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Argentina case highlights need for sovereign debt workout process

Argentina has found itself embroiled in a court case brought by hedge funds over its 2001 default and subsequent restructuring of its sovereign debt. The dispute, in which the funds have rejected the restructuring deal and seek instead full repayment of the debt, brings home the urgent need to establish a sovereign debt workout regime at international level.

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Argentina's hedge funds case threatens sovereign debt restructuring

A legal tussle being fought out over Argentine loan repayments underlines the pressing need for an internationally agreed sovereign debt resolution process.

by Bhumika Muchhala

NEW YORK: The ongoing legal battle between hedge funds and Argentina over the nation's 2001 debt default is an urgent reminder of the need for a sovereign debt workout regime.

Senior lawyers, fund managers and former policymakers are reported as saying that an initial New York court ruling against Argentina (as well as the sovereign debt crises in Europe) – in what has been dubbed by the *Financial Times* as the sovereign debt "trial of the century" – highlights the weaknesses of the current ad hoc, contractual approach to government debt workouts.

Some argue that the time has come to revisit the sovereign debt restructuring mechanism proposed by the International Monetary Fund (IMF) in 2002, while others call for sovereign debt resolution mechanisms supported by an international debt court that is independent of the IMF.

The sovereign debt restructuring mechanism drawn up by former senior IMF official Anne Krueger was envisaged as a kind of voluntary Chapter 11 for countries. Due to US opposition, however, it never materialized. (Chapter 11 refers to the relevant part of US domestic legislation that provides for debt restructuring for businesses in bankruptcy situations.)

Argentina was brought to court in New York by hedge funds led by Elliott Associates, creditors who have been claiming debt payments from the nation ever since its 2001 default. Argentina had reached an agreement with most of its private creditors to pay 25-35 cents for every dollar owed, in effect giving creditors about 30% of their money back in a restructured debt deal. However, some creditors such as Elliott Associates refused Argentina's restructuring deal, which was in effect a steep discount on the amount owed.

A subsidiary of Elliott Associates, NML Capital, is a US hedge fund that pioneered "vulture fund" activity by winning a case against Peru in the 1990s, retrieving 400% what they paid for Peru's debt. Vulture funds purchase cheap debt from distressed companies or countries, and then seek repayment of the full face value together with interest, penalties and legal costs. If this repayment is not made by the borrower, the creditor can impound assets of the country or company in an effort to force repayment.

After years of pursuing Argentina through foreign courts, NML Capital impounded the Argentine naval vessel *Libertad* in the Ghanaian port of Tema on 2 October 2012. After months of seizure, the *Libertad* was recently released by an international tribunal and returned to Argentina on 9 January.

Argentine President Cristina Fernandez de Kirchner had condemned the *Libertad*'s seizure and clarified that there would be no negotiations with creditors. She was quoted in a BBC article published on 25 October as saying that Argentina would not bow to "blackmail by vulture funds."

She asserted, "As long as I am president, they can keep the frigate but nobody is going to keep the liberty, sovereignty and dignity of this country."

Elliott Associates has convinced the US Appeals Court that Argentina cannot continue to pay holders of its restructured debt while ignoring creditors that refused to sign up to the restructuring deal. This argument is based on an obscure legal clause that promises equal treatment to Argentina's creditors.

The implication is that if and when Argentina pays off its debt to its creditors which accepted the restructuring, it must also pay off its debt to holdout creditors such as Elliott Associates, at 100% of the original loan. This would require Argentina to pay $1.33 billion to Elliott Associates if and when it made any payments on its new debt.

However, a stay was issued on the case by the US Court of Appeals for the

Second Circuit on 28 November 2012, and an appeal against the court decision will be heard on 27 February. In the meantime, important aspects of the judgment still need to be confirmed by the US Court of Appeals, with the possibility that the case could end up in the Supreme Court.

If enforced, the ramifications for sovereign debt workouts would be enormous. A few creditors could prevent debt restructurings and negotiations, threatening the ability of sovereign states to achieve debt workouts and causing chaos in debt markets globally.

The creditors which accepted the 2001 restructuring receive payments from Argentina via banks based in New York, because when issuing the bonds Argentina placed itself under New York State jurisdiction. If the court ruling is enforced, the potential implications are such that the New York-based banks can only process payments from Argentina if the hedge funds are also being paid, something President Kirchner has vowed not to do. If Elliott Associates is triumphant in the February hearing, one possible consequence for bond issuers is that they may prefer to go through jurisdictions such as London or Frankfurt rather than New York.

Ultimately, if the hedge fund wins in February, the Argentine government could face a choice of making debt payments to the hedge funds at 100% of the original loan, or be forced to default on payments to all creditors.

Debt restructuring mechanism and the IMF

Creating a sovereign debt restructuring mechanism, either inside or outside the IMF, will pose a formidable challenge in generating the political will, in which the role of the US Treasury and Congress is pivotal. The US Treasury would have to seek congressional approval for the necessary change to the IMF's articles of agreement. Capitol Hill is likely to be highly suspicious of allowing an international institution to override, in effect, US bankruptcy proceedings. Legal experts doubt whether the US has enthusiasm for this.

Meanwhile, Jubilee Debt Campaign activists have publicly opposed the IMF as the institutional home of a debt resolution court or mechanism. In a letter to the *Financial Times*, Nick Dearden of Jubilee Debt Campaign UK argues that a debt court cannot be taken seriously "if housed in one of the biggest creditors in the world," and that "no court of law would be taken seriously if judge and jury were drawn from the prosecution."

However, a comprehensive debt resolution mechanism is urgently needed. Such a mechanism has the potential to redress the power imbalance between debtors and creditors, which has devastated the economies of southern Europe and many developing economies. A fair and development-oriented debt mechanism could also enshrine the legal principle of "odious debt" and strive to ensure that a government's international duty to respect its people's social and economic rights is no longer subordinated to external debt payments.

Jubilee Debt Campaign also placed an advertisement in an Argentine newspaper, the *Buenos Aires Herald*, on 11 January. The advertisement declares support for Argentina's right to refuse to pay the vulture funds, condemns the decision of the New York court which implies that payment to vulture funds supersedes a state's right to protect its people under international law, and calls for a debt audit in Argentina to ascertain the extent of illegitimate debt which should not warrant repayment.

Campaigners recall that Argentina was driven to debt default at the end of 2001 after three years of economic recession where the country was following policy conditions attached to bailout loans by the IMF. Over half the population, some 20 million people, were living below the poverty line and the public debt ratio was 160% of GDP.

After its debt default, Argentina's economy started growing out of several years of stagnation in the matter of a few months. Subsequently, Argentina became the fastest-growing economy in the Americas. Eleven million people were pulled out of poverty and unemployment more than halved in the following five years.

UN expert calls out against vulture funds

Meanwhile, the United Nations Independent Expert on foreign debt and human rights, Cephas Lumina, has stressed that successful debt restructuring for deeply indebted countries will be made impossible if vulture funds are allowed to paralyze debt relief.

In a UN press release distributed on 13 December, Lumina urged world governments not to allow vulture funds, such as NML Capital, to purchase debts of distressed companies or sovereign states on the secondary market for a sum far less than the face value of the debt obligation.

"From a human rights perspective," the UN expert said, "reduced debt burdens and increased fiscal capacity contribute to the creation of the conditions necessary for the realization of all human rights, particularly economic, social and cultural rights."

Lumina called on states to follow the example of the Channel Island of Jersey and the United Kingdom, which have recently adopted legislation to prevent vulture funds from pursuing excessive claims against heavily indebted countries before their national courts.

The UN press release also highlighted the UN Guiding Principles on Foreign Debt and Human Rights, which were endorsed by the UN Human Rights Council in June 2012.

The Guiding Principles underscore that states, international financial institutions and private companies have an obligation to respect human rights, including the duty to refrain from formulating, adopting, funding and implementing policies and programmes that directly or indirectly contravene the enjoyment of human rights.

According to the principles, "loan agreements should impose clear restrictions on the sale or assignment of debts to third parties by creditors without the prior informed consent of the Borrower State concerned. Every effort must be directed towards achieving a negotiated settlement between the creditor and the debtor."

