussion, such as the World Economic Forum's Infrastructure Private Investment Attractiveness Index and Global Competitiveness Index, and the CG/LA Country Infrastructure Capacity Model. Furthermore, such methodologies can also embed a number of discussion elements that capture the potential benefits of infrastructure development (improvement of health, restraint of poverty, etc.).

The following stakeholder has roles and actions to perform:

G20: The G20 should set up a task group to develop a methodology to assess a country's infrastructure readiness/attractiveness. The G20 should then promote country-level self-assessments using the methodology, thereby allowing the country to better evaluate opportunities and risks.

III. Proposed Actions in Cannes

If countries have well thought through, actionable and deliverable infrastructure plans, they will be able to secure more funding and interest from engineering, procurement and construction companies. This will reduce the cost of national infrastructure. If this infrastructure is strategic in nature and is aligned to the country's economic, social and environmental priorities, the infrastructure will then spur economic growth.

Many of the G20 Working Group's recommendations are therefore directed at the country level. However, out of the recommendations, six are proposed for action by the G20 in Cannes:

- The G20 should encourage governments to engage in multistakeholder dialogue with the private sector and civil society/NGOs in all phases of infrastructure planning, development and implementation to enable more cost-effective and efficient development of infrastructure that also addresses environmental and societal concerns.
- Due to the challenges of evaluating the whole life costs and environmental impacts of infrastructure, it is recommended that the G20 set up a working group to consider the formulation or adoption of a recognized evaluation standard, seeking advice from the MDBs and select environmental organizations.
- It is recommended that the G20 create a task force to consider appropriate project risk frameworks and risk management/mitigation strategies and guidelines for governments and the private sector. The guidance should also include project management techniques required to manage the construction and operation of infrastructure.
- The G20 should encourage national governments to engage with MDBs to discuss how MDB processes can be accelerated.
- The G20 should encourage increased use of innovative MDB guarantees to increase market liquidity and help re-establish a thriving infrastructure investment market.
- Building on the work that already exists, the G20 should set up a task group to develop a methodology to assess a country's infrastructure readiness/attractiveness. The G20 should then promote country-level self-assessments using the methodology, thereby allowing the country to better evaluate opportunities and risks.

World Economic Forum G20 Working Group on Reform of the International Monetary System

I. Framing the Issue

Background
Two developments have provided impetus for a reform of the international monetary system:

- First, the financial and economic crisis has exposed some weaknesses in the operation of the global monetary system which have contributed to the crisis.
- Second, the secular trend of a growing role played by emerging markets in the global economy. Their increasing importance should be reflected adequately in the international monetary system and its institutions, most importantly the IMF.

Against this background, and despite the rapid, concerted and beneficial actions taken by the G20 at the height of the crisis, improvements to the international monetary system appear justified. However, any changes must not only respond to what is economically warranted, but also respect what is politically feasible. Hence, any changes will probably be evolutionary and incremental rather than revolutionary. However, this does not mean that changes should be delayed as a recurrence of the weaknesses playing out must be avoided.

Design elements
The international monetary system is rightly called a "system", because it is composed of several elements which interact and must be compatible with each other:

- Rules for macroeconomic coordination and adjustment
- Securing international liquidity
- Defining the reserve medium
- Rules for international capital flows
- Design of the exchange rate regime

In addition, any regime designed at the international level must be compatible with policy preferences at the national level, as regimes will not be sustainable over the long term otherwise. Hence, an international monetary regime must satisfy three objectives in order to be both useful and enduring:

- It must be economically effective and efficient, delivering the public good "international financial stability".
- It must be perceived as internationally legitimate by giving due voice and influence to all players and by distributing the costs and benefits between participating countries in a manner perceived as fair.
- It must be perceived as legitimate and fair at the national level, and be compatible with domestic policy interests.

A stable international monetary system requires meaningful reform that will inevitably limit policy discretion for individual countries, including those of systemic relevance, for the sake of the common good, which will eventually result in more robust and sustainable economic growth for all countries. This may include restraining national policy choices by means of the multilaterally agreed rules, even if alternatives are considered preferable in the short-term by national electorates.[28] At the domestic level, these policy constraints on national economic policies must be acceptable to national electorates.

Deficiencies of the status quo
The financial crisis highlighted the following deficiencies in the operation of the current international monetary system. Many of these shortcomings are interrelated, pointing to the fact that any attempt to improve the structure and functionalities of the current regime must be construed as a comprehensive approach that addresses several issues simultaneously.

- **Balance of payments imbalances:** Balance of payments imbalances contributed to the development of the crisis. While the potential negative repercussions of large and persistent balance of payments

[28] To illustrate: Prior to the crisis, policy choices in the US – geared at increasing domestic consumption at the expense of greater indebtedness to foreign creditors – was not only compatible with policy preferences of the domestic electorate, but also compatible with policy choices in those surplus countries (in Asia, the Middle East and, to a lesser extent, some European countries) that accumulated claims on the US. However, both policy courses were clearly unsustainable from the point of view of global stability and should have been restrained by international rules – which, however, were considered inacceptable to national policy-makers.

imbalances were known, there were neither automatic nor political mechanisms that would have enabled the reduction of these imbalances. Underlying these balance of payments imbalances were unsustainable patterns of spending and saving, respectively, across countries. While rational from the perspective of each country, the collective outcome of such patterns is that the global economy as a whole runs the risk of abrupt and costly corrections. National policy frameworks, acting on their own, are insufficient to correct such imbalances and the current international framework for multilateral policy coordination is too weak to enforce action.

- **Excess reserve accumulation:** Related to the first issue, an extremely high accumulation of reserves occurred. This was a reflection of as much as a cause of the current account imbalances. Reserve accumulation had two motivations: On the one hand, they reflected a conscious policy by several countries to manage their respective exchange rates. Specifically, many countries in Asia have aimed at keeping their exchange rate low vis-à-vis the US dollar to support export-led growth models. On the other hand, reserve accumulation served as a means of self-insurance against potential balance-of-payments crisis. The latter reflects that, for many countries, recourse to IMF assistance has not been an adequate and acceptable alternative to self-insurance by means of reserve accumulation. In particular, many countries resented the prospect of being subjected to IMF conditionality. However, the remedy chosen aggravated the imbalances, as the scale of reserve accumulation was far in excess of the resources required for self-insurance.

- **Exchange misalignments:** Some exchange rates have been marked by persistent, substantial misalignments, without there being an automatic or, at least, a workable discretionary mechanism to remove these misalignments.

- **International capital flows:** There is a lack of consensus on appropriate tools to promote international capital flows, both with respect to inflows and outflows, while maintaining economic and financial equilibria. The renewed debate on the usefulness of capital controls is a reflection of this reality.

- **Provision of international liquidity:** The provision of international liquidity is currently based on a non-systematic regime of *ad hoc* measures in the shape of discretionary SDR allocation, bilateral swap arrangements between central banks, and regional arrangements. While it could be argued that these *ad hoc* measures have been successful in the crisis to forestall an even deeper global recession, it is undoubtedly true that relying on *ad hoc* measures is a sub-optimal way of running the international monetary systems and creates uncertainty in times of market stress and crisis as market participants question whether such ad hoc action will be forthcoming or not.

- **Representativeness/legitimacy**: Recent (re-)allocations of quotas and voting rights were an important step towards addressing the issue of voice and representativeness at the IMF which has emerged in response to the rise of the economic and political weight of emerging markets in the global economy. In other areas, e.g. the selection process of the IMF leadership, political commitments for procedural changes still have to be fully translated into practice.

II. Key Policy Messages

Based on the aforementioned analysis, the working group wishes to submit the following recommendations:

a) Macroeconomic coordination and adjustment

- There is a need to internalize the externalities of national policy choices. That is to say that a mechanism needs to be developed by which countries can agree more effectively than in the past on a collective approach to develop and pursue mutually compatible courses of economic policy and choices of economic actors.

- In this context, it is important to realize that market discipline, while effective, primarily comes to bear in the case of deficit countries (unless their status as a reserve currency allows them to defer such an adjustment), but does not exert influence on surplus countries and is unable to respond to the collective impact of imbalances on the global economy as a whole. Furthermore, even in the case of deficit countries, market discipline is often slow to materialize – and when it does finally materialize the economic and social costs of adjustment are substantial, especially in EM deficit countries.

- The IMF's multilateral surveillance is a useful tool to highlight potential incompatibilities in the policies of IMF member states. Similarly, the Mutual Assessments Programme (MAP), launched by the G20 at the Pittsburgh Summit, and the "G20 Indicative Guidelines", which build on the MAP and were agreed at the

G20 Finance Ministers' and Central Bank Governors' Meeting in April 2011, are useful steps towards identifying incompatible national policies *ex ante* and towards reducing the likelihood of massive balance of payments imbalances. These processes will help to establish a shared analysis of the problems created by national policies and the autonomous decisions of households and companies. The value of such a shared analysis should not be underestimated, as it can help to galvanize a common set of thinking among political decision-makers. Too often in the past, political action has not been forthcoming because policy-makers had different views of the underlying realities.

- In addition to identifying actual and potential spillover effects, i.e. the external dimension of imbalances, Art. IV must highlight the domestic policies and structures that give rise to such imbalances in the first place, i.e. the national dimension of imbalances. A special aspect to this is the issue of imbalances *within* currency areas, which, if left unattended, can ultimately give rise to external problems as well.

- However, while processes such as the MAP and the Indicative Guidelines can help to elucidate the potential repercussions of national policy choices, they can, by themselves, not prevent mis-developments nor rectify imbalances. Mere indicative guidelines are not sufficient, as governments will always choose to ignore them if opposition to them arises in the domestic policy context.

- Hence, the economic policy guidelines developed in the "G20 Indicative Guidelines" ultimately need to be hardened. The agreement on a set of guidelines for economic policies is an important step towards an evidence-based discussion of adjustment needs and an identification of needs for action by governments and other authorities, such as central banks. Indeed, we would note that the private sector, especially the financial industry regularly benchmarks countries' performance against such indicators to assess investment risks and opportunities. This analysis is geared not only to assessing the creditworthiness, but also to the sustainability of economic policies pursued by individual countries. Similarly, inspiration could be drawn from recent decisions within the EU and the euro zone for a more stringent framework for macroeconomic policy coordination based on clearly defined indicators.

