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## Global governance for global crisis

### Creating an international framework for sustainable business

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*Date*  
18 March 2009

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The world is in the midst of a serious financial and economic crisis. The impact of the crisis, in which a strongly export-oriented German industry is suffering to a marked extent, and the major challenges of the period after the crisis call for international cooperation and consultation. Unilateral national initiatives are not the right answer, protectionist tendencies must be cut off at an early stage.

In order to restore economic growth and jobs on a sustainable basis, BDI is committed to an intelligent international regulatory framework. BDI broadly supports the proposals that came out of the preparatory summit of the European G20 countries held on 22 February 2009 whereby Europe will use the G20 summit on 2 April 2009 in London to push for a worldwide regulatory framework for global financial markets, to promote freedom of trade and investment around the world, to combat climate change at global level and to draw up a “charter for sustainable business” in the areas of business, finance and social affairs.

The charter could serve for creation of a framework at international level leading to greater transparency on financial markets, to a strengthening of market forces and to common principles for sustainable behaviour. Establishment of a common regulatory framework is welcome if at the same time companies and markets are protected from undue state intervention. An instrument for implementing this charter could be the German Chancellor’s proposal for networking national governments and international organisations institutionally in a “world economic council”. However, further details have not yet been decided.

### 1. Create worldwide regulatory framework for global financial markets

The G20 summit in Washington in mid-November 2008 showed that international policy-makers are capable of constructive action under pressure from the crisis. At that time BDI welcomed the “action plan” launched on that occasion as an important step towards a global financial market order. BDI supports the wish of the participants in the European preparatory summit for the upcoming G20 summit to implement the Washington decisions rapidly and consistently. The global financial market crisis calls for resolute and coordinated action by international economic policy actors. The enormous “rescue

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packages” deployed around the globe seek to stabilise markets and to ensure that finance continues to flow around the economy. However, state aid programmes can only be part of the solution.

A sustained return of confidence cannot be achieved without a fundamental overhaul of the global financial market order. The following points have priority:

### **1.1 Make financial supervision proof against crisis**

The own capital underpinning banks’ risk positions need to be strengthened. Basel II has to be revisited, in particular regarding own capital requirements for structures securities, as well as in terms of prevention vis-à-vis liquidity risk and of how large loans are supervised. The pro-cyclical nature of the current financial supervision regime must be tempered through more flexible own capital rules. Basel II must be implemented internationally as rapidly as possible. The transparency of systemically relevant hedge funds and other financial investors has to be improved via their risk structures and financial obligations.

### **1.2 Improve cooperation between national supervision authorities**

Bearing in mind the high and still increasing importance of cross-border financial structures, coordination of supervision as well as cooperation between central banks and supervision authorities need to be intensified – across Europe and worldwide. The creation of “supervisory colleges” at international level for cross-border bank groups would be an important intermediate goal.

### **1.3 Reform international financial institutions**

The International Monetary Fund should in future play a stronger role in supervision of financial markets. The aim should be to merge the core competences of FSF (Financial Stability Forum) and IMF. The instruments should be modernised so that IMF can step in as a preventive measure. Risks on financial markets should be identified in good time via a global “early warning system”. IMF, World Bank and regional development banks should work together more closely on regulation and supervision of regional financial markets. However, regional financial supervision authorities should only be put in place in close coordination with the Bretton Woods institutions. A strengthening of the WTO’s world trade system would also be important as a support for a stable world financial order.

### **1.4 Supervise rating agencies better**

The financial crisis and the role that rating agencies have played in it expose spectacular weaknesses in the self-regulation practised by rating agencies. Formal registration and supervision of agencies is indispensable. Integrity, independence and transparency of rating agencies and of the rating process must be improved through corresponding requirements, conflicts of interest must be avoided.

Regulatory interventions should be restricted to the rating procedures only. Rating content should, as before, not be the subject of regulations.

### **1.5 Rethink incentive and remuneration structures**

The sub-prime crisis demonstrates many shortcomings in banks' risk management. Particularly counterproductive have been the incentive and remuneration structures in the bank sector which reward risk-taking. Obviously risky behaviour should no longer be rewarded. Creation of sensible incentive structures also includes introduction of appropriate restraint among banks regarding securitisation.

### **1.6 Improve accounting rules**

The fair-value rules in IFRS continue to be fundamentally right. However, improvements are needed to consolidation rules, to additional disclosure on the valuation of financial market instruments and to fair-values in illiquid markets. In addition, supervision rules must ensure that book profits in rising markets do not lead to excessive lending. Overall, accounting rules need to be harmonised worldwide. Unilateral action on accounting issues through "carve-outs" leads to a loss of confidence in company accounts.

### **1.7 Take coordinated action against tax havens**

OECD's efforts to act against uncooperative states and territories with a view to improving exchange of information deserve support. The multilateral and bilateral exchange of tax-relevant information should be improved. To that end, the model OECD agreement published in 2002 (*Agreement on Exchange of Information in Tax Matters*, also known as *Tax Information Exchange Agreement*, abbreviated to TIEA), which can be used both bilaterally and multilaterally, is an appropriate tool. Unilateral national action targeting taxpayers in individual high-tax countries distorts international competition to the detriment of honest taxpayers.