They also state that "creditors should not sell sovereign debt on the secondary market to other creditors that have previously refused to participate in agreed debt restructuring." ❐

A resurgence in global unemployment, reports ILO

After two years of decline in the number of jobless people worldwide, 2012 saw a rise in unemployment, says the International Labour Organization (ILO), which has urged decisive policy action to promote job creation and investment.

by Kanaga Raja

GENEVA: After a fall for two straight years, the number of unemployed worldwide rose by 4.2 million in 2012 to over 197 million, with a further expected rise projected for this year and the next, according to the International Labour Organization (ILO).

In its *Global Employment Trends 2013* report, the ILO said that a quarter of the increase in global unemployment last year was in advanced economies, while three-quarters were through spillovers into other regions, with marked effects in developing economies in East Asia, South Asia and Sub-Saharan Africa.

On a slightly positive note on its gloomy employment forecasts over the next years, the ILO highlighted the continued progress in reducing poverty, with the number of workers living in extreme poverty dramatically declining over the past decade and throughout the global crisis, and the number living in moderate poverty also declining.

As the total share of poor and near-poor workers gradually fell, an estimated 41.6% of the developing world's workers were attaining the middle and upper-middle classes in 2011, the ILO said. According to current projections, the number of workers in the middle class and above in the developing world could grow by an additional 390 million by 2017, with the share of middle-class workers rising to 51.9%.

"This emerging middle-class in the developing world could bring about a new driver of global growth, with stronger investment and consumption, in particular among poorer parts of the developing world," the ILO report said.

At a media briefing on 21 January, ILO Director-General Guy Ryder said that the most important headline finding in the report is that after two years of decline in the number of unemployed around the world, the year 2012 saw a resurgence of unemployment by 4.2 million. Today, there are 28 million more unemployed people around the world than there were in 2007.

He also noted that the average duration of unemployment has increased notably, and "long-term unemployment is a major qualitative and very worrying feature of this quantitative situation."

One-third of all job-seekers in the developed economies have been unemployed for one year or longer, and "I think that the move towards long duration unemployment which affects particularly young people as well should be a matter of particular concern", he said.

As for future prospects, Ryder cautioned that unfortunately these are "not good". "We see that unemployment is set to rise again. Our projection would be for 5.1 million more in 2013 and still a further 3 million in 2014. So, the trends are very much in the wrong direction."

Adverse macroeconomic trends

According to the ILO report, the global economic and jobs crisis has entered its fifth year, following a year of economic adversity and disappointing labour market trends. After a relatively encouraging first quarter, the crisis returned during the remainder of 2012, with weakening economic growth in nearly every region of the world. On an annualized basis, global economic growth is estimated to have decelerated to 3.3% in 2012, compared with 3.8% in 2011 and 5.1% in 2010.

"These adverse macroeconomic trends occurred alongside rising uncertainties stemming from a number of factors, most importantly the prolonged and deepening crisis in the Euro area and policy ambiguity related to fiscal tightening and the debt ceiling debate in the United States."

Entering 2013, the report noted, the crisis in the euro area constitutes the single biggest risk to global employment trends for the year ahead. The financial crisis in the euro area, brought on by a combination of banking sector distress and protracted financial and household deleveraging, coupled with high levels of sovereign debt and unsustainably high government bond yields in some countries, has emerged as a disruptive and destabilizing force not only in the euro area itself, but also for the global economy as a whole.

To restore confidence, the pressing challenge in Europe and elsewhere is to effectively restart the engines of economic growth – most urgently in countries facing a prolonged contraction in economic activities. Also needed will be continued action on the part of policymakers to enact extraordinary fiscal and monetary measures to support growth, along with strong international policy coordination.

According to the report, the global economy is projected to show a modest rebound beginning in 2013, with output growth edging up to 3.6% versus 3.3% in 2012. All regions are expected to see moderately increased growth, except North Africa, where growth of 4.4% is projected, a reversion to a more typical rate following the post-conflict surge in 2012, and Sub-Saharan Africa, where output is projected to remain at a healthy rate of 5.3%.

"Yet, whether or not the modest global recovery that is currently projected will emerge is highly dependent on the ability of governments to put in place the necessary policy mix in order to reverse negative trends that have become more entrenched over the past year. In particular, this requires ending the negative feedback loop between the macro economy and labour markets, and restoring confidence by seriously tackling tail risks."

Even if the expected recovery is set to strengthen, global unemployment is likely to remain elevated and even increase further over the short term.

According to the report, key macroeconomic risks to the outlook for 2013 include a further deterioration in the euro area, where the baseline scenario of modest recovery is dependent upon policymakers continuing to establish credible policies to promote fiscal integration of euro area economies.

The negotiations in the United States surrounding the country's debt ceiling and the expenditure side of the "fiscal cliff" represent an additional risk, as the baseline assumes that policymakers successfully reach agreement to avoid automatic reductions in government expenditure and tax increases, particularly on the middle class.

The rise in estimated global unemployment by 4.2 million in 2012 is one of the largest increases since the early 2000s, excluding the immediate crisis years.

Reaching 197.3 million job-seekers in 2012, the number of unemployed is expected to rise further by about 5 million in 2013 and by 2.9 million in 2014 in the ILO's baseline projection, which assumes effective policy action in the United States to avoid a sharp reduction in fiscal expenditures and successful resolution of the debt ceiling discussions and no intensification of the euro area sovereign debt and banking crisis.

At the same time, the global unemployment rate is projected to edge higher and remain stuck at around 6% until at least 2017.

The larger increase in global unemployment projected for 2013 as compared with 2012 is due to projected increases in the Developed Economies and European Union region as well as South-East Asia and the Pacific, South Asia and Latin America and the Caribbean. Some of this, in turn, is due to population and labour force growth, while some is due to lags between economic changes and changes in the labour market.

However, said the report, a downside scenario was also estimated, one that assumes an intensification of the crisis in the euro area. In this downside scenario, global unemployment would severely worsen. Global output growth would fall to 2.2% in 2013 and 3.2% in 2014.

As a consequence, global unemployment would increase by an additional 3.5 million in 2013 (a total increase of 8.7 million versus 2012) to 206 million, corresponding to a rate of 6.1%, rising to 212.2 million in 2014, a rate of 6.2%. The bulk of the increase in unemployment would occur in the Developed Economies and European Union region, where the unemployment rate would reach 9.2% in 2013 and rise further to 9.5% in 2014, versus 8.7% and 8.6% respectively in the baseline.

The downside scenario implies that failure to enact effective policies to avoid a further intensification of the euro area crisis would raise the global unemployment rate to a level not seen since the depths of the crisis in 2009. The unemployment rate in the Developed Economies and European Union region would far exceed the peak rate reached in 2010.

"Importantly, this scenario only considers the effects of insufficient policy response in Europe. It does not include a potential double impact of insufficient policies in both Europe and the United States. Such a development would undoubtedly bring about an even larger surge in unemployment."

The report noted that the labour market situation remains particularly bleak for the world's youth. The ILO estimates global youth unemployment of 73.8 million in 2012, a rate of 12.6%, versus 12.4% in the previous year. Global youth unemployment has increased by 3.4 million since 2007.

The rise in youth unemployment is occurring alongside a withdrawal of young people from the labour market, with 22.9 million fewer employed youth in 2012 than in 2007, despite growth in the global youth population of more than 12 million. This resulted in a decline in the global youth labour force participation rate of about 2 percentage points between 2007 and 2012.

North-South divide

Unemployment rates remain far above historical levels in the Developed Economies and European Union region (8.6% in 2012 versus an average of 6.9% between 1998 and 2007), while in nearly every developing region, unemployment rates in 2012 were actually below average in comparison with the decade preceding the crisis.

In the Central and South-Eastern Europe (non-EU) and CIS (Commonwealth of Independent States), South-East Asia and the Pacific, Latin America and the Caribbean and North Africa regions, unemployment rates in 2012 stood more than 1 percentage point below the average over the decade from 1998 to 2007.