- Multilateral surveillance and the MAP, as preventive instruments, must be complemented by mechanisms for an orderly adjustment of imbalances. We suggest that the following mechanisms might be conducive to make the preventive tools, currently available to the IMF, more effective:

  - Art. IV of the Articles of Agreement should be amended to codify explicitly that Art. IV surveillance must be comprehensive. Presently, Art. IV explicitly mentions only a country's exchange rate arrangements as the subject of Art. IV consultations. As mentioned above, this, however, is too limited, given the wide range of potential causes for imbalances that comprise both external and domestic policies and structures. Hence, a revised Art. IV should explicitly refer to domestic policies and economic structures that might have a bearing on external imbalances, internal imbalances, financial sector issues and exchange rate arrangements.

  - The IMF should become more autonomous in its Art. IV reports. While IMF member states should remain free to comment on Art. IV reports, the IMF should be fully entrusted to publish its assessment without clearance by the country concerned or the board of directors.

  - To facilitate a comparison of Art. IV reports across countries, it would be helpful if each Art. IV report contained a standardized table of key performance indicators that allow for an assessment of the sustainability of economic policies. The parameters used for the "Indicative Guideline" could be a useful starting point. A traffic light approach might be a useful instrument to indicate concerns.

    An important pre-condition for the effectiveness of such comparative analysis that the indicators used is gathered on a harmonized statistical basis in order to be comparable. For example, the definition of an indicator such as public debt/GDP needs to be fully aligned as regards the inclusion of exposures from swap arrangements and that of sub-sovereign debt.

    In this context, note should also be taken of the fact that enabling market participants to better assess sovereign risk by themselves on the basis of reliable assessments provided by the IMF would, as a side-effect, contribute to reducing investors' reliance on external ratings provided by rating agencies.

  - No matter how well structured and well-targeted such a framework is, the main challenge lies in implementation and enforcement. The MAP must be complemented by mechanisms that increase the likelihood of measures being implemented. Specifically, the MAP needs to be embedded in a stringent peer review procedure which identifies those countries in need of action and creates a disciplined approach for them to take action or explain why action is not being taken (“comply or explain”). Commitments to comply with the recommendations could be published, which would result in greater market discipline, as governments would then more easily be held accountable.

- Imbalances usually reflect underlying structural deficiencies. Consequently, short-term policy measures, in both deficit and surplus countries, aimed at correcting imbalances must always be embedded in a broader policy-approach that address these structural deficiencies. Specifically, deficit countries should not only pursue austerity policies but should complement these with structural policy reforms that create conditions for structurally higher growth rates and higher domestic savings. Similarly, surplus countries need to explore policies that increase domestic consumption and lower domestic savings; a reform of social security systems which allows households to lower their private savings might be one such measure. More generally, specific country circumstances such as the economic structure will need to be part of any comprehensive analysis of the causes of imbalances as well as measures to address these.

- Incidentally, a thorough analysis of the underlying reasons for imbalances will also help to highlight differences in policy focus. For instance, while at the global level, much of the focus is on surplus countries, in Europe the policies of deficit countries are in focus. It will also help to enable a more differentiated analysis of imbalances, as regards their underlying causes and sustainability. For instance, in the case of surplus countries it would differentiate whether reserve accumulation resulted from authorities’ intervention in currency markets or from the export prowess of private-sector firms. Similarly, imbalances can reflect demographic developments which make it appropriate, indeed advisable for ageing economies to accumulate claims on growing economies, which can be drawn down at a later stage with a view to smoothing inter-generational consumption.

- More flexible exchange rates, especially in those countries that account for sizeable shares in the global economy, will play an important role in orderly adjustment processes. It is therefore desirable to chart a roadmap for greater exchange-rate flexibility in those countries that hitherto have managed their exchange rates. In this context, greater exchange rate flexibility does not necessarily mean a transition towards a regime of fully flexible exchange-rates, universally applied in all countries. Rather, it denotes a regime in which any exchange-rate regime – floating, managed, fixed – is flexible enough to avoid massive and lasting misalignments of a country’s real (effective) exchange rate. These changes and adjustments should take place along a predictable path, in order to avoid the significant economic disruption that a rapid re-pricing of currencies would cause.

b) Securing international liquidity

- A credible and sufficient availability of international liquidity is not only necessary to deal effectively with balance of payments crises, should they occur. It is also an effective means to reduce the likelihood of imbalances occurring in the first place: The more countries feel comfortable with the availability of international liquidity and, equally important, the conditions for access to it, the less they will resort to excess reserve accumulation as a means of self-insurance. Such national safety-nets (reserves) have increased dramatically relative to collective safety-nets (IMF facilities) over the last decade. This process should be reversed. Recent initiatives taken by the IMF to re-adjust the facilities available to member states (i.e. the Flexible Credit Line, FCL, and the Precautionary Credit Line, PCL) as well as the framework of ex ante and ex post conditionality attached to these have been helpful in this respect and, in our view, strike the right balance between the need for conditionality that safeguards the interests of IMF creditor countries and deficit countries. However, in spite of the efforts to re-adjust the facilities, only three countries resorted to the FCL during the recent crisis. Perhaps because many countries had accumulated large amounts of reserves, the FCL was perceived as unnecessary. Another explanation might be that this facility inevitably came with the stigma associated with having to turn to the Fund for assistance. It is important to analyse these three experiences to better address the stigma problem, so that countries feel more comfortable with precautionary borrowing.

- Regional initiatives, such as the Chiang Mai Initiatives or the European Stabilisation Mechanism, ESM, can complement the multilateral system. Specifically, the bilateral swap agreements established on an ad hoc basis between central banks at the height of the crisis have been useful in dealing effectively with the closure of access to foreign currency funding that many financial institutions were facing at the time. While efforts must be made (indeed, have been made) be by financial institutions to address the underlying cause of this problem – i.e. inappropriately large currency mismatches on their balance sheets – such mismatches are to some extent a logical corollary of internationally integrated financial markets. Therefore, on a limited scale, permanent bilateral swap agreements could be an important feature in a broader framework for international liquidity.

- Regional arrangements for international liquidity are an expression of closer economic ties in certain regions. In addition, as they are an expression of a willingness to coordinate economic policies more closely than is possible at the global level, they offer the opportunity to embed the liquidity arrangement into a broader framework of policy coordination aimed at reducing the likelihood of economic imbalances occurring in the first place.

- However, regional arrangements suffer from three weaknesses: Firstly, by definition they run counter to a multilateral approach and have the potential to undermine global governance structures. Secondly, regional arrangements, too, require surveillance. But (outside of the EU) there is no such tradition and hence only weak enforcement. Thirdly, a grave crisis could overwhelm regional arrangements. To counter such potential deficiencies, it is desirable that the IMF be part of such a system in order to ensure that these regional systems are compatible with the multilateral approach.

- Management of international liquidity must work in both directions: not only is it necessary to ensure that there is sufficient liquidity in times of crisis; it is also necessary to ensure that international liquidity is withdrawn if it threatens monetary stability. The Working Group welcomes that IMF members were willing, at the height of the crisis, to bolster the confidence of economic actors in the stability of the global economy by means of an unprecedented special allocation of SDR. But this willingness and ability to increase global liquidity on an ad hoc basis needs to be balanced by a formal mechanism to assess whether any given level of SDR allocation is still justified by economic circumstances. However, outside of the rather routine exercise of regular SDR reviews, the IMF lacks a formal format for the potential withdrawal of such special SDR allocations. Such a mechanism should be established. One idea would be to task the FSB, in the context of its role as the global macro-prudential supervisor, to make an assessment of the adequacy of global liquidity and to make, if deemed necessary, recommendations on adjusting the amount. Another (non-exclusive) idea would be to have the IMF conduct a review if a certain quorum of member states – say 20% of IMF quotas – request such a review.

c) Reserve currency arrangements

- Essentially, two parallel processes are currently under way regarding reserve currency arrangements.

  - On the one hand, there is a more technical discussion on the inclusion of the RMB in the basket of currencies constituting the SDR.
  - On the other hand, there is a broader debate about the gradual shift of the global monetary system from a dollar-based system towards a multi-currency monetary system.

- As regards the former, this is already under discussion in the international community. We support these efforts as they will help to put the global monetary system on a more balanced footing and will help to enhance the representativeness of the system. However, we note that a pre-condition for an inclusion of the RMB in the SDR basket is the full convertibility of the RMB. A path should be set that charts pre-conditions and mile-stones for the inclusion of the RMB into the SDR.

- As regards the latter, the development of the reserve currency regime will ultimately depend on the choices of economic actors and thus be the result of a market-led (and presumably lengthy) process.

  - A global monetary system in which the role of the reserve currency is based more broadly than is the case in the present system is a logical corollary of the shifts in the economic weight amongst national economies. It also reflects a geographically more balanced structure of trade, production and investment at the regional level which creates incentives for countries to re-balance their currency reserves in light of these interlinkages.

  - A multi-polar reserve currency regime will be possible only if financial markets in those currencies currently used less become deeper and more liquid. Hence, the development of financial markets (indeed, in some cases the transition to full convertibility) will be a pre-condition for this process. Indeed, we would note that the share of the USD in international currency reserves has already started to decline; this, in our view, is a reflection of the greater attractiveness of non-dollar capital markets.

  - Compared to the dollar-standard, the transition towards as well as the existence of a multi-polar currency regime can, theoretically, be marked by greater instability, as major shifts in reserve currency allocation – and ensuing capital flows – can occur. Consequently, in a multi-polar currency regime, predictability, sustainability and transparency of economic policies by reserve currency countries (areas) become even more important.

- The role of the SDR in such a multi-polar regime is open. A case can be made that SDR might help to smooth the transition from the current system to a multi-polar regime. However, irrespective of what IMF member may decide concerning the official use of SDR, the extent to which SDR are used by private actors should be left to the autonomous decisions of private-sector market participants. Private-sector initiatives that would foster the private use of SDRs should be supported by the public sector.[29]

d) Capital controls

- Full capital account liberalization and free capital flows continue to remain a desirable objective of economic policies. This holds true for short-term capital flows as much as for long-term capital flows in the shape of FDI, where ownership restrictions are still prevalent in many countries. Policies that discourage FDI are especially of concern from the perspective of financial stability, as these long-term capital flows have proven to be particularly stable.