## **2. Promote freedom of trade and investment around the world**

Almost one half of German gross national product is earned from exports. This means that the world's export champion is also a complete victim of the global downturn. Nevertheless, German industry is extremely competitive and widely diversified in terms of its international sales. More than three million jobs have been created in Germany over the last ten years in the wake of globalisation. In order to emerge strengthened from the crisis, we now need more trade and not less.

BDI welcomes G20's commitment in favour of free trade and against protectionism issued in Washington D.C. in November 2008, and confirmed in February 2009 at the European meeting in preparation for the next G20 summit. G20's intentions in the area of trade policy must be implemented in practice. What is needed in particular is:

## **2.1 Firmly resist protectionism**

BDI is very concerned to note that many governments are combating the crisis by protecting their markets, and giving support to national companies and sectors in a manner that distorts competition. BDI therefore calls on the German government, the European Union, G8 and G20 countries to make every effort to ensure open markets for trade and investment at home and worldwide, and to act against protectionism.

## **2.2 Conclude the Doha round successfully**

BDI is working for a successful conclusion of the Doha Development Agenda before the end of this year. Even if satisfactory results for German industry cannot be expected in all areas, the advantages of the July 2008 package should be secured, and further concessions on industry coefficients and flexibilities should be prevented. This conclusion would at the same time restrict the leeway still available to individual member states to institute further safeguard measures and hence avoid access to these markets being made more difficult.

## **2.3 Strengthen the world trade system**

WTO has a decisive role in monitoring and enforcing international trade rules. It is a guarantor of free trade. German industry, which is intensively intermeshed in the global economy, benefits from this to a significant extent. The confirmation and further development of WTO as one of the central institutions of the world economy therefore has a considerable influence on Germany's economic success. After conclusion of the Doha round, WTO should be reformed with the aim of ensuring that progress in the area of free trade is achieved more rapidly in future. The reforms should comprise better priority-setting, attention to themes such as investments, public procurement and export duties, as well as regular involvement at political level (including regular ministerial meetings).

## **2.4 Push ahead with bilateral free-trade agreements on a targeted basis**

Multilateral liberalisation of global markets continues to be BDI's top priority. Bilateral free-trade agreements can establish market access above and beyond WTO rules and help to ensure that European industry remains successful on international growth markets also in the future. In these negotiations, the EU offers access to the world's largest economic area, this must be matched by clearly simplified access for European industry on markets such as Korea and, further down the line, India, Mercosur, Canada and other countries. Closer regulatory cooperation with important trading partners, for instance in the framework of the Transatlantic Economic Council, is a further important instrument for improvement of mutual market access.

### **3. Combat climate change at global level**

Sustainable responses to climate change are a major national and international challenge. In this connection, environment and climate policy issues can no longer be kept separate from economic policy issues, given global interdependence between economic, social and ecological aspects. For that reason, climate policy is always also economic and societal policy. For industry, a business-friendly climate policy also opens up great opportunities: successful development and export of climate and environmental technologies are business areas with high growth potential and benefits for reducing emissions in industrialised, emerging and developing countries.

#### **3.1 Commitment to climate protection**

German industry is committed to climate protection. Compared with other countries in Europe and beyond, Germany is reducing greenhouse gases most clearly. The greatest contribution to this is made by German industry. It supports the EU's target of cutting emission by 20% by 2020, with 1990 as the base year.

#### **3.2 Only global solutions are successful**

Climate change calls for an international response. Only global responses based on long-term strategies will lead to the desired results. Whereas the EU has only a 14% share in global CO<sub>2</sub> emissions, emerging and developing countries such as China and India now account for 53% of CO<sub>2</sub> emissions. The figures show that unilateral initiatives by Germany or Europe in climate policy offer little promise of success and that effective climate protection can only be achieved through international cooperation.

#### **3.3 Adopt a substantial post-Kyoto protocol**

German industry attaches great importance to international climate protection negotiations and expects policy-makers at the UN climate conference in Copenhagen in December 2009 to put in place a substantial successor agreement to the Kyoto protocol.

#### **3.4 Kyoto protocol rules are not sufficient**

The negotiations in Copenhagen offer the opportunity to remove the weaknesses present in the Kyoto protocol. These arise principally from the fact that:

- the protocol has no global validity given that it has not been ratified by the USA – a major emitter – and that there are no reduction commitments for developing and emerging countries – in particular China and India,
- in the absence of global validity and the different reduction targets, there are no comparable conditions for fair competition between market participants and market distortions with the danger of job and carbon leakage,

- the practical arrangements for the Kyoto mechanisms Clean Development Mechanism (CDM) and Joint Implementation (JI) are complicated, unworkable and bureaucratic, and
- the agreement lacks sanction possibilities if the agreed targets are not met.

### **3.5 Design an industry-friendly post-Kyoto agreement**

For an effective Kyoto successor agreement that eliminates the identified deficits, German industry believes that the post-Kyoto agreement must meet a number of essential requirements. These include: involvement of the USA, binding reduction targets for China and India, internationally comparable framework conditions for sectors in competition (i.e. a level playing field), improvement of CDM and JI, clear rules for technology transfer, protection of intellectual property, promotion of research and development for low-carbon technologies, creation of economic incentives for investment in climate-friendly technologies, and elimination of obstacles to technology transfer. Industry should be informed about the progress of the ongoing negotiation process on a regular basis and consulted on individual questions.