One reason for this divide is that by and large, developing economies have significantly outperformed developed economies during the recovery period in terms of economic growth. There is also evidence that stimulus packages enacted in developing countries to counter the impact of the crisis were targeted more towards addressing labour market weaknesses.

In contrast, in the Developed Economies and European Union region, broadly weak growth underscored by recession conditions in Europe, and limited effectiveness of fiscal and monetary measures implemented to mitigate the impact of the crisis on labour markets, has contributed to an increase of 14.8 million unemployed since 2007.

This amounts to more than half of the total global increase in unemployment, despite the region accounting for less than 16% of the global workforce.

Another reason for the divide in unemployment trends between developed and developing economies is that in developing countries, which often have large shares of workers outside of formal wage employment, unemployment rates typically have a weaker correlation with macroeconomic changes than in developed economies.

For many workers, job destruction and unemployment associated with the economic crisis has resulted in the need to look for jobs in "new" sectors and occupations. Some of the workers who lost their jobs in the financial and construction sectors, which were the first to be hit by the crisis in late 2008 and 2009, were forced to look for employment in sectors less strongly affected.

The report cautioned that as economies are restructuring, a mismatch may therefore arise between the supply of skills that is available in the large stock of unemployed created by the economic crisis and the demand for skills, in particular in developed economies. Such a mismatch hampers the reallocation of labour and will put upward pressure on unemployment rates.

Although the issue of skills mismatch has received renewed attention in developed economies due to the economic crisis, skills mismatch has affected and continues to affect labour markets around the world, it noted.

As of 2012, the global employment-to-population ratio (EPR) – the share of the working-age population that is employed – stood at 60.3%. The global EPR declined by 1 percentage point between 2007 and 2012, reflecting a substantial weakening in economies' employment-generating capacity.

The ILO estimates that a global jobs gap of 67 million has emerged as a result of the economic crisis – that is, there were 67 million fewer employed people around the world in 2012 than expected based on pre-crisis trends.

Labour productivity growth slowed sharply in 2012. At the global level, output per worker grew by only 1.9% in 2012, down from an average of 2.9% in the two previous years and below the pre-crisis average growth rate of 2.3%.

All regions excluding North Africa and Sub-Saharan Africa experienced a decline in productivity growth, and growth remains well below the pre-crisis trend in the Developed Economies and European Union, Central and South-Eastern Europe (non-EU) and CIS, East Asia and South Asian regions. In North Africa, the rapid productivity growth in 2012 reflects the sharp rebound in economic growth following the conflict-induced contraction of the previous year.

"The main factor underpinning this broad decline in productivity growth is weak investment. Investment growth has fallen further over the past year, with weakness spreading even to regions such as East Asia, where investment had been holding up well. The persistence of weak investment growth despite progress in repairing balance sheets reflects the new headwinds that have emerged from the sharp increase in macroeconomic uncertainties."

Poverty decline

Diminished investment and consumption in developing regions is likely to reduce progress in shrinking the share of workers in vulnerable employment – comprising own-account workers and contributing family workers – who are far less likely than waged and salaried workers to benefit from existing social protection systems.

In 2012, 1.49 billion workers in developing countries – 56% of all workers in the developing world – were in vulnerable employment, an increase of more than 9 million from the previous year.

On a positive note, the report highlighted the continued progress in reducing poverty. The number of workers living in extreme poverty has dramatically declined over the past decade and throughout the global crisis: the number of workers living with their families on less than $1.25 a day fell by 281 million in the decade to 2011, leaving a total of 397 million working poor below this threshold. This is equal to just over 15.2% of the developing world's total employment, down from 30.7% in 2001 and 45.2% in 1991.

The number of workers living in moderate poverty also declined over this period, but by a more modest 35 million, for a total of 472 million workers living with their families on between $1.25 and $2 a day.

Altogether, one-third of the developing world's workforce was living in poverty in 2011, down sharply from 53.7% in 2001 and from 66.7% in 1991.

New ILO estimates of employment by economic class show that in addition to the 868 million workers living with their families below the $2 poverty line, there are 661 million "near poor" workers – living between $2 and $4 a day – amounting to 25.2% of the developing world's workforce.

The number of near-poor workers has increased by nearly 142 million over the past decade, with more than 141 million of this increase occurring outside East Asia. Altogether, 58.4% of the developing world's workforce remained either poor or near-poor in 2011.

As the total share of poor and near-poor workers gradually fell, an estimated 41.6% of the developing world's workers were attaining the middle and upper-middle classes in 2011.

According to the report, this is a remarkable development given that in 2001, less than 23% of the developing world's workforce was middle-class versus 53.7% living in poverty.

The decade from 2001 to 2011 saw rapid growth in middle-class employment, with an increase of nearly 401 million middle-class workers (above $4 and below $13) and an additional increase of 186 million workers above the $13-a-day line.

Current ILO projections indicate that the number of workers in the middle class and above in the developing world could grow by an additional 390 million by 2017, with the share of middle-class workers rising to 51.9%.

"This emerging middle-class in the developing world could bring about a new driver of global growth, with stronger investment and consumption, in particular among poorer parts of the developing world."

The correlation indicates that in recent years (2011) total investment at the country level is associated with the share of the employed labour force that has reached middle-income status or above, thereby increasing domestic absorption. This would help foster structural change in these countries, increase global aggregate demand and potentially contribute to more balanced and sustainable global economic growth, to the extent that rising investment absorbs increasing shares of domestic savings, the ILO said.

Negative impact

The report summarized that available labour market data leave no doubt that the slowdown in global economic growth in 2012 has had a widespread, negative impact on the world of work. Global unemployment is rising once again, with particularly negative implications for the world's youth. Growth in the numbers of long-term unemployed and increased labour market detachment is raising the risk of the emergence of structural labour market problems that could become entrenched, lowering potential rates of growth and reducing the likelihood of a sustainable recovery taking hold.

The increase in macroeconomic uncertainty is a reflection of the sharp downturn in aggregate demand that has taken place; but increasingly, this macro uncertainty as well as diminished confidence in the ability of policymakers to address the current economic challenges is also one of the main contributing factors to slowing growth and poor labour market outcomes.

"Closing the global employment gap, which has now reached 67 million, will require decisive action by policymakers to restore confidence and promote investment and job creation."

The report noted that much of the current attention is focused on problems in the advanced economies – with record unemployment, recession conditions in Europe and risks of further deterioration in growth and contagion effects, should tail risks materialize.

Yet policymakers in developing regions also cannot afford to sit idle, as economic growth and trade are slowing, as is the rate of productive structural transformation that has driven much of the developing world's progress in reducing poverty and growing a larger middle class.

At the same time, this new cohort of middle-class workers in the developing countries provides hope that a new global economic engine will emerge through higher consumption and investment, leading to a more balanced and

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The return of austerity – a view from Africa

The austerity preached in the West is not the right fiscal policy path for African economies – instead, they should look to their own recent experience in managing recovery and growth.

by Léonce Ndikumana

Following the intense debate on the fiscal deficit during the US presidential campaign, fiscal consolidation continues to dominate discussions in policy circles and academia. The large fiscal deficit in the US and sovereign debt woes in the eurozone are used by proponents of the "small government" mantra as a means to advance the belief that fiscal consolidation is the only way to bring the economy back to sustained growth and full employment. While the arguments are not new, the current circumstances of a global recession and a slow recovery in the US make it somehow easier for proponents of this school of thought to fool the public into believing that tying the hands of the government is the only road to salvation.

African countries and developing countries in general know too well about the ravages of austerity programmes; they certainly would not want to revisit the era of the 1980s that left permanent scars from fiscal retrenchment. While arguments for the alleged benefits of fiscal consolidation in terms of accelerated recovery and long-run growth are built on shaky empirical grounds in the case of developed countries, they are even more tenuous for African countries.