- Free capital flows are in the interest of capital exporters – among them ageing societies that aim at investing present income in fast-growing economies as a means of inter-temporal consumption smoothing – and in the interest of capital importers that aim at financing investment or at bridging temporary shortfalls in income. Hence, policy-makers as well as the IMF should continue to strive to create the pre-conditions for a smooth development of international capital flows.

- Two important pre-conditions for these are:
  - (1) An adequate and effective supervisory system that has sufficient capabilities to analyse and, if necessary, control financial risks. Macro-prudential supervision is an important part of supervisors' tool-box in this respect.
  - (2) The development of local financial markets, especially local bond markets. The deeper and more developed domestic financial markets are, the easier it is to smoothly absorb capital inflows and withstand capital outflows.[30] Ongoing efforts, supported i.a. by the IMF and multilateral development banks and aiming at developing local financial markets, are therefore strongly supported. Financial firms stand ready to support such initiatives with their expertise.

- However, there can be circumstances in which international capital flows can be unstable and disruptive. In such circumstances, capital controls, especially on short-term flows, can be an effective tool to deal with distortions and a useful element to deal with the instability of capital flows.

- However, it is necessary to differentiate between controls on capital inflows and controls on capital outflows on the other hand, as their impact on investment decisions and investor confidence is different. In the case of controls on capital inflows, investors know the rules of the game and make investment decisions with complete knowledge of the impact of the controls on their investment. In contrast, controls on capital outflows constitute an ex post change to the original investment case and therefore undermine the original investment rationale. As such, controls on capital outflows are much more disruptive and should be strongly discouraged.

- Capital controls can have distortive effects. They hinder the ability of financial institutions, and financial markets more broadly, to intermediate efficiently and effectively and thereby to allocate resources to their most efficient use. Hence, their use should be limited. In particular, capital controls should only be used for limited time-spans. Moreover, countries that impose capital controls should be required to notify the IMF, clearly stating the rationale, objective and likely duration of the measures taken. The IMF should be tasked with monitoring the effectiveness of the measures taken by any member state; based on this it should report regularly whether the measures are adequate and still justified. Its assessment should explicitly include an analysis of the spill-over effects of the measures on other jurisdictions.

- Furthermore, it needs to be recognized that capital flows respond to economic incentives set by macro-economic policies. Therefore, the management and surveillance of capital controls must be embedded in

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[29] One example would be the issuance of SDR-denominated bonds.
[30] This might be called the „big fish, small pond" problem: While it is rational and desirable that institutional investors – which overwhelmingly still reside in large, developed economies – diversify their portfolios and invest a greater share of assets in emerging financial markets, such capital inflows can quickly overwhelm an illiquid, small market.

a broader framework of analysing the underlying causes of capital flows, in particular monetary, fiscal and financial sector policies. An effective intertwining of this analysis with macro-prudential supervision is desirable given the pivotal role that financial systems and institutions play in intermediating cross-border capital flows. For instance, if excessive capital inflows reflected local asset price bubbles, in which foreign investors wished to participate, then addressing these capital inflows by means of supervisory tools (e.g. higher margin requirements, lower LTVs, etc.) or the use of monetary and fiscal policy measures can be more effective and less disruptive to international capital flows than the use of capital controls.

e) Delineation of tasks

- Mandate of the IMF on financial regulation: The IMF should refrain from entering into the area of financial rule-making. Rule-setting should be coordinated by the FSB, which has proven itself as an effective coordinator of G20 activities in the field of financial regulation. This delineation of task should be strictly maintained to avoid duplicative efforts and inconsistent messages to economic actors

- Similarly, the FSB, as agreed upon by G20 countries, should be entrusted with macro-prudential supervision at the global level. Importantly, in this role the FSB needs to coordinate effectively with other macro-prudential supervisors so as to avoid contradictory analyses and messages to financial markets.[31]

- The IMF has an important role in assessing the stability of financial systems in IMF member states. The Financial Sector Assessment Programme (FSAP) should be seen as a natural complement to the MAP surveillance, as real economy imbalances often have their origin in financial sector imbalances and, vice versa, real economy developments can affect the stability of financial sectors.

f) IMF governance

- The recently agreed (re-)allocations of IMF quotas are an important step towards responding to the shifting balances in geopolitical and economic power. However, given the pace of this re-balancing in the global economy and considering the tortuous process of arriving at quota reform, it would seem advisable to have a more automatic process of re-balancing IMF governance structures, quotas and voting rights. In addition, in other areas, e.g. the selection process of the IMF leadership, political commitments for procedural changes still have to be fully translated into practice.

- While the perception of fair governance structures increases the legitimacy of an institution such as the IMF, we would emphasize, though, that greater voice also comes with greater responsibility. It is our expectation that countries that are more influential in international institutions, such as the IMF, feel particularly committed to bringing into line their policies with internationally agreed standards.

- Greater representativeness must not come at the expense of effectiveness.

Improving Financial Market Characteristics

The issue

Market developments over recent years have underlined that financial markets are prone to exaggerations and herd behaviour. Financial markets are susceptible to self-reinforcing effects which can accentuate upward and downward movements. Underlying these phenomena is the fact that financial markets are on the one hand guided by fundamentals and on the other hand comparable to “beauty contests” in which investors’ actions are guided by those of other investors – making the system self-referential.

The relative balance between investors trading on the basis of fundamentals and uninformed noise traders following the herd depends on several factors. One such factor are market structures, such as the prevalence of algorithmic trading that follows market trends; another is the relative importance of investment strategies: thus, for example, it is obvious that a dominance of passive investment strategies would tend to favour herd behaviour in markets. Furthermore, the financial crisis starting in 2007 has undoubtedly left many market participants bereft of mental models that previously guided their investment decisions. Such models, which substitute fundamental analysis and rational decision-making with heuristic decisions based on experience and knowledge about historically applicable correlations and patterns of reactions, have, in the eyes of many market participants, become useless in the crisis. Many market participants may therefore be more inclined to follow market trends and the actions of other investors.

[31] In fact, the same point holds true for other macro-prudential supervisors which are currently being established at the national or EU level. Their messages, too, need to be aligned.

Recommendations
To avoid market disruptions and excessive movements of asset prices and volumes, it would therefore be desirable to strengthen the weight of fundamentally-driven investors with a long-term investment perspective. This will help to stabilize investment flows, thereby dampening the volatility of asset prices and the likelihood of bubbles.

Measures to achieve this would appear to be the following:

- First, macro-prudential supervision which is now being established as an explicit supervisory tool in many jurisdictions will undoubtedly be helpful to deal with the issue of herd behaviour. Macro-prudential supervision is explicitly charged with identifying and addressing financial imbalances. As a preventive tool, it can therefore help to act as a stop to herd mentality, especially in the building-up of asset price bubbles.
- Second, market participants themselves should, in their own interest, include the systemic consequences of new products and investment strategies in their product approval processes and risk assessments. Again, the systematic dialogue that will probably be established between macro-prudential supervisors and the industry may help to foster such a development. However, industry itself should collectively address these issues as well.
- Third, trading platforms should ensure that algorithmic trading systems are being stress-tested with respect to their systemic implications before being admitted to trading.
- Fourth, governments should intensify long-standing efforts to encourage long-term investment by increasing the importance of private pension systems and other forms of institutionalized savings. Insurance companies and pension funds tend to have a long-term investment horizon.
- Finally, regulation should eschew measures that discourage long-term investments. Thus, for instance, it might be considered counter-productive that Solvency II discourages insurers' investment into equity and long-term debt. Similarly, prohibiting CDS on sovereign debt will discourage investors from investing in long-dated government debt due to the lack of hedging options.

III. Proposed Actions in Cannes

We propose that G20 leaders advance the process of international monetary system reform at their Cannes Summit by agreeing to:

1. **Macroeconomic coordination and adjustment:** IMF surveillance, the Multilateral Assessment process (MAP) and the G20 "Indicative Guidelines" must be hardened to better ensure that national economic policy choices are compatible with multilateral objectives and the avoidance of imbalances. Specifically, we propose that:
   a. Art. IV of the IMF Articles of Agreement be reformed to explicitly broaden the mandate for the IMF to look beyond exchange-rate arrangements and include domestic imbalances, policies and other sources of potential instability
   b. … each Art. IV report contain a standardized table of key performance indicators that allow for the assessment of the sustainability of economic policies
   c. … the MAP be embedded in a stringent peer review procedure which creates a disciplined approach for countries identified in need of action on a "comply and explain" basis;
   d. ... countries that manage their exchange-rates chart a road-map for greater exchange-rate flexibility aimed at avoiding massive and lasting misalignments of real (effective) exchange-rates
   e. ... the IMF become more autonomous in its Art. IV reports

2. **International liquidity:** To ensure the provision of liquidity in times of crisis and to, simultaneously, reduce incentives for excessive reserve accumulation, multiple sources of international liquidity should be developed (further), incl. IMF precautionary lines, regional initiatives, and bilateral swap lines. To ensure the compatibility of these sources, the IMF should be given a coordinating role and set minimum guidelines for such initiatives. Furthermore, a formal format should be established for examining the adequacy, and, potentially, the withdrawal of IMF liquidity.

3. **Reserve currencies:** The development of local financial markets and the transition to full convertibility should be intensified and speeded up to create more alternatives to the US Dollar as international reserve currency. We stand ready to support efforts to develop financial markets.

4. **Capital controls** should only be used for limited time-spans; the IMF should be notified whenever they are imposed, clearly stating the rationale, objective and likely duration. Alternatives to capital controls, especially the use of macro-prudential policies, should be examined and used wherever possible. The IMF should be tasked to regularly report on the effectiveness and side-effects of capital controls.

IV. Contribution from the ICC G20 Advisory Group on Reforming the International Monetary System

Issue

The global economic crisis heralded, indeed accelerated, a transition towards a new world where emerging market economies play a large role on a par with advanced ones in driving global growth, a world that will be fundamentally multipolar and in which global monetary problems must be dealt with cooperatively.[32]

Analysis

The crisis caught many experts and policy-makers by surprise revealing vulnerabilities in the international monetary system. While these were principally in developed economies, their effects quickly spread to the entire monetary and financial system.

However, the crisis highlighted the need for effective international policy coordination. The G20 is a powerful response in this regard.

While the global economy may have avoided the worst of the crisis through the injection of massive amounts of fiscal and monetary stimulus, several broad issues regarding the current international monetary system remain, including the set of rules, norms and institutions that govern the world's currencies and the flow of capital across borders.