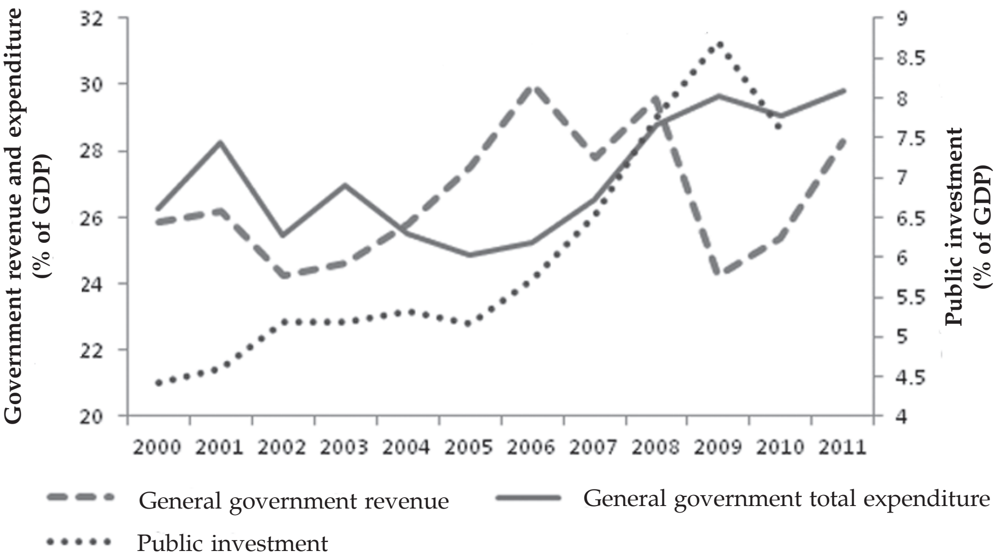
First is the chimera of "expansionary fiscal contraction" whereby fiscal consolidation is arguably supposed to boost growth through expansion of private spending driven by improved business confidence. In the case of developing countries, fiscal retrenchment typically involves substantial cuts in public expenditures including infrastructure, which worsens rather than improves the business environment by raising production costs. So, "expansionary fiscal contraction" isn't, and can't be, a developing-country phenomenon.

Second, it is alleged that fiscal consolidation would cause interest rates to decline, thereby raising private investment and consumption. The fact is that interest rates in African countries and in developing countries in general are sticky downward, notably due to pervasive distortions in credit markets. Furthermore, investment in that part of the world is constrained less by the cost of credit than by other economic and non-economic factors, so that a deficit-reduction-induced decline in interest rates – to the extent that they actually decline – will have limited effects on private investment. In contrast, countries will most likely suffer substantial decline in private investment following a reduction in public investment associated with fiscal consolidation.

Third, it is argued that the negative impact of fiscal contraction would be mitigated by the effects of the depreciation of the national currency on trade – raising exports and reducing imports. In African countries, exports are price-inelastic, especially given the predominance of primary commodities. Moreover, the increase in global demand is typically met with a lag due to supply-side constraints. In contrast, a depreciation of the national currency carries heavy costs due to the increase in the bill associated with imports of indispensable goods such as raw materials.

It is also alleged that the negative impacts of fiscal contraction, especially if due to a cut in public expenditures, can be mitigated by a monetary stimulus. The problem is that African countries have limited space for such stimulus, especially given their commitment to low inflation. This means that their economies would most likely absorb the full blow of fiscal contraction.

Figure 1: Africa: Average public revenue, expenditure and investment (% of GDP)



Source: World Bank, African Development Indicators; IMF, World Economic Outlook database.

Policy lessons

So, if African countries can't look westward for models on fiscal management during hard economic times, where can they turn to? First, African countries can learn from their good performance during the global recession. While they suffered a decline in public revenue, this did not translate into a proportional decline in public expenditure (see Figure 1). In fact, on average the continent managed to maintain the general upward trend of public expenditure which has sustained the growth resurgence over the past two decades.

Second, African countries can leverage untapped potential for domestic saving through innovative mechanisms such as local-currency infrastructure bonds. When the government of Kenya floated an infrastructure bond for Sh31.6 billion in 2010, it was oversubscribed by 18%. Other countries can emulate the Kenyan example and leverage increased appetite for fixed-income instruments in the context of high market uncertainty. African countries can raise more domestic resources by expanding the tax base and exploiting other revenue-generating instruments, in both the public and private sectors.

All this is to say that African countries have plenty of lessons to learn from the continent itself in managing a demand-led recovery and sustaining robust long-term growth. They must choose a fiscal policy stance that sustains, not stunts, the growth momentum. ❐

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sustainable growth model in the years to come.

"Above all, at this critical moment for the global economy, what is needed is a renewed focus on the world of work. This will require focusing policy action on employment generation, the promotion of investment and productivity growth. Without a significant improvement in the global labour market situation, there will be little hope of breaking the negative feedback loop still plaguing the global economy."

The report highlighted several promising areas for action including tackling policy uncertainty to increase investment and job creation, coordinating stimulus for global demand and employment creation, addressing labour market mismatch and promoting structural change, and increasing efforts to promote youth employment, with a special focus on long-term unemployment for youth. *(SUNS7509)* ❐

Too much of the same

The increasing homogenization of financial systems is hurting developing economies, writes *Jayati Ghosh*.

There is a common view that developing countries – particularly some of the larger and stronger emerging markets – have been faring rather well in the latest round of the ongoing global financial crisis. Indeed, there have even been some arguments that the successive rounds of crisis are weakening the developed world, first the US and then Europe, while some developing countries continue to forge ahead, thereby accelerating the global shift in balance of economic power.

This view is overly simplistic. The past few years have made it clear that "decoupling" was a mirage. Developing countries – even the strongest ones like China – are immune neither to the storms raging in financial markets in industrial countries, nor to the impact of recession in the core of capitalism.

There has been a remarkable degree of global synchronicity in the changes in the rates of growth of national income over the past few years. The transmission of recessionary tendencies operates through several channels. They include changes in the exports of goods and services, in international capital flows, in patterns of migration and remittances, and in world trade prices for essential goods like oil and food.

Unhelpful volatility

Volatile capital flows matter greatly. Rapid movement of highly mobile finance capital was made possible by financial liberalization in past decades. Similar policies were adopted to greater or lesser extent across the developing world, so capital markets have become much more integrated. These policies created new and similar forms of financial fragility almost everywhere.

Today, any new global trend can cause movements of finance in or out of a developing country, even when there is no real change in the "fundamentals" of that specific country's economy. It is worth noting that in 2009, for example, the worst-performing stock markets were not those of developed countries that were the epicentre of the crisis, but those of emerging markets like China, Brazil and India – even though the underlying data in these economies were more favourable than in the US, for example.

Obviously, the shift of internationally mobile finance capital away from developing countries to the advanced core of capitalism in periods of global turmoil does not reflect any objective assessment of the relative current and potential future economic prospects of the regions concerned. It does show, however, how imperfect and inefficient global capital markets can be, and how "flights to safety" can be determined by criteria that are not necessarily economic.

The dynamics of global finance affect developing countries in another way because financial players have been becoming increasingly active in global commodity markets. Financial deregulation allowed unrestricted activities by an increasing number of players on commodity exchanges, and speculation has grown dramatically. The result is the excessive price volatility in international markets that we have witnessed in recent years.

Not only have the prices of grain and other food crops changed sharply, but prices for oil and mineral resources have risen fast too. Speculative behaviour is clearly behind such volatility, but the effects are not confined to financial markets. These prices directly affect the real economies of developing countries.

These forces affect all developing countries, but they are felt differently in different places. In particular, the extent of financial contagion and likelihood of local financial crisis depends on how far the developing country concerned has gone along the road of financial liberalization. Countries with large external debts and current account deficits face particular problems.

The developing countries that have gone furthest in terms of deregulating their financial markets along the lines of the US model – for example, Indonesia – are likely to be the worst affected. They may well yet face financial crises of their own.

By contrast, China, which still keeps most of its banking system under state control, is relatively safe, despite the dangers of explosive growth in its shadow banking system. At least, the People's Republic did not allow many of the financial "innovations" that caused the current mess in developed markets.

Loss of diversity

It should now be evident for all to see that the global homogenization of the past decades was unhealthy. The regulatory structures that evolved in financial systems across the world have led to conformist patterns of behaviour among financial institutions. Accordingly, these institutions have become more fragile and more susceptible to contagion.