Dealing with these issues requires both fiscal and structural reform as one without the other is not sustainable in the long term. Structural reforms are critical at the micro level, including encouragement of innovation and reduction of youth unemployment.

In addition, G20 leaders should look to strengthen financial markets in emerging economies by developing capital markets and improving access to retail financial services to increase both domestic confidence and investment opportunities, both of which could stimulate consumption and help to offset global imbalances as well as reduce the risk of asset bubbles.

These are critical issues for business as increasing **global economic imbalances could lead to currency wars, bankrupt states and trade protectionism.** Moreover, persistent vulnerabilities remain in the international monetary system, including:

- Excessive economic imbalances, within both developed countries and developing countries. Currently, average government debt-to-GDP ratios in the G7 economies are at their highest level since the 1940s.

- Excessive exchange rate fluctuations. Since the beginning of generalized floating exchange rates in 1973, rates have failed to move consistently and have promoted imbalances.

- A need for more effective global governance to ensure that decisions are consistent and contribute to global stability. The International Monetary Fund (IMF), intended for this purpose, has not been able to achieve this task fully.

Recommendations

Excessive economic imbalances
Global liquidity conditions are influenced by monetary policy in major countries, exchange rates and innovation and risk-taking behaviour in the financial sector. Liquidity can change because of many conditions, including perceptions.

Thus a global approach is particularly difficult. One item which the G20 leaders can act on is enhancing economic surveillance to provide as accurate a picture as possible of economic flows and overall sustainable

[32] This paper draws extensively on the ideas contained in an article entitled "Beyond Bretton Woods 2" published in *The Economist* magazine of 6 November 2010; and on the report of the Palais Royal Initiative entitled "Reform of the International Monetary System: A cooperative approach for the twenty-first century", 8 February 2011.

economic development of an economy. G20 leaders must take into account that their countries' domestic policies interact and affect global stability and have spillover effects.

There also needs to be greater understanding and cooperation among central banks and finance ministries on macro policies that impact liquidity. Sound macro policies combined with time-limited interventions and capital controls may be effective to protect countries from large and volatile (short-term) capital flows, though measures should not create distortions and not affect countries negatively. The development of internationally agreed guidelines in this area would be critical, as well as joint monitoring to insure that interventions are limiting and not distorting. Working with the private sector is critical in this regard.

Excessive exchange rate fluctuations

Renewed leadership by G20 leaders to promote international exchange rate coordination is particularly important to avoid currency wars. Countries need to conduct their economic and fiscal policies with a goal to ensuring that exchange rates are broadly in line with market fundamentals and global balance. It should be recalled that, while IMF members, under its Articles of Agreement, have the right to choose their respective exchange rate policies, they also have a stated obligation to avoid manipulating exchange rates to secure a competitive advantage.

G20 leaders could consider making countries' obligations more specific, perhaps through the use of benchmarks to identify instability and misalignment. G20 leaders could further develop/integrate a joint monitoring system along the lines of that for capital controls to monitor excessive exchange rate fluctuations.

Global governance

In light of the experience of the recent crisis, further steps should be taken to make the IMF more receptive to being a global lender of last resort ready to act in a reliable, rules-based fashion with appropriate protections to limit moral hazard.

Rather than try to create a global reserve asset, G20 leaders might achieve more by reducing the demand for reserves. This can be done by improving countries' access to funds in a crisis. The IMF's lending facilities have already been overhauled so that well-governed countries can get unlimited funds for two years.

G20 leaders could develop a plan for rebalancing the world economy, perhaps with target ranges for current account balances and real exchange rates, supported by peer review rather than explicit sanctions.

A rebalancing plan would address many of the tensions in the monetary system. But shifting the resources of surplus countries from exports to consumption will take time. Meanwhile, capital flows into emerging markets are likely to surge much faster.

There is also a need for a more integrated architecture and decision-making structure in the international monetary system by developing a more formal framework for the relationship between G20 leaders and key intergovernmental financial institutions like the IMF. The IMF should play the role of neutral arbitrator in cases of exchange rate misalignments. It has the knowledge and authority to intervene more actively in disputes that cannot be mediated by individual countries. It also has a long track record of resolving various economic crises through multilateral coordination.

The economic crisis demonstrated that greater global coordination is needed. G20 leaders have taken the first steps in London and subsequent summits. It is essential that a reformed international monetary system should safeguard the gains of the past 65 years. We must ensure that whatever measures are taken preserve and indeed strengthen a system that maintains freedom of trade and current payments and that allows the benefits of financial globalization to be shared more widely.

World Economic Forum G20 Working Group on the Role of Business in Society

I. Framing the Issue

The challenges and opportunities confronting society today and over the next 5-10 years are immense and interlinked. These include historic shifts of economic activity to emerging markets; rapid and ongoing technology change; increased demand on limited resource supplies such as energy, food and water; increasing employment challenges (e.g. the need to create a large number of jobs for youth in developed and emerging economies); ageing populations in developed economies; and substantial fiscal and equity challenges on governments around the world. Each will put substantial pressures on leaders in both government and business.

We believe that these challenges and opportunities are too broad for any one sector or institution to tackle alone. These matters should not be left to government to resolve – business should take more responsibility and initiative to address them, working in partnership with government and civil society. As the B20 summit in Korea demonstrated, there is plenty of excitement on the part of business leaders to play this role.

As a task force, we have tried to identify a set of issues where we believe that business can make a difference and help put the global economy on a sustainable growth path. Our task force identified more than 20 broad ideas – but decided to focus on a few proposals where we believe the private sector can help accelerate a broader process and set of actions (and where we saw strong agreement).

We have outlined a set of recommendations in five areas. Four involve a much higher level of business-government cooperation to help deal with major issues and capture opportunities; and one involves business stepping up its game to act in a more long-term, multistakeholder manner. Our headline recommendations are as follows:

1. Improving Corporate Governance
Business and governments should collaborate on measures to help corporate boards focus on long-term value creation; work together on compensation systems to reward executives for long-term value creation; co-develop global corporate governance principles to satisfy all stakeholders of a level playing field; and establish a task force to propose measures to encourage longer-term investing. Business should develop a strategy that can help convey the public benefits of private enterprise, including how business is good for development and growth.

2. Building and Renewing Infrastructure
The world faces huge infrastructure requirements in the emerging and developed worlds, but we will not “get there” without substantial improvements in business and government cooperation. Business and governments should work together to establish independent national and regional bodies to identify overall infrastructure needs and evaluate and prioritize individual projects; and encourage flexible rules and contracts to reduce construction times, required capital and risk. Business should provide input on ways that governments can reduce barriers to private investment infrastructure.

3. Increasing Education for Employment
Creating jobs at scale is an imperative in both developed and emerging economies. Business, government and education providers, as well as labour unions should work together more closely to help identify job needs and requirements in each country. Specific recommendations include: the financial services sector helping to develop a policy environment that will better support SME financing; creating “learn and earn” opportunities for students, particularly girls, in occupations where candidates are in short supply, such as technical fields; companies and industry associations partnering with high schools, community colleges and universities to boost rates of post-secondary education and the number of graduates with job-ready skills (especially for women); and business, government and educational and training providers should create efficient programmes to enable middle-aged and older workers to retain and gain new skills faster, particularly in those countries that are ageing rapidly.

4. Increasing Energy Efficiency
Governments and businesses should implement national education and awareness programmes to help society understand real energy costs; and encourage industry associations to set voluntary industry-specific energy standards. Where possible, business should seek opportunities to collaborate with governments on

creating consumer incentives for energy efficiency. Governments should consider changing their approach to subsidies from broad price setting to direct subsidies targeted at the poor and selected industries.

5. Responsible Regulation
While business recognizes that more regulation is required in some areas, it is keen to provide more input and work more closely with government to ensure that regulation does not unnecessarily impede private sector investment and job growth. Specific recommendations involve asking for regular reviews by government of regulation on a holistic versus incremental basis to ensure that rules keep up with an increasingly dynamic environment and that cross-sector and second-order effects are fully taken into account. Efforts should be made to ensure that a level playing field is in place for all companies, including SMEs, by devoting greater resources to ensuring the consistent application and enforcement of regulation (e.g. by ensuring that regulators investigate how rules will affect different-sized firms). Business and the G20 should also work together on the future of international trade.

II. Key Policy Messages

1. Improving Corporate Governance

Context
- Trust in business hit historically low levels more than a decade ago and has deteriorated further during the recent financial crisis, especially in Western countries.
- While many factors triggered the crisis, the recession clearly revealed deficiencies on how businesses are governed.
- This realization has led to broad calls for improved regulation across many sectors and throughout the globe.

Challenges
- **Short-termism**: In an era when capital markets exert pressure for continuous near-term results, some corporate boards and executives tend to under-invest in efforts to plan for long-term value creation.
- **Transient investing**: The spike in equity churn in recent years by institutional investors and hedge funds has made it difficult for managers to know who company owners are, and for owners to know the business. Some short-term shareholders (the average owner now stays in a stock just seven months) essentially speculate on near-term company performance.
- **Effective oversight**: Instead of helping to insulate management from the pressures of transient owners, some corporate boards encourage the trend by compensating CEOs based on short-term measures.
- **Excessive leverage**: With corporate performance measured largely by earnings per share and returns on equity, management in some sectors has strong incentives to reduce equity to boost share prices and improve these metrics – even without any change in underlying corporate performance.

Recommendations[33]
- Business and governments should improve the ability of corporate boards to focus on long-term value creation. Options include:
  - Fiduciary duties are explicitly defined to guide corporate boards to maximize the long-term value of the company, rather than focusing on boosting short-term shareholder returns
  - Introduce skills-training mechanisms and guidelines for empowering corporate boards to create "ownership-based governance" (e.g. requiring that non-executive corporate directors commit sufficient time to their duties by agreement with the board chairman before accepting an appointment)
  - Establish a broader range of metrics for board oversight of corporate performance that reflects a longer-term strategy (e.g. metrics related to customer satisfaction, research and development, quality and brand value)
- Business and government should develop one global set of corporate governance principles to ensure a level playing field across all regions.
- Business and governments should define new ways of compensating executives to reward long-term value creation and focus on broader value impact, options include:
  - Linking variable compensation to basic drivers of long-term value and sustainability, such as innovation and efficiency, not just share prices; considering in detail the current and future risks of

[33] These recommendations are informed by the work of the World Economic Forum's Global Agenda Council on the Role of Business

the level of variable compensation across a company; evaluating executives on rolling multi-year periods

- Business and governments should establish a task force to study and propose measures to encourage long-term investing.
- Business should develop a strategy that can help convey the public benefits of private enterprise, including how business is vital for development and growth.
- Major regional and global industry associations should develop guidelines on responsible and sustainable local involvement through community social-investment programmes; for instance, the associations could recommend that:
  – Member companies consider devoting a certain percentage of net income to local partners for projects that deliver tangible and lasting socio-economic benefits to communities

2. Building and Renewing Infrastructure

Context

- Infrastructure is essential to functioning markets and economic growth. It connects businesses to consumers and enables the manufacture and delivery of goods and services. More broadly, infrastructure remains a key driver of productivity, competitiveness, economic growth and living standards.
- Huge gaps in infrastructure, ranging from non-existent roads to insufficient power generation, hobble many emerging economies. In developed economies, much infrastructure is poorly maintained.
- Inadequate infrastructure and weak provision of basic services such as transportation, energy, communication infrastructure, urban planning and production sites represent particular impediments for SMEs, which are crucial drivers of economic growth and job creation.
- The social and economic costs of inadequate infrastructure are substantial and growing: for instance, India's electricity generation falls 16-20% short of peak demand; gaps in Indonesia's infrastructure may be undercutting economic growth by 3-4% of GDP[34]; and, in the United States, road congestion costs more than US$ 85 billion annually.[35]
- To remedy these problems and accommodate the explosion in demand for new infrastructure in emerging markets will require massive new investment. Asia alone must spend US$ 8 trillion on infrastructure projects in the next decade. By 2030, annual global infrastructure demand is projected to more than double from today's levels, to US$ 3.7 trillion in real terms.[36]
- In an era of deficits and budgetary constraints, governments cannot mobilize such sums by themselves. Significant private investment is required.

Challenges

- **Barriers to private investment**: Much of the required infrastructure investment, especially in developing countries, will involve greenfield projects. Investment approaches lack clear rules, well-structured procurement processes and investor safeguards. Long-term, focused investors (such as pension funds) voice interest in such projects but face daunting concerns:
  – The permitted returns on these assets is insufficient (and subject to dramatic change) to compensate for the risks involved (including the risk of government-imposed pricing changes or capital controls over the project life).
  – Uncertainty from poor land acquisition and project approval processes can delay work (e.g. the Bandra-Worli Seal Link in Mumbai required more than 20 years to gain approval).
  – Legal and regulatory regimes in many emerging economies are weak. (e.g. top Russian government officials acknowledge that weak legal protections have dampened investments in the country, although they are working on this[37]).
  – Capital requirements for the financial sector are increasing at the same time as demand for infrastructure funding (see Korea B20 paper for more detail, including McKinsey Global Institute research).
- **Prioritization**: Some new infrastructure fails to generate long-term GDP growth and social benefits, largely because planners did not carefully evaluate the long-term payoffs (e.g. Japan's overbuild during its "lost decade"; Alaska's "bridge to nowhere").

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[34] *Asia's US$1 trillion infrastructure opportunity*, McKinsey Quarterly, March 2011

[35] *Growth and Renewal in the United States*, McKinsey Global Institute (February 2011)

[36] *Farewell to cheap capital? The implications of long-term shifts in global investment and saving*, McKinsey Global Institute (December 2010)

[37] President Medvedev's top economic aide recently dismissed the failure of a BP investment in Russia by arguing that "Right now our investment climate is so bad that it won't be [further] affected", Reuters Newswire, 29 March 2011

- **Productivity**: Slow productivity growth – construction labour productivity in the OECD has fallen over the past 15 years[38] – worsens the infrastructure gap and raises the cost of projects.

Recommendations

- Business and governments should collaborate to create liquidity in infrastructure financing by developing holistic infrastructure markets that create incentives for equity and debt investors to participate in infrastructure projects, while emphasizing transparency in regulations (including tendering and approval processes). A comprehensive approach could also use centres of excellence (see below) to develop and promote best practices in financing and development.
- Business and governments should jointly establish centres of excellence to help develop best practices in infrastructure development. Such a centre may provide:
  - Reference cases, with complete model documentation, for various types of infrastructure (e.g. a high-speed rail network built using debt and equity capital)
  - Global knowledge and expertise on private financing and management of infrastructure
- Business and governments should work together to establish accountable bodies at the national and regional levels to identify overall infrastructure needs; evaluate and prioritize individual projects; and make decisions on an economic, not political, basis. Governments might develop:
  - A centralized body (along the lines of Infrastructure Australia) with the skills and capabilities to work across federal, state and municipal bodies to prioritize projects by their economic and social benefits
- Business and governments should work together to cut construction times by 30-70% and reduce capital and risk through more flexible rules and contracts. Project planners could segment activities to run in parallel, start construction while tendering, set high aspirations at all stages, and centralize and streamline planning and approval. Planners could devise flexible labour laws to protect workers' rights while addressing industry's needs.
- Business should propose measures by which governments can reduce the barriers to private investment by promoting revenue models that reflect the real costs of infrastructure projects, use public capital and involve flexible risk allocation approaches. For example, they might seek to:
  - Implement transparent bidding rules, standardized concession/project agreements and definitive bid award time lines (e.g. the success of water and power privatization in the Middle East is driven by international developer and lender confidence in a well laid out bidding process and meticulous adherence to timelines)
  - Establish an agency to develop and implement one comprehensive and coherent national public-private partnership policy
  - Upgrade public-private partnership risk allocation and incorporate adjustment processes (e.g. the 3-5 year adjustments that have kept Brazilian concessions relatively stable)
  - Provide stronger legal assurances that private companies and investors can retain earnings from their investments and control of their assets
  - Make private investment more attractive by minimizing or ending subsidies that distort the pricing for infrastructure consumption (e.g. road tolls to reflect the true cost of building and maintaining a highway)
  - Improve the case for projects by using public funds to leverage private investment, for example by offering government guarantees on minimum returns or tranching risk of investors so the public sector takes first loss
- Business and governments should collaborate with development financial institutions (DFIs) to rationalize environmental and sustainability policies. For instance, they could encourage DFIs such as the World Bank, the IFC and regional development banks to evaluate and categorize projects by consistent, rather than customized, yardsticks.
- Business and governments should address infrastructure market fragmentation through regional focus. Small, fragmented markets, such as those in sub-Saharan Africa, create inefficiencies through a lack of scale and varying legal and regulatory frameworks. Conceptualizing and implementing infrastructure projects on a regional level could address this market failure.

3. Increasing Education for Employment

Context

- Structural unemployment has risen significantly throughout the world since the financial crisis. By the end of 2010, global unemployment was estimated at 205 million workers (6.2% of the working-age

[38] Labour Productivity per Unit Labour Input, OECD Statistical Abstracts (www.oecd.org)

population). This number is 27.6 million higher than in 2007, when global unemployment was 5.6%. Younger workers have been particularly hard hit: at the end of 2010, 77.7 million young people (or 12.6% of the cohort) lacked employment, up from 73.5 million in 2007. Youth unemployment continues to plague many countries and regions (e.g. Spain 44%, Middle East 25%, USA 18%). In the Middle East and North Africa, almost 20% of youth were unable to find work in 2008. Many more remain unemployed.[39]

- The pressure on some countries like India to create new jobs for their youth is immense (over 200 million in the next 10 years)
- The consequences of high unemployment stretch beyond those directly affected. Prolonged unemployment can have significant economic and social consequences, including:
  - Increased political instability as a result of high youth unemployment
  - Reduced lifetime earnings trajectory and career prospects, and worse health outcomes
  - Reduced economic contributions, stemming from lower consumption and savings
  - Increased crime, mental-health problems, violence, conflicts and drug use[40]
- Ironically, even with high unemployment rates, many nations are experiencing a shortage of skilled workers. In the United States, for instance, 30% of employers in a recent survey report having positions open for six months or longer as they search for qualified candidates, despite the abundance of people looking for work.[41]
- While youth unemployment is a major issue in many developing and even some developed economies, ageing populations will also cause shortages of skilled workers in other parts of the developed world. In Japan, for instance, the working-age population is expected to decline by 9% by 2020. Within the EU15, it is expected to fall by 4% in the next 10 years.[42] This shift will lead to massive shortages of skilled workers, especially in technical fields.
- Increasing employment and creating jobs are critical to growth. In Africa, for example, the move from rural to urban employment accounts for 20-50% of productivity growth.[43]
- To address these challenges, business, government and education providers should work together to develop solutions that encourage job creation and tailored programmes ensuring a skilled and capable future workforce.
- Business and governments must seek ways to preserve and enhance the role of SME economic development, particularly in emerging countries. Indeed, SMEs are major employment generators and can surpass larger firms in net job creation: for instance, SMEs account for approximately half of total employment in the OECD and 70% in Japan.[44]

Challenges

- **Fast-growing populations**: In parts of the developing world, the population is growing much faster than the economy, thus increasing the unemployment problem.
- **Informed decision-making**: Some young people lack the information to make informed decisions about which jobs are being created and their skill requirements.
- **Skills mismatch**: Some universities and colleges are not producing students with the right mix of skills. For example, despite the need in the job market, the STEM fields (science, technology, engineering and mathematics) are growing at only 0.8% in the United States versus a 1.7% growth in business fields.[45]
- **Ageism**: Evidence suggests that older skilled workers are sometimes pressured to leave the workforce, although they account for a growing portion of it in Europe, the United States, South Korea, Japan and China.

Recommendations

- Business should work with governments, education providers and labour unions to identify job needs, skill gaps and education requirements (as Singapore, for example, has done).
- Business should work with the financial services industry to develop a policy environment that supports SME financing and further establishment of credit bureaus in emerging markets.