So far, current regulatory practices and even the proposals to reform them do not recognize the dangers of over-homogenization. Nonetheless, steps need to be taken to reverse the trend. It is a recipe for disaster to make all banks operate in the same way and follow the same guidelines (see box next page). Herd behaviour will always compound excesses, in terms of both irrational exuberance and, more recently, frantic deleveraging.

Dwindling financial diversity means less resilience everywhere. In the developing world, however, there are some additional serious consequences. The ability of financial systems to channel domestic savings into investment has been reduced. In particular, banks are now less prepared to lend money to small and medium-sized enterprises (SMEs), cooperatives and other businesses that drive local economies though they do not come up with huge figures on their balance sheets.

Historically, these smaller-scale producers used to be outside the reach of formal finance, and things have lately become tougher for them once again. They deserve to be properly covered by institutional finance instead of having to rely merely on expensive and short-term microfinance.

For that purpose, some forms of subsidy may be required. Moreover, central banks and regulators should take creative and flexible approaches to ensure that different banks (commercial, cooperative, development, etc) reach SMEs, self-employed workers, peasants, women and those without land titles or other collateral.

Developing countries need a broad variety of banking institutions to boost growth and foster business in different areas and sectors. Today, global homogenization and increasingly standardized regulations are thwarting the scope for different types of banks to emerge and/or survive. This trend is reducing the diversity needed to expand access to financial services in developing countries.

The rules that apply to multinational investment banks and national-level commercial banks cannot and must not apply to government-run development banks, local savings banks or cooperative banks. Instead, diversity in the financial system can and should be encouraged at several levels and by several means. Central banks and regulators should focus on aspects such as:

- encouraging or even requiring financial institutions to specialize in different activities;
- reducing or even eliminating the convergence of risk management systems across different financial institutions, by emphasizing different ways of modelling risk for different kinds of financial institutions;
- encouraging the creation and expansion of development banks that are subject to different regulatory requirements from normal commercial banks;
- creating and expanding national networks of community development banks that serve financially underserved communities, whilst allowing for cross-subsidization and synergies, and
- ensuring that sector-specific banks and client-specific financial institutions operate under prudential norms and other regulations that are sensitive to their specific areas of business (agricultural banks or cooperative banks, for instance).

If the G20 is to fulfil its role of adequately representing the needs of the majority of the world population, it needs to take these concerns on board. Global leaders must consider developing an international financial architecture that recognizes the need for diversity in finance even as it prevents or at least reduces institutional fragility and market volatility.

So far, the G20 has not risen to this challenge. It is too early to tell the reason. Perhaps the structure of this informal global-governance body is to blame. Perhaps domestic politics in member countries is blocking progress. It is obvious, however, that global leaders have been doing more to promote the interests of finance capital than to serve the interests of their peoples ever since the global crisis broke out in 2007-08. ❐

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Similar portfolios

Obviously, different types of financial institutions should serve different purposes. A rural development bank should not have the same priorities as a consumer credit institution, for instance. But instead of diversity, we now see fairly standardized herd behaviour among banks all over the world. Global homogenization has led to similar portfolios and similar risk exposures at otherwise quite different institutions.

Such conformity is the logical result of deregulation. There are several reasons. The most important are:

- moral hazard, as banks have incentives to undertake correlated activities because they are likely to be bailed out collectively in the event of joint failure;
- externalities, as bank managers have no reason to consider systemic risks that increase when all financial institutions behave the same way, but rather know they will be able to avoid personal responsibility for failure should they all fail at once for the same reasons; and finally
- entanglement, as financial institutions generally tend to pool risks and act in an interconnected manner.

Standard prudential regulations, moreover, stop banking institutions from providing financial services to neglected sectors and people, such as agriculture and small-scale producers. Regulators need to take different approaches to different types of banks and they must use different criteria for monitoring and supervising them. For instance, they must not apply the same rules to multinational investment banks and rural cooperative banks.

On the other hand, homogenization constrains the necessary use of development finance, which is defined as long-term finance for development provided by public banks. It also increases the difficulties of ensuring that financial institutions encourage financial widening in the sense of granting more people access to financial services, but tends to reinforce the trend of – often unnecessary – financial deepening, understood as banks using an ever-greater variety of financial instruments. *– Jayati Ghosh*

The persistent power of finance

Approval by US authorities of a fund which could drive financial speculation in the copper market points to the continued influence of finance capital.

by CP Chandrasekhar

In a move that went contrary to what is expected of regulators, the Securities and Exchange Commission (SEC) of the US approved in mid-December a controversial JPMorgan-created exchange-traded fund (ETF) backed by physical supplies of copper.

The fund will use investor money to buy and hold copper, presumably to earn a profit when prices rise. According to a NASDAQ analysis, the investment vehicle will register 6.18 million shares backed by 61,800 metric tonnes of copper in physical form stored in warehouses approved by the London Metal Exchange or located in the Netherlands, Singapore, South Korea, China and the US, and not approved by the LME.

With this decision of the SEC, copper joins metals such as gold, silver, platinum and palladium that are already traded through ETFs. If the JPMorgan proposal goes through, so would another ETF proposed by Blackrock titled iShares Copper Trust, which is currently awaiting SEC approval.

Copper is a metal much in demand for electricity wiring and various industrial uses that are growth areas in many emerging markets. The result is that copper has been trading in rather tight markets. According to the International Copper Study Group, apparent global usage of copper grew by 5.2% during the first nine months of 2012 as compared with the corresponding period of 2011, driven largely by a 19% increase in China's apparent usage. China accounted for 43% of world usage over this period.

As a result, the refined copper balance for the first nine months of 2012 points to a deficit of 594,000 tonnes, which was more than a third of refined copper production with capacity utilized to the extent of 80%. While slowing growth in China may have led to accumulation of inventories, the market is indeed tight. According to the Economist Intelligence Unit, copper will be the strongest performer among metals in 2013, with prices rising by 12% thanks to the supply-demand balance.

Potential for "havoc"

Given this context, the SEC's decision has been mired in controversy though taken after a delay of more than two years since JPMorgan first proposed the fund. The fundamental issue is whether the process of buying and holding claims on physical stocks of copper would keep supplies out of a tight market and drive up prices to deliver speculative gains to financial investors.

Copper traders and users argue it would. The JPMorgan and Blackrock ETFs together would, in their view, reduce copper available for immediate delivery by about 34% and "wreak havoc" as a result of a "substantial artificially induced rise in near-term copper prices." Complainants include companies such as Southwire, Encore Wire, Luvata and AmRod and a trading house, Red Kite.

The SEC on the other hand has held that since copper held by the fund can be redeemed in three business days against a share purchase, there would be no "meaningful change" in availability. Rather, in its view, this provides another route to purchasing copper and thereby increases competition in the market.

This argument makes little sense since creating a financial instrument against physical copper is essentially a way of offering one more alternative asset to financial investors interested in profiting from speculation in the copper market. At a time when restrictions on futures trading in commodities have been recommended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, inducing additional elements of speculation into the market is hardly defensible.

Moreover, the SEC's argument, which suggests that it has bought into JPMorgan's reasoning, flies in the face of facts. Thus, according to the *Financial Times*, since the launch of physical gold ETFs in the US in 2004, they have collectively acquired $140 billion worth of gold (which is more than what most central banks hold), in the aftermath of which gold prices have risen by 282%. Similarly, a new palladium ETF launched in 2010 acquired 505,000 ounces in two months, which was equivalent to 42% of mine production over the period. The result was that prices rose to a two-year high, forcing even JPMorgan to admit that ETF buying had "crowded out" the market.

Stuart Burns, writing on the Seeking Alpha website, refers to similar evidence from the aluminium market. According to him: "Financial involvement has distorted the aluminium market so badly that there are officially some 5 million tons and potentially twice that sitting isolated from the market in park-and-ride finance deals. The resulting competition for metal has created premiums for primary ingot over and above the LME price."