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[39] *Global Employment Trends for Youth: Special issue on the impact of the global economic crisis on youth*, International Labour Office, August 2010
[40] *Id.*
[41] *An Economy that works: Job creation and America's future,* McKinsey Global Institute (June 2011)
[42] *Growth and renewal in the United States,* McKinsey Global Institute (February 2011)
[43] *Lions on the Move: The progress and potential of African economies,* McKinsey Global Institute (June 2010)
[44] *Findings and Recommendations,* Seoul G20 Business Summit (November 2010)
[45] *Growth and renewal in the United States: Retooling America's economic engine,* McKinsey Global Institute, February 2011

- Business should establish a task forces at the national (and potentially regional) level to identify key barriers to promoting foreign direct investment as an engine of job creation, especially in emerging markets.
- Individual companies or industry associations should partner with high schools, community colleges and universities to boost post-secondary education rates while ensuring that students, particularly girls, who attend such institutions emerge with job-ready skills. Companies could, for example, encourage their employees to volunteer as mentors or guest speakers at schools. They should also partner with high schools, community colleges and universities to incorporate entrepreneurship into school curricula.
- Businesses should create “learn and earn” opportunities for students, especially girls, studying for occupations where candidates are in short supply, such as technical fields. Internships, scholarships and mentoring can increase the graduation rate in such fields and attract more students to them.
- Businesses should create new models to enable older workers to stay in the workforce if they choose, while making room for younger employees to advance. For instance, part-time positions and work-from-home programmes may be attractive to workers nearing retirement age.
- Business, government and educational and training providers should create more efficient programmes to enable middle-aged workers to retrain and gain new skills faster. Programmes allowing workers to obtain certification after short educational leaves or on-the-job training can improve their employability.
- Business should collaborate with governments to create an international framework recognizing standards for vocational training across countries.

4. Improving Energy Efficiency

Context

- An expanding population and fast-rising living standards in the developing world are driving global demand for energy.
- Energy needs will increase 2.1% a year until 2020, even by modest projections, eclipsing the unprecedented growth in demand (by 1.7% a year) since 1985. More than 90% of demand growth comes from developing countries,[46] although many developed economies have large opportunities to curtail energy demand growth by raising efficiency.
- In many countries, government subsidies hide the real price of energy from consumers and distort the market in ways that increase the likelihood of demand and supply imbalances.
- Reducing energy use can provide short-term relief for the widening gap between supply and demand. Businesses must help by improving their energy efficiency. This is also good business. On average, every US$ 1 spent on reducing energy use by businesses and consumers saves more than US$ 2 in incremental investments in supply.[47]

Challenges

- Differences in national energy regulations make it difficult for companies to identify and apply energy reduction best practices globally.
- Consumers have little incentive to improve their energy use, as regulations and subsidies mask real prices.

Recommendations

- Governments and business must implement national education and awareness programmes to help society understand energy’s real cost.
- Governments should consider changing their approach to subsidies from broad price setting to direct subsidies targeted at the poor and selected industries (such as fertilizers).
- Governments and business should encourage industry associations to set voluntary industry-specific standards; for instance, the US Consumer Electronics Association drove a standard for the maximum energy consumption of digital set-top boxes or PCs in “sleep mode”.
- Education providers, government and business should establish national panels to encourage the creation of innovative energy efficiency technology (e.g. by awarding loans or funds to support university research).
- International standards bodies should collaborate to define and implement consistent energy efficiency standards across countries. For instance, such a forum could drive the development of clearer, more consistent regulation within regions and throughout the world, as well as provide more transparency on the evolution of international standards.

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[46] *Averting the next energy crisis: The demand challenge,* McKinsey Global Institute (February 2009)

[47] International Energy Agency

- Government should create incentives for consumers to enhance the energy efficiency of their homes and vehicles (e.g. tax credits for green investments).

5. Streamlining Regulations

Context

- Efficient, effective regulation is good for both business and society; yet, governments often struggle to get it right – poor regulation is a primary inhibitor to productivity and growth throughout the world.
- For business, the stakes in getting regulation right are substantial: worldwide, an unprecedented US$ 3.6 trillion of earnings (EBITDA) is at risk from state intervention;[48] not surprisingly, CEOs consistently identify overregulation as one of the top three threats to business growth prospects.[49]
- Increasingly, businesses provide many services seen as public goods critical to the functioning of an integrated global economy – for instance, the international financial infrastructure. The oversight and regulation of these services must be designed to ensure their efficiency and effectiveness.
- At the same time, regulation must take into account the needs of all types of companies including SMEs – which contribute up to 45% of employment and up to 33% of GDP in developing economies[50,] especially relating to their limited access to capital markets because of informational barriers, transaction costs, and a perception of higher risk regulations (for e.g. some of the existing regulatory changes, such as Basel III's treatment of trade finance, are disproportionately costly to SMEs[51]).
- Given the stakes, business needs to step up efforts to engage with governments and regulators in an open, fact-based dialogue on rule setting.

Challenges

- **Protectionism**: Regulation is frequently designed to save employment in particular sectors, to their long-term competitive disadvantage and often at the expense of job creation elsewhere in the economy.
- **Flexibility**: Governments rarely succeed in creating flexible frameworks that anticipate and respond to conditions as markets evolve. The result: cumbersome and outdated regulations that continually undercut competitiveness.
- **Differential impact**: In many countries, regulators ignore a large informal economy in which companies underreport employment, avoid paying taxes and ignore quality and safety regulations. This failure significantly disadvantages large, productive, law-abiding firms that faithfully follow regulations.
- **Coordination**: Limited coordination among and within regulators at the local, national and international levels frequently results in duplicative, unnecessarily burdensome and even contradictory rules.

Recommendations

- Business should propose measures to governments to help make regulation more dynamic; for example, business associations could recommend that regulators adopt:
  – Sunset clauses that require regular reviews of how well regulations fulfil their purpose and either extend their sunset dates or automatically terminate them
- Business should collaborate with governments to help develop impact assessments that systematically examine the advantages and disadvantages of regulations, including the cross-sector impact of regulations (e.g. five quantitative impact studies were carried out for European Solvency II insurance regulations)
- Business should establish task forces at the national and international levels to advise policy-makers on ways to create an enabling legal, regulatory and financial framework to favour SMEs – the most important source of job creation in most countries – and ensure that they are not disproportionately disadvantaged.
- Business should work with governments to ensure regulatory processes do not unnecessarily impede private sector investment and economic growth. Even at a time of high unemployment, companies may need years to obtain the necessary approvals for new construction and greenfield investments that would create jobs.
- Governments should level the playing field for companies, especially SMEs, by devoting more resources to consistent and adequate enforcement of existing regulations.
- Governments should establish independent consultative bodies to promote fact-based, transparent regulation and policy; for example, such a body might:

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[48] *The new value at stake in regulation*, McKinsey Quarterly, January 2010
[49] PwC 14th Annual Global CEO Survey
[50] *Scaling-Up SME Access to Financial Services in the Developing World,* G20 Seoul Summit (October 2010)
[51] See *Scaling-up SME access to financial services in the developing world*, released at the G-20 Seoul Summit, by the World Bank Group International Finance Corporation, November 2010; and Stein, Goland, and Schiff, 2010.

  - Make regulatory barriers more transparent by measuring levels of regulation against relevant international benchmarks and proposing improvements
  - Analyse how different regulatory options affect the economics of competition in a sector and the social and political implications
- Business and government should establish a joint forum to rewrite existing regulations in a simple and concise way while preserving their original spirit and intent; for example, such a forum might:
  - create a single, holistic regulatory framework overseen by a “one stop shop” authority; for instance, the United Kingdom’s Health Research Regulatory Agency will combine and streamline approvals for health research now scattered across many organizations
- International standard setters, such as the Basel Committee on Banking Supervision or the World Trade Organization, should ensure that processes are in place to audit the implementation of regulation. The results should be made public to ensure that national jurisdictions apply rules in an equivalent way.
- Working with business and the WTO, the G20 should create a task force to consider the future direction of international trade and proactively identify next steps in developing a global trade regime, now shaped largely by bilateral and ad hoc measures.

Contribution from the ICC G20 Advisory Group on Trade, Investment and Development

Issue

The G20 has a key role to play in ensuring an open global economy that will facilitate cross-border trade and investment by business to nurture the economic recovery, job creation and sustainable development.

Analysis

The Doha Round
Over the past 60 years, the multilateral trading system has contributed to improving the standard of living of billions of people around the world by creating new economic opportunities and providing greater choice and lower prices to consumers. An open international trade and investment environment is fundamental to foster economic growth, job creation and prosperity.

The value of the rules-based multilateral trading system as an insurance policy against protectionism cannot be overstated. Without it, helping governments resist strong protectionist pressures and open trade commitments would have eroded even further than they have since the onset of the recent global crisis. The latest WTO-OECD-UNCTAD report reveals G20 governments implemented more *new* trade restrictive measures in the last six months than in any other previously reported period.[52] Of those measures, 30 consisted of new export restrictions, despite the 2010 Seoul commitment to roll back any new protectionist measure that may have arisen, including export restrictions. The G20 Seoul Summit Leaders' Declaration that "[w]hat we promise, we will deliver" has not borne true. In fact, the exact opposite is taking place.

The joint report further confirms an ICC-commissioned study, released by the Peterson Institute for International Economics in 2010, stating that all G20 countries have implemented protectionist trade measures since 2008.[53] G20 countries applied discriminatory measures worth US$ 1.6 trillion, or 10% of all world trade, in 2008 alone.[54] Therefore, locking in new multilateral trade liberalization commitments and strengthening WTO rules is especially needed to reign in strong protectionist pressures in the global economy. WTO members must take a long-term view of what is at stake in the Doha Round and remind themselves of their individual and collective responsibility as custodians of the rules-based multilateral trading system.

A sustainable economic recovery hinges on job creation. The International Labour Organization (ILO) estimates that unemployment rose between 30 and 50 million in 2009. Despite the recovery of global GDP growth in 2010, labour markets have started to improve only recently – and only marginally. Thus, unemployment remains very high compared to historic levels. The WTO, OECD, ILO and the World Bank predict further trade liberalization will lead to long-term employment growth worldwide, with lower-skilled employment rising from 0.9 to 3.9% and that of skilled workers rising by 0.1 to 4.0%.[55] Domestic policies that help accompany labour market adjustments should be implemented in conjunction with trade opening. In an era of high budget deficits, a multilateral agreement on trade constitutes a fiscally responsible method of creating employment.