In sum, the SEC was not short of evidence to reject JPMorgan's proposal. That it has instead decided to back it points to the influence that finance capital exerts. At the time of the 2008 financial crisis, there was enough evidence that it was not because of regulatory failure but in part because of regulatory capture and collusion that matters took the turn they did. The post-crisis debate had raised expectations that this would be corrected. The SEC's decision, along with developments in other markets, is strong evidence that those expectations have been belied. ❒

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Cautious welcome for "Robin Hood" tax

Lauding the imposition by 11 European states of a levy on financial transactions, civil society groups have called on the countries concerned to earmark part of the earnings for development uses.

by AD McKenzie

PARIS: Non-governmental organizations across Europe welcomed the move by 11 European Union countries on 22 January to move forward with the introduction of a financial transaction tax (FTT), but they urged national governments to ensure that a part of the revenues would be allocated to development.

Calling the tax a "golden anniversary" present because it came on the 50th anniversary of French-German friendship, a coalition of more than 70 NGOs appealed to French President Francois Hollande and German Chancellor Angela Merkel to spread a "public message of solidarity outside their borders" to guarantee that the FTT would be used particularly in the fight against poverty and HIV/AIDS, and to combat climate change.

"We are happy to see that the process is moving ahead but we're very worried that the issue of allocating part of the money to development is not going to be taken up," said Friederike Roder, a spokesperson for anti-poverty group ONE, which was co-founded by rock musician Bono.

"What can happen is that the countries will be so pleased to see additional revenues coming in that they might use the funds for their general national budgets and not be willing to earmark any for development," she told Inter Press Service (IPS).

So far, Hollande is the only head of state who has said the FTT will go partly for development.

France and Germany spearheaded adoption of this "major milestone" for EU tax guidelines, as the European Union's taxation commissioner Algirdas Semeta put it on 22 January.

The decision came after a meeting of the EU's 27 finance ministers in Brussels, but France had long been pressing for the move.

Former French president Nicolas Sarkozy vowed a year ago to implement the FTT without waiting for his European or G20 partners to come on board. "If France waits for others to tax finance, then finance will never be taxed," Sarkozy said at the time.

The country's parliament approved the tax and it was introduced last February during the waning days of Sarkozy's presidency, but without the development aspect.

Under Sarkozy's socialist successor Hollande, who won the presidency last May, the law was amended to allocate an unspecified percentage of the tax revenue to development aid, compared with the 50% that French NGOs had requested.

During his campaign, Hollande had supported the so-called Robin Hood tax, amid vows to tax the rich and to alleviate poverty.

His government has now pledged that this year 60 million euros of the funds from the FTT will be assigned to development aid, a sum that may account for only about 4% of the revenues, according to NGOs. But once the tax is fully in place, the government is expected to allocate 10% of the revenues for development.

"This would happen as from 2015, and it's still way lower than what we expected," Roder told IPS. "But what we have to acknowledge is that the law now stipulates that a part of the revenue will go to development, which is clearly progress."

"Enhanced cooperation procedure"

For Germany, Merkel had said that the tax would be the "right signal to show that we have understood that financial markets have to contribute their share to the recovery of economies," but she wanted all members of the 27-nation European Union to agree on the measure before its imposition.

However, some EU members such as the United Kingdom, which already has a stamp duty, and Sweden have remained opposed to the idea, and it was only through the EU's "enhanced cooperation procedure" that the FTT was given the green light for 11 instead of all 27 member states.

Under this procedure, a minimum of nine EU member countries are allowed to establish integration or cooperation if they wish, without the others being involved.

The 11 nations backing the tax are Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain. A 12th country is expected to join the group, according to sources in Brussels.

The measure will go now go before the European Parliament as a formality, to approve the European Commission's proposal that transactions in shares and bonds be taxed at 0.1%, and trades in derivatives at 0.01%.

Overall, by implementing a levy of this percentage on financial transactions, France could gain up to 12 billion euros a year, according to the International Monetary Fund. At the European level, about 50 billion euros could be raised annually, the IMF says.

Some EU governments may consider using FTT revenues to support the banking industry, but several NGOs said that banks have continued to make profits despite being the main cause of the eurozone's ongoing economic crisis.

Governments in Spain, Greece and several other countries have had to prop up banks that were floundering after bad investments.

"The European FTT is a major step forward, but the main aim of this tax should be the fight against hunger, poverty, pandemics and climate change," said Alexandre Naulot of Oxfam France.

"A joint announcement by Francois Hollande and Angela Merkel would complete a constructive European approach in these times of crisis and budget cuts."

Meanwhile, Khalil Elouardighi, chief campaigner for Coalition PLUS, a group of organizations that work to combat HIV/AIDS, told IPS: "If European leaders see the tax only as a way to plug their immediate budget problems as opposed to a once-in-a-century opportunity to finally finance those global challenges that are a huge threat to everybody, that would be a complete mistake."

The group says that the financial transaction tax in France alone could help to treat an additional 400,000 people living with HIV/AIDS in the developing world, and there would still be "money left over" for many other problems. *(IPS)* ❐

EU massively under-notified its agri subsidies, argues paper

A study by a French development group has found discrepancies in European Union farm subsidy figures reported to the WTO.

by Kanaga Raja

GENEVA: The European Union has so massively under-notified its agricultural subsidies to the World Trade Organization (WTO) that it will not be able to comply with its proposal to reduce by 80% its allowed overall trade-distorting domestic support (OTDS), a paper by the French non-governmental organization (NGO) Solidarite has argued.

The paper, dated 24 January and authored by Jacques Berthelot, comments on the state of play in the WTO's Doha Round negotiations, focusing in particular on the issue of domestic support in agriculture.

According to the Berthelot paper, the stalemate in the Doha Round negotiations is largely due to agricultural issues, not only because it was the main breaker of the negotiations in New Delhi in July 2008 but, "more largely, because the DCs (developing countries) think that the developed countries' demands on non-agricultural products market access (NAMA) and services are disproportionate with the feasibility of their offers on agriculture."

The paper argues that the December 2008 draft modalities text on agriculture (DMA) is full of inconsistencies with the WTO Agreement on Agriculture (AoA) and that the EU made massive under-notifications of its subsidies so that it cannot comply with its proposals to cut by 80% its allowed OTDS because it is lower than the level it has calculated whereas its applied level is much higher than the level it has notified.

It notes that the allowed OTDS that the EU agreed to cut by 80% at the end of the Doha Round implementation period is that of the base period 1995-2000, which was the Uruguay Round implementation period.

Simulation exercise

On 22 May 2006, Canada circulated a report on "Agriculture domestic support simulations" [WTO document JOB(06)/151] with this introduction: "Representatives of Australia, Brazil, Canada, China, the European Communities, Egypt, India, Japan, Kenya, Malaysia, Norway and the United States have undertaken a data simulation exercise on various reduction options for the Total AMS and the Base for the Overall Commitments, using information provided by the European Communities, Japan and the United States. This effort was based on assumptions and indicators agreed by these Members for purposes of this statistical exercise alone. It was undertaken without prejudice to the positions of the Members involved. These Members would now like to share the results of this simulation exercise, including the data, assumptions and results, with the WTO Membership as a whole."

The Berthelot paper said that from that date on most members, the media and NGOs have based their comments and negotiating positions on these simulations, without taking account of their huge flaws.

According to Canada's simulations, endorsed by the EU and the WTO, the EU's authorized OTDS (at that time it was the EU15) would be 110.305 billion euros [67.159 for the Final Bound Total AMS (Aggregate Measurement of Support on 30 June 2001) (FBTA) + 11.129 (product-specific *de minimis*, PSdm) + 11.129 (non-product-specific *de minimis*, NPSdm) + 20.888 (Blue Box, BB)] and its reduction by 80% would lower it to 22.061 billion euros at the end of the Doha Round (DR) implementation period.

However, says the Berthelot paper, this calculation contradicts the AoA rules on two points: the allowed product-specific *de minimis* (PSdm) is not 5% of the value of the whole agricultural production (VOP) and the EU feed subsidies conferred PS AMSs to all animal products.

Therefore, the authorized OTDS is only 90.496 billion euros and its reduction by 80% would lower it to 18.099 billion euros at the end of the DR implementation period.

The paper said that these OTDS data must be revised to take into account the revised FBTA notified to the WTO at 72.244 billion euros for the EU27 after the adhesion of the EU12 New Member States (NMS), but the EU did not revise and notify the value of its total agricultural production (VOP) of the EU27 for the years 1995 to 1997, by lack of data for some NMS so that it could not revise the *de minimis* NPS AMS.

Berthelot, in his Solidarite paper, has however actualized these data relying on FAOSTAT values of all agricultural products (VOP) which, for the base period 1995-00, was 271.947 billion euros in the EU27, so that, according to Canada's simulations endorsed by the EU, the PSdm and NPSdm were each 5% of that VOP value, i.e., 13.597 billion euros.

As very few notifications of Blue Box payments were made by the EU12 NMS in 1995-00 – only Estonia, Slovakia and Slovenia notified BB payments, and only in 2000 for Estonia and Slovenia – contrary to the EU12, their applied BB was much lower than 5% of their VOP so that their allowed BB is only of 5% of their average VOP of 35.316 billion euros in the base period, i.e., of 1.766 billion euros – so that the EU27 allowed BB amounted to 22.654 billion euros and the allowed EU27 OTDS was, on the lines of Canada's simulations, 122.292 billion euros [72.244 (FBTA) + 13.597 (PSdm) + 13.597 (NPSdm) + 22.654 (BB)] and the 80% reduction gives an allowed OTDS of 24.418 billion euros at the end of the DR implementation period.

PSdm support

The paper also argues that the PSdm support is not 5% of the value of the whole agricultural production.

It cites paragraph 1 of the December 2008 draft modalities text on agriculture as stating: "The base level for reductions in Overall Trade-Distorting Domestic Support … shall be the sum of: (a) the Final Bound Total AMS specified in Part IV of a Member's Schedule; plus (b) for developed country Members, 10 per cent of the average total value of agricultural production in the 1995-2000 base period (this being composed of 5 per cent of the average total value of production for product-specific and non-product-specific AMS respectively)."

According to the Berthelot paper, this statement contradicts paragraph 30 of the DMA on *de minimis* support confirming the AoA definition of the PSdm: "The *de minimis* levels referred to in Article 6.4(a) of the Uruguay Round Agreement on Agriculture for developed country Members (i.e. 5 per cent of a Member's total value of production of a basic agricultural product in the case of product-specific *de minimis* and 5 per cent of the value of a Member's total agricultural production in the case of non-product-specific *de minimis*) shall be reduced by no less than 50 per cent effective on the first day of the implementation period."

In other words, as soon as a product-specific coupled support reaches 5% of the production value of a product, it loses its PSdm for that product and gets a PS AMS which is added to the total applied AMS, and the production value of that product is added to the production value of all the products with PS AMSs.

The hidden reason for which Canada's simulations and the DMA violated the AoA rule on the PSdm is that Japan up to 2009 (last notified year) and the EU up to 1999-00 did not notify the production value of products for which they calculated a PS AMS.

Therefore, they were unable to check if those PS AMSs were lower than 5% of the production value of those products during the base period 1995-00. It is only from 2000-01 that the EU notified the production value of each product.

That is why paragraph 12 of the DMA proposed the new requirement that "The data on value of production shall, for all Members undertaking OTDS reduction commitments, be annexed to these modalities".

"The WTO Secretariat should have asked the EU and Japan to rectify their notifications by adding the production values of all products, which would not have been impossible since Solidarite was able to assess them," said Berthelot.

Feedstuff subsidies

According to Berthelot, the consequences of the false interpretation of the AoA rule on the PSdm support are felt mainly when it is combined with the refusal of the EU and the other developed Members to consider feedstuffs as inputs.

The developed countries have refused to consider their subsidies to feedstuffs (COPs: cereals, oilseeds, pulses) as input subsidies to be notified in the PS AMS of the animal products (meats, eggs, dairy products) fed by these COPs.

The EU notified in the PS AMS some feed subsidies such as to dry fodder (374 million euros on average from 1995 to 2000 and 121.9 million euros for 2009-10, the last notified year; the OECD database showed that they were 141 million euros in 2010 and 97 million euros in 2011), and to skimmed milk fed to calves (513 million euros on average from 1995 to 2000, and subsidies only eliminated since 2008), showing that the EU is quite aware that feed subsidies are coupled subsidies.

These feed subsidies confer PS AMSs to all animal products which consumed the feed, increasing the production value of products with PS AMS and consequently reducing the production value of products without PS AMSs.

Thus, the EU15 average production value of products with PS AMSs was not 122.922 billion euros in the 1995-00 base period but 201.323 billion euros, so that, given the 222.577 billion euros of the average whole agricultural production value (VOP), the average value of products without PS AMS collapsed to 21.253 billion euros and the allowed PSdm, which is 5% of that value, fell at 1.063 billion euros.

Correlatively, the average Blue Box was reduced to 11.145 billion euros instead of 20.888 billion euros because 9.743 billion euros of direct payments to the EU COPs used as feed were transferred to the PS AMSs of animal products having consumed these feedstuffs.

Therefore, the EU15 allowed OTDS for 1995-00 fell at 90.496 billion euros [67.159 (FBTA) + 1.063 (PSdm) + 11.129 (NPSdm) + 11.145 (BB)] instead of 110.305 billion euros according to Canada's simulations. And the 80% reduction gives an allowed OTDS of 18.099 billion euros at the end of the Doha Round implementation period instead of 22.061 billion euros.

The Berthelot Solidarite paper assessed the allowed EU27 OTDS in 1995-00. Having availed already of the revised FBTA of 72.244 billion euros, of the revised VOP of 271.947 billion euros, of the NPSdm of 13.597 billion euros and of the revised BB of 12.911 billion euros (11.145 for the EU15 + 1.766 for the EU12), the PSdm remains to be assessed.

For this, Solidarite said that there is a need to find the PS AMS of the EU12 animal products having consumed the share of COPs used as feed. Here, a problem is faced in the lack of data in Eurostat for the years 1995 to 1997 for which the value of meats, milk and eggs is not available for all NMS, and FAOSTAT here cannot help.

Given that we avail of the EU12 VOP from 1995 to 2000, we assume that the average distribution of the 34.204 billion euros in the total production value of animals+milk+eggs for the years 1998 to 2000 between the three products holds also for the years 1995 to 1997.

Therefore, we get 16.008 billion euros of additional PS AMS of animal products issued from the EU12 feed subsidies, to be added to the 201.323 billion euros of the EU15 PS AMS, making a total of 217.331 billion euros.

Given the 271.947 billion euros of the EU27 VOP, the average value of products without PS AMS fell at 54.616 billion euros and the allowed PSdm, which is 5% of that value, fell at 2.731 billion euros.

Finally, the allowed EU27 OTDS for the 1995-00 base period fell at 101.483 billion euros [72.244 (FBTA) + 2.731 (PSdm) + 13.597 (NPSdm) + 12.911 (BB)] instead of 110.305 billion euros according to Canada's simulations for the EU15 only. And the 80% reduction gives an allowed OTDS of 20.297 billion euros for the EU27 at the end of the DR implementation period.

Applied OTDS

The paper also underscores that the EU's applied OTDS in the 1995-00 period and up to now is considerably larger than the notifications already made to the WTO. Indeed, on the one hand, the applied PS AMS was much larger and, on the other hand, the Single Payment Scheme (SPS) and the Single Area Payment Scheme (SAPS) since 2005 are not fully decoupled and are therefore in the AMS.

As for the BB, the WTO framework agreement of 31 July 2004 decided that it should be considered as a coupled payment. Besides, the EU has hugely undernotified to the WTO its NPS AMS comparatively to that notified to the OECD. Therefore, the fact that the remaining BB payments and the PS AMSs continue to be transferred to the SPS does not change the applied OTDS.

The EU15 applied PS AMS was on average 60.973 billion euros in the base period 1995-00, not 48.425 billion euros as notified. The transfer of the BB going to COPs used as feedstuffs had the double effect of reducing the BB and increasing the PS AMSs of the animal products having consumed those feeds, and we get an average actual PS AMS of 60.973 billion euros in the 1995-00 period, instead of the notified 48.425 billion euros.