A failure to reach agreement on a future work programme by the December WTO ministerial conference would cause serious damage to the credibility of the WTO and the multilateral trading system more generally. The absence of progress on the Doha Round combined with the proliferation of preferential trade agreements (PTAs) may lead to: a weakening of the multilateral trading system's capacity to deliver effective non-preferential global trade rules; the danger that such an environment could significantly restrict trade opportunities for developing countries; and an increasingly complex regulatory environment for companies engaged in cross-border trade. Businesses base their activity and competitiveness largely on a global network which requires long-standing commitments. A multilateral trade agreement can best guarantee the needed predictability of the business conditions on which such investment decisions are made. G20 leaders

52 *Reports on G20 Trade and Investment Measures (mid-October 2010 to April 2011)*, OECD, ILO, WTO, released 24 May 2011.
53 "Figuring Out the Doha Round", Policy Analyses in International Economics 91, by Gary Clyde Hufbauer , Jeffrey J. Schott and Woan Foong Wong, June 2010 • 128 pp. ISBN paper 978-0-88132-503-4.
54 Global Trade Alert. www.globaltradealert.com
55 *Seizing the Benefits of Trade for Employment and Growth*, OECD, ILO, World Bank, WTO Final Report, submitted to the G20 Summit in Seoul (November 2010).

acknowledged in Seoul that uneven growth and widening imbalances fuel the temptation to diverge from global solutions into uncoordinated actions, but that such uncoordinated policy actions only lead to worse outcomes for all. PTAs should be viewed as a complement to the WTO, not as a substitute.

Current WTO rules lack the effective checks on PTAs that have the potential to promote regional economic gains at the expense of multilateral trade. Efforts to make relevant WTO provisions more explicit and comprehensive with regard to PTAs have yielded limited practical results, yet only on a provisional basis. The role PTAs play in conjunction with the multilateral trading system fundamentally calls into question the founding precepts of the WTO. Given the proliferation of PTAs, both governments and businesses should seek effective ways to ensure complementary multilateral and preferential trade rules, and remind themselves of the primacy of multilateral rules-based trade.

The G20 was created to promote multilateralism and international economic cooperation. The multilateral trading system is the most successful example of international economic cooperation and there is simply no substitute to this system for locking-in the benefits of trade liberalization through effective rules and commitments that benefit all WTO members. G20 leaders must demonstrate the necessary leadership and collective will to deliver a substantive political response to the 10 years of work on the Doha Round. Failure to do so would constitute an abdication of responsibility on the part of G20 governments and an unfortunate admission that the G20 is not yet able to live up to its ambitions of being “the premier forum for international economic cooperation.”

Working towards a framework for FDI

Global FDI flows have risen rapidly in the past two decades.[56] FDI inflows worldwide more than quintupled from US$ 208 billion in 1990 to US$ 1.1 trillion in 2009. The total stock of inward FDI rose at the same time from just under US$ 2 trillion to nearly US$ 18 trillion by the end of 2009.[57] In that year, the stock generated sales by foreign affiliates of about US$ 29 trillion – almost twice the value of world exports (US$ 16 trillion). In other words, FDI has become critical in the delivery of goods and services to foreign markets.

The major changes in FDI patterns preceding the financial crisis will likely continue and gain momentum; the relative weight of developing and transition economies as both destinations and sources of global FDI will continue to increase as these economies lead current FDI recovery. While the majority of FDI continues to go to developed countries, the share dramatically eroded to 51% by the end of 2009. Simultaneously the share of FDI going to developing countries more than doubled from 17% to 43%. In addition, the outward FDI flows from developing countries rose from 5% in 1990 to 21% in 2009 and those of transition economies increased from a negligible amount to 5% of global FDI outflows during the same period.[58]

G20 leaders should recall that FDI and local investment are not alternatives to each other. Rather, they are complementary in a mutual partnership of cooperation and competition, with a key role for FDI in improving the growth impact of overall private investment. Successful and sustainable investments by companies enable employees, suppliers, customers/consumers, communities and host countries to participate in the value generated by these investments.

A concrete step for G20 leaders to take would be to build on the efforts of past G8 and G20 Summits aimed at “creating a predictable and stable climate for investment” and elaborate a reference framework for international investment, as a practical tool to help countries review their international investment agreements.

Such a non-binding framework could help to build common ground and understanding, and provide more clarity, predictability and transparency for companies investing across borders. Agreement on shared principles may serve as a basis for a more structured and wider process towards an agreed common multilateral framework in the long term.

Given the evolving nature of the international investment law regime and its multifaceted, multilayered nature, a first step towards such a reference framework would be to examine to what extent agreement already exists on key elements.

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[56] UNCTAD, *World Investment Report 2010 Overview: Investing in a Low-Carbon Economy* (Geneva: UNCTAD, 2010).
[57] UNCTAD FDI statistical database http://stats.unctad.org/
[58] “Encouraging and Strengthening Foreign Direct Investment”, B20 Working Group II Seoul, Korea (November 2011).

From a global business perspective, key elements to include in a reference framework for international investment would be:

- absence of violent conflict
- broad definition of investment
- transparency and predictability
- negative list approach for pre-establishment, including national treatment, MFN treatment and market access provisions
- national treatment and MFN treatment in the post-entry stage
- high standard of investment protection
- provisions for comprehensive and unrestricted transfer of funds
- requirement to provide for investor-to-state dispute settlement procedures

Strengthening the business contribution to sustainable development
Business contributes resources, skills, infrastructure, goodwill and technological innovation in support of economic and social development, even in the most adverse circumstances. Examples of sustainable business solutions that expand access to goods, services and livelihood opportunities for low-income communities in commercially viable ways include the creation of employment opportunities either directly or through companies' value chains as suppliers, distributors, retailers and service providers; the supply of affordable products and services to meet basic needs for food, water, sanitation, housing and healthcare; and innovative business models to enhance access to key development enablers such as energy, communications, financing and insurance.

The challenge now is to scale up these models to make faster progress in wealth creation and sustainable development. Meeting the needs of the developing world, and especially those of the bottom-half of the pyramid, represents a huge opportunity for business, given long-term demand for investment, infrastructure, products and services in these regions. Business is committed to sharing the benefits of such opportunities by creating jobs, building skills, developing new technologies and investing in communities.

Collaboration between business, government and civil society, especially through public-private partnerships, has succeeded in furthering the objectives of poverty reduction and sustainable development. Business is convinced that substantial private investment will flow to countries that can establish conducive business environments and a level playing field. Business can do more if it is more embedded in the economic fabric of societies and has a greater stake in their future development. This will only happen if companies have a predictable stable investment and policy environment. In this regard, business has consistently emphasized the importance of mobilizing domestic resources, encouraging local entrepreneurship and fostering foreign direct investment.

Business alone cannot develop sustainable market-based solutions to poverty challenges. The support of government to successfully deploy sound enabling frameworks and new innovative funding mechanisms requires collaborative action on issues such as:

- promoting open and competitive markets based on the principles of non-discrimination and national treatment
- establishing regulatory frameworks that uphold property rights, accelerating entry to the formal economy and rooting out corruption
- providing capacity building and general education
- facilitating access to finance and investment mitigation instruments, in particular for SMEs
- securing necessary investments in core infrastructure, such as roads, energy systems, telecommunications and ports
- creating a catalytic fund for new public-private partnership cooperation models, whereby financial support should be focused on those fields where there is a particular need for action and whereby those means are necessary to deploy cost-efficient and highly innovative approaches by companies on the ground. In particular, financial and public support is needed to reduce and jointly share investment risks for business and to enhance the regulatory framework and set standards where necessary

Business has a critical role to play in accelerating progress towards sustainable development as an engine of economic growth and employment; as a key contributor of government revenues; and as a driver of innovation, capacity building and technology development. The success of sustainable development and poverty alleviation depends on actively engaging the private sector. Business commits to partnering with governments to build capacity and supports strengthening the policy tools and indicator framework of the

Inter-Agency Working Group on the private investment and job creation pillar of the G20 Multi-Year Action Plan on Development.[59]

Recommendations

- The ICC strongly recommends that the G20 take concrete decisions to lay the groundwork for an ambitious, balanced and comprehensive Doha Round agreement under a single undertaking approach as originally envisaged, if possible. At the very least, the G20 should agree to implement a future work programme at the WTO's December 2011 Ministerial Conference.60 At the same time, G20 governments should re-engage substantively in negotiations among themselves and with other WTO members to produce better offers on agriculture, industrial goods and services.

- G20 leaders should build on the efforts of past G8 and G20 Summits aimed at "creating a predictable and stable climate for investment" and elaborate a reference framework for international investment, as a practical tool to help countries review their international investment agreements. Agreement on shared principles may serve as a basis for a more structured and wider process towards an agreed common multilateral framework in the long term. From a global business perspective, key elements to include in a reference framework for international investment would be:

  - absence of violent conflict
  - broad definition of investment
  - transparency and predictability
  - negative list approach for pre-establishment, including national treatment, MFN treatment and market access provisions
  - national treatment and MFN treatment in the post-entry stage
  - investor-to-state dispute settlement mechanism

- The G20 should create the conditions for scaling up the business contribution to sustainable development through public-private partnerships and the facilitation of conducive business environments. Business is committed to partnering with governments to develop solutions, build capacity and empower people to find the pathway out of poverty. Business also supports the G20 strengthening the policy tools and indicator framework of the Inter-Agency Working Group on the private investment and job creation pillar of the G20 Multi-Year Action Plan on Development through, among others:

  - technical assistance
  - investment policy reviews
  - exchanges of best policy practices
  - fostering linkages between foreign investors and domestic enterprises
  - advisory services on streamlining of investment facilitation
  - advisory services on improvement of governance in investment promotion
  - advisory work on international investment agreements to ensure coherence with national policy objectives[61]

[59] "Indicators for measuring and maximizing economic value added and job creation arising from private sector investment in value chains", Interim Report to the High-level Development Working Group (June 2011)
[60] Schott, Jeffrey J. "What Should the United States Do about Doha?" Policy Brief 11-8, Peterson Institute for International Economics (June 2011)
[61] "Indicators for measuring and maximizing economic value added and job creation arising from private sector investment in value chains", Interim Report to the High-level Development Working Group (June 2011)

Contribution from the ICC G20 Advisory Group on Strengthening Financial Regulation and Ensuring the Availability of Trade Finance

Issue

New global financial regulations should be complemented by effective international supervisory mechanisms and consistent implementation across jurisdictions.

Great care should be taken to avoid new regulations having a detrimental effect on the availability of trade finance, especially in developing countries.