The additional 12.548 billion euros

came from: (1) on the one hand, the PS AMSs of the animal products linked to the subsidies to the feed integrated into these products: milk (4.078 billion euros), bovine meat (2.630 billion euros), pig meat (2.522 billion euros), poultry meat and eggs (1.358 billion euros); and (2) on the other hand, the PS AMS conferred to oilseeds meals processed from the EU oilseeds (800 million euros) and pulses (525 million euros), and the subsidies to the fat content of milk (428 million euros) and to the skimmed milk for casein (207 million euros), that the EU did not notify.

Taking into account the EU12 data, the EU27 total AMS of the 1995-00 base period was 61.766 billion euros, of which 61.282 billion euros was for the PS AMS.

For 2009-10 (the last notified year for the EU27), to the notified PS AMS of 8.764 billion euros we must add first the PS AMSs of the animal products linked to the subsidies to the feed of EU27 origin integrated into these products, for 13.733 billion euros in 2009 – of which 11.690 billion euros is to energy feed (8.926 billion euros in the EU15 and 2.764 billion euros in the EU12) and 2.043 billion euros to protein feed (1.955 billion euros in the EU15 and 88 million euros in the EU12) – according to a report not yet published, which makes a total of 22.497 billion euros of PS AMS.

On the 13.733 billion euros of feed subsidies, 12.084 billion euros were decoupled (of which 9.479 billion euros of SPS and 2.605 billion euros of SAPS) and 1.649 billion euros were coupled [of which 1.402 billion euros in the EU15 and 247 million euros of CNDP (complementary national direct payments) in the EU12].

Any challenge at the WTO against the SPS and the future BPS (Basic Payment Scheme) is sure to put them in the Amber Box (AMS) of coupled subsidies, Solidarite said, citing a number of reasons for this.

The paper also found that the subsidies of non-product-specific AMS were hugely under-notified. The main under-notifications are on subsidies to farm investments, marketing and promotion, agricultural fuels and irrigation. According to the AoA, all these subsidies are in the Amber Box for the developed countries.

Based mostly on the EU notifications to the OECD, the EU15 NPS AMS was at least 7.924 billion euros on average in the base period 1995-00, against a notified average of 528 million euros, and 11.976 billion euros in the last notified year 2009-10.

The EU27 notified NPS AMS in 1995-00 was 1.031 billion euros and the actual applied NPS AMS was 8.434 billion euros.

The paper found that the EU15 average applied OTDS in the base period 1995-00 was 80.077 billion euros instead of the notified 69.269 billion euros. The EU27 applied OTDS was 81.442 billion euros against a notified 71.234 billion euros. The EU27 BB was not significantly different from the EU15 BB as the EU12 average BB was only 24.6 million euros.

The EU27 applied OTDS in 2009-10, the last notified year, was 70.665 billion euros. The EU27 production value of products with PS AMSs rises from the notified 33.272 billion euros to 165.076 billion euros, after addition of 82.36 billion euros for the production value of animals plus 49.768 billion euros for the production value of milk and eggs.

As the notified production value of all agricultural products (VOP) was 302.611 billion euros, the value of products without PS AMS was 137.535 billion euros and the actual PSdm, which is 5% of that value, was 6.877 billion euros.

The other OTDS components were: 46.377 billion euros for total AMS, after addition to the notified 8.764 billion euros of 13.733 billion euros of feed subsidies, 22.003 billion euros of SPS (after deduction of 10.881 billion euros of feed subsidies from the notified 31.482 billion of SPS) and 1.877 billion euros of SAPS (after deduction of 2.605 billion euros of feed subsidies from the notified 4.482 billion of SAPS); 12.087 billion euros for the NPS *de minimis*; and 5.324 billion euros for the BB.

If we compare the applied OTDS in 2009-10 with the EU commitments reflected in the DMA, we see that the EU is not prepared to face such commitments, as the 2009-10 applied OTDS is 3.5 times higher than the objective at the end of the DR implementation period; it is 2.1 times higher for the total AMS; 78% higher for the NPSdm; and 5 times higher for the PSdm, even if there is a small leeway of 1.475 billion euros for the BB, the paper concluded. *(SUNS7511)* ❐

The full Solidarite paper, with data tables, can be accessed at http://www.solidarite.asso.fr/IMG/pdf/Solidarite_s_comments_on_the_State_of_play_of_DDA_negotiations_24_January_2013.pdf.

Death of an Internet open-access activist

The tragic suicide of a well-known Internet open-access advocate has sparked protests against the highly protected system that limits public access to knowledge.

by Martin Khor

The suicide death of an American Internet activist and leader of the open-access movement, after he was prosecuted for computer-related crimes, has sparked protests and a debate on laws that hinder the public's access to information and knowledge.

Aaron Swartz, 26, was no ordinary Internet activist. A *Financial Times* article lists his achievements: a software programmer who developed an online tool that contributed to the Web 2.0 movement, and a co-founder of the Creative Commons initiative to promote information free from copyright. He also developed an online information service that later became the popular information site Reddit. He later co-founded the Demand Progress group which opposed legislation limiting access to online information and which last year together with other groups defeated the US Stop Online Piracy Act.

Swartz was charged in 2011 with getting into the network of the Massachusetts Institute of Technology (MIT) and downloading millions of pages of academic papers and scientific journals. These papers are in the database of the JSTOR group that makes it available to libraries and others through subscription. He faced up to 35 years in jail and fines of millions of dollars if found guilty. On 11 January, a month before his court case, he was found dead in his apartment.

The stress of being prosecuted led to his suicide, according to his family, which slammed the "exceptionally harsh array of charges" and blamed his death on "a criminal justice system rife with intimidation and prosecutional over-reach."

Access to knowledge

After Swartz's death, a debate has erupted over the intellectual property laws that limit access to knowledge in scientific journals and other information to those that can pay expensive subscriptions, and the strong enforcement and prosecution methods.

Critics of the copyright system complain that a few big companies like Reed Elsevier and Springer dominate the scientific information industry and charge high subscription fees because of the monopoly granted to them. They also point out that the generation of the research is often funded or subsidized by public money and thus the research outcomes should be made publicly and freely available.

"The government's prosecution of Swartz was a grotesque miscarriage of justice, a distorted and perverse shadow of the justice that Aaron died fighting for – freeing the publicly funded scientific literature from a publishing system that makes it inaccessible to most of those who paid for it," said a message by the Internet activist group Anonymous, which they placed on the MIT website.

The critics and activists advocate open access to scientific literature. Instead of journals and data owned by publishing monopolies charging high subscription fees and available only to well-endowed universities and individuals, they believe in information being made freely available through the Internet. Research and publishing costs could be met by the public sector or philanthropic organizations.

In line with this approach, a range of "open access" initiatives has developed through the years. They include open-source software, the Creative Commons licence free from copyright, open-access publishers such as the San Francisco-based Public Library of Science (PLOS) and research funding groups such as the UK Wellcome Trust which supports open access to the research it funds.

In contrast to this, the official copyright and related laws have recently grown stronger in favour of intellectual property rights holders, due to new national laws, the expansion of private rights through free trade agreements, increasingly strict enforcement mechanisms and harsh prosecution of violators.

The prosecution and death of Swartz, a talented and much-admired leader of the open-access movement, can be expected to strengthen this movement and create new momentum for reform of the established system.

Parts of the establishment are also demonstrating some soul-searching. There is an outpouring of praise for the noble aims of Swartz, even though acknowledging he may have broken the law, and calls for changing the imbalanced and unjust laws. The President of MIT expressed condolences to Swartz's family and announced an "analysis" would be conducted on the actions by MIT that relate to his death.

The debates and developments arising from Aaron Swartz's suicide are even more important for people in developing countries, since the barriers to their access to knowledge are more and far stronger. Due to their lower income levels, they can ill afford the high cost of subscriptions and fees and are thus blocked from sharing knowledge and information. ❒

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