Analysis

Strengthening financial oversight
Since the outset of the financial crisis, the focus of near-term policy action has been on strengthening the regulatory framework. But regulation is only part of the solution; it is through supervision that the authorities enforce compliance with the rules.[62]

To prevent the recurrence of financial crises in the future, G20 nations declared supervision a key pillar of the financial reform agenda and gave an explicit mandate to develop it. Thus:

- Every country should have a supervisory system that is up to the task of ensuring that the regulations, including new ones coming out of Basel III, are backed up by effective risk assessment and enforcement, especially as they relate to systemically important financial institutions (SIFIs). Supervisors are expected to detect problems proactively and intervene early to reduce the impact of potential stresses on financial institutions, and therefore on the financial system as a whole.[63]

- Each supervisory agency must have a clear mandate and timetable to supervise financial institutions and markets, with priority given to the maintenance of financial stability and the safety and soundness of the financial system.

- National oversight boards are unable to monitor effectively financial conglomerates active on a global scale. Only a unified global system would be able to detect and sanction off-balance sheet activities and regulatory arbitrage that overlap national borders and sectors. In terms of regulatory oversight, the prevention of coordination failures requires a transnational mandate. This can only be achieved through the creation of a global financial market oversight system.[64]

Balancing financial stability and the role of finance as a growth driver
Since the global financial crisis, policy-makers have been focusing on building a new regulatory bulwark to minimize the likelihood of another financial tsunami. The resulting atmosphere of caution, however, has led to the creation of various regulations that impose considerable costs on businesses and consumers and diminish the economic benefits of a competitive and dynamic financial services sector. A well-developed financial system is not only the product of economic growth but also a key driver of such growth. Therefore, regulatory authorities should always be mindful that striking an optimal balance between stability and innovation will remain a key challenge in their quest for more sustainable economic growth.

Improving rules on financial market integrity and transparency
The implementation phase of Basel III will require the transposition of the global framework into national rules. While the Basel Committee on Bank Supervision ("BCBS") and the G20 have pledged to adhere to the global framework, there are signs that implementation in individual jurisdictions might diverge in a number of important respects. Some jurisdictions are likely to "top up" Basel III minima and/or accelerate implementation timetables. Others might opt for implementing only portions of the new rules or local adaptations of the new rules. An undesired consequence could be that it might unbalance the playing-field and create market disruption.

[62] Shaping the New Financial System (2010). Vinãls, José; Fiechter, Jonathan; Pazarbasioglu, Ceyla; Kodres, Laura E.; Narain, Aditya; Moretti, Marina
[63] Reducing the moral hazard posed by systemically important financial institutions (2010). The Financial Stability Board (FSB)
[64] Agenda for a New Financial Market Architecture (2009). German Institute for Economic Research

The ICC is of the view that Basel III should be understood and implemented in a consistent manner across jurisdictions, building on the guidance published over the years by the Basel Committee on Banking Supervision (BCBS) but perhaps with additional guidance focused on the very different conditions created by Basel III.

Ensuring the availability of trade finance

The global financial crisis of 2007 was unique in many ways. Among its effects were unprecedented limits on the access to trade finance, an impediment that continued for more than two years (2007–2009) and significantly curbed import and export trade, one of the principal drivers of economic growth worldwide.

The G20 London Summit in April 2009 came up with a substantial package of measures to support trade finance – specifically, US$ 250 billion of funding to be made available through multilateral banks and export credit agencies, as well as a mandate for regulators to “make use of available flexibility in capital requirements for trade finance.”

At its December 2009 meeting, the BCBS approved for consultation a package of proposals to strengthen global capital and liquidity regulations with the goal of promoting a “more resilient” banking sector. At the November 2010 G20 Summit in Seoul, a number of proposals were accepted and a timetable put in place for regulators to implement the new regulatory regime.

Defining new bank capital and liquidity standards

The recent crisis signalled the need to review the global financial regulatory framework to reinforce the banking sector’s ability to absorb economic shocks and to build a stronger, safer international financial system. The private sector has consistently voiced strong public support for these objectives.

However, in attempting to create a more robust regulatory framework and curb speculative and highly leveraged instruments, Basel III could significantly curtail the ability of banks to provide affordable financing to businesses.

ICC respondents to the ICC Global Survey on Trade & Finance 2011[65] were concerned about the unintended consequences arising from the new regulatory regime, which would indiscriminately put trade finance into the same risk class as high-risk financial instruments. According to many respondents, the new regulatory regime was obviously not taking into account the adverse effects of the proposed changes on global trade and growth. Specifically, the augmentation of the leverage ratio under the new regime will significantly curtail the ability of banks to provide affordable trade financing to businesses in developing and low-income countries and to SMEs in developed countries. Banks would now be required to set aside 100% of capital for any off-balance sheet trade finance instruments such as commercial letters of credit (compared to 20% under Basel II) which are commonly used in developing and low-income countries to secure trade transactions.

The concerns expressed by banks in the ICC Survey 2011 can be summarized as follows:

- **Banks moving away from trade finance**. There is a risk that small to medium size banks will move away from the trade finance market, thereby significantly reducing market liquidity. Regulatory capital under Basel III requires multiple times higher pricing than economic capital. This would first impact small and medium size enterprises that are the engines of economic growth in poor countries for which trade finance is critical to the sustenance of these emerging markets. The vast majority of trade financed from low-income countries is through traditional trade products such as letters of credit (LCs) and guarantees. For larger banks, with lower internal rates of return, trade finance may also be less attractive compared to riskier products, so banks will allocate more of their balance sheets to speculative leveraged instruments.

- **Unintended consequences on the timing of the implementation of the regulatory regime in different regions**. There is still quite a lot of uncertainty about the impact of Basel III because of the role of national regulators in deciding the local form of the rules. This uncertainty over local implementation was already a problem with Basel II rules, which have been implemented by many European banks, but were implemented much later or not at all in many countries. The non-implementation of the regulatory

[65] http://rebusparis.com/icc/ICC2011GlobalSurvey210311S144.pdf

regime in a consistent fashion would create competitive arbitrage opportunity for some financial institutions and may impact on the domiciling of banks.

- **Unintended consequences on cost of trade**. Those who remain in trade finance could naturally raise their costs as a result of the more stringent regulatory requirements. We have already seen what can happen when liquidity is reduced: during the crisis, markets such as South Korea and India faced a hike in letter of credit pricing from 0.2% to 6.5% per annum.

- **Unintended consequences on SMEs and banks in emerging markets**. Again, as a result of a reduction in the supply of trade financing and an increase in pricing, the most severe effects would be felt by small to medium size enterprises in the developing world, where trade financing is needed most to create jobs and alleviate poverty.

- **Unintended consequences on non-regulated sectors**. Banks may be encouraged to move high-quality trade assets and contingents into non-bank sectors such as hedge funds. For instance, banks may likely decide to securitize their trade assets – pushing them into higher risk, unregulated markets. This clearly would defeat the very purpose of Basel III, which was implemented to prevent another financial crisis and use of such practices.

Evidence has shown that trade finance is generally low risk, self-liquidating, and short term in nature, which is markedly different from most corporate or financial institution lending exposures, which tend to be larger in size and longer term. The difference is demonstrated in the ICC-ADB Trade Register. Created in November 2009, the register pools performance data for trade finance products from nine international banks, covering a total of 5.2 million transactions between 2005 and 2009 with a total value of over US$ 2.5 trillion. Analysis of the data largely supports the view that trade finance is a relatively low-risk asset class:

- Trade finance transactions have an average tenor of only 115 days
- Trade finance transactions typically have a low incidence of default, with less than 1,200 defaults reported for all 5.2 million transactions. Off-balance sheet trade transactions have an even lower default rate, with only 110 defaults reported for 2.4 million transactions
- Even during the global economic downturn, trade finance transactions experienced relatively low levels of default, with fewer than 500 defaults among 2.8 million transactions
- For written-off products, recovery rates average 60% for all product types, albeit with significant variance year to year and by product type

The collected data supports the view that trade finance should be given treatment that reflects business realities under Basel III, in terms of the capital, leverage and liquidity requirements. Indeed, grouping trade finance with other corporate asset classes suggests that default and recovery rates are similar, but this is clearly not the case. Restricting trade finance would be unwise under any circumstances and we can now see from the data that it would also be unwarranted.

Recommendations

Based on the above, business would like to make the following recommendations to G20 leaders:

- **Retain current CCF values**. Increasing the Credit Conversion Factor (CCF) to 100% for trade-related contingencies for the purposes of calculating a leverage ratio could significantly disadvantage trade finance-focused banks. As such, the ICC recommended that if a leverage ratio is to be adopted, off-balance sheet trade products should be allowed to retain the CCF values used by banks under the current "risk-weighted assets" calculation (Basel II). This would point in the same direction as foreseen in the "additional option for impact assessment" in the consultative document, which would allow financial institutions to "apply a lower (positive) CCF for unconditionally cancellable commitments or Basel II standardized CCFs." The ICC proposed to allow key risk attributes to be determined on the basis of industry benchmarking. As noted above, many banks have historically faced difficulties identifying and isolating sufficient data to produce validated estimates of risk attributes for trade lending. Today, the ICC register can provide evidenced-based information for this purpose. It is our view that such an approach would be consistent with the G20 agenda to promote trade finance, without compromising the overall objective of the BCBS proposals.

- **Reconsider maturity floor**. Business has asserted that there should be reconsideration of the Basel rules in respect of the maturity floor applied to trade assets under the advanced model. While trade financing is usually short term in nature, based on between 0 to 180 days maturity, the Basel II framework applies a one-year maturity floor for all lending facilities. Since capital requirements (naturally) increase with maturity length, the capital costs of trade financing are artificially inflated as a result. All regulators have the (national) discretion to waive this floor (so far only three regulatory agencies in the world have been inclined to waive – Germany, Hong Kong SAR and the United Kingdom). The ICC register clearly confirmed that the average LC has a maturity close to 90 days (a standard of payment in short-term international trade) so obliging financial institutions to back self-liquidating asset for a full year is a considerable waste of capital resources at a time when these are scarce.

- **Improve liquidity**. The ICC proposed to include trade instruments below 30 days and correspondent banking deposits as a stable source of funding. Practical considerations suggest that correspondent banking deposits have similar characteristics as operational deposits and are typically operationally complex and logistically difficult to move within 30 days.