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Every year, we ask all participants of our Institute to rank the topics of our summit. One topic received more votes than any topic ever before: “Entrepreneurial instincts – Taking risks, when others hesitate”. It’s a dream. The idea of becoming an entrepreneur.

Having a real impact. That’s probably what’s so fascinating about entrepreneurship. You don’t have to be a Zuckerberg to make a difference. In fact, it might be easier if you’re not. Because entrepreneurship isn’t about the fame. Entrepreneurship starts with risks. Comes with fear. Leads to many, sometimes uncomfortable decisions. Going against the grain. Brings more critics and judges than supporters and fans. Might at first even lead to failure instead of success. It’s the character: The idea of always standing up again.

Entrepreneurs are sometimes lone wolves. But in today’s world it takes a team to really have an impact. At one point we thought incentive compensation might create an entrepreneurial culture. What a disaster. Mainly disappointment and frustration because entrepreneurship is not about the money. And it is an illusion that everybody in a large company can or wants to be an entrepreneur. Entrepreneurs need to create a space with purpose and meaning. A space with high-speed decision-making. A space that allows for failures. And entrepreneurs are truly self-confident. They find and develop diverse teams of independent thinking personalities. It’s leadership. The idea of multiplying your impact.

Once you’ve tasted it, you want more. There are so many opportunities in our crazy, topsy-turvy VUCA world. It’s an addiction. The idea of...no...just don’t hesitate.

I truly enjoy being around entrepreneurial thinking people. You can feel their energy. That’s the idea of our Institute. I am grateful to you all for sharing your ideas and dreams. Enjoy the read.

Yours,

Markus Pertl
Chairman of The Stern Stewart Institute
Entrepreneurial Instincts...

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Markus Pertl,
Chairman of The Stern Stewart Institute

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Imprint
Connecting the Dots
Finding a Holistic Approach towards the Development of the Next Generation Finance Organization
Rapid diffusion of new technologies such as artificial intelligence, the emergence of new digital business models, increasing regulatory complexities and intensified global competition are among the many trends that will continue to shape the competitive environment of the future. Increasing volatility, uncertainty, complexity and ambiguity are projected to characterize future market environments, coining the term of the “VUCA world”.

Marcus Kuhnert  
CFO  
Merck
Adapting a company’s organization to maintain a competitive edge in such an environment seems compulsory. The finance organization, as an essential function within every company, is no exception to this.

Hardly anyone would disagree that substantial change is ahead and that finance organizations need to evolve to deal with the challenges of the future. However, the solutions proposed to overcome these challenges vary in terms of focus and scope and often lack a holistic approach. Proposed actions address important aspects of a next generation finance function, such as the adaptation of new technologies (e.g., AI-based predictive analytics) or the attraction of more IT-literate employees but sometimes fail to complement such initiatives with other equally important aspects.

For example, organizations will also need to redesign their operating model to be able to leverage the advantages of stability and control while simultaneously achieving a necessary degree of agility. Also, addressing the challenges of constant innovation and an empowered workforce are important aspects that need to be considered.

When we developed our approach to evolve towards the next generation finance function at Merck, six crucial building blocks have emerged. Although only providing a glimpse into a comprehensive strategy, the following aspects might serve as helpful food for thought on the journey to transform the finance organization:

1. Maximize the value of technology – driven by concrete business demand

In the digital future, data and systems will be at the core of every finance organization. More integrated systems, harmonized data sets and the use of powerful analytical tools, complemented by artificial intelligence, will provide many opportunities to retrieve new and meaningful insights. But with the multitude of opportunities also comes the need for prioritization. To maximize the value contribution of a technology and data-driven finance function, it is crucial to first identify the most important unanswered business questions. Taking such a demand perspective will help to determine those technologies that will ultimately deliver the most value to the organization. Cutting-edge technologies will surely be on top of the list, but unanswered business questions will often reveal also a need to fix some of the basics of the data and system landscape. As enhanced data quality and system integration are fundamental prerequisites to fully leverage many new technologies, dedicating enough resources to address those topics might be revealed as an additional priority.
2. Break the silos – create a process-oriented service platform to unlock further efficiencies

Increasing efficiency and reducing the costs of transactional and service-type activities has been on the agenda of many finance organizations for years and will continue to be. While standardizing and integrating such activities into global shared-service centers (SSC) has been the solution of choice in the past, fully leveraging technologies like robotics and artificial intelligence within those organizations will be essential to achieve further efficiency enhancements. Unfortunately, fractions at the interfaces between functional silos often hinder such technologies to unleash their full potential, as each function works with differing systems, applications and data structures. Thus, evolving the SSC organization from a functional organization towards a service platform, that is organized along integrated end-to-end processes, is crucial to enable an acceleration in automatization and digitalization of activities and thereby unlock further efficiencies.

3. Complement your platform – evolve the value proposition of your expert functions

Finance organizations provide substantial value through activities that lie way beyond transactional tasks. Departments such as M&A, Tax and Treasury address significant value levers and thus need to harbor highly experienced experts. Such might seem immune to the foreseen higher degree of automation and increase in technology-enabled self-service solutions. But as SSCs evolve towards efficient service platforms and are enabled to absorb even non-transactional tasks, also those departments will be relieved of some operational activities, allowing them to focus more on advanced business partnering. Furthermore, organizations will need to adapt to a work environment that becomes increasingly cross-functional and project-driven. Therefore, it is critical to complement the service platform and expert functions with agile organizational structures (e.g. swarm organizations).
4. Prioritize and scale – maximize the value contribution of innovation

To keep a competitive edge, innovation programs are essential to companies and meanwhile even to their finance functions. Unfortunately, innovation programs often fail to deliver. To avoid this common fate, innovation management systems should address three important aspects: focus, agility and scalability.

Although innovation depends on a certain degree of freedom to explore new ideas, explorative efforts should focus on areas in which innovating is of the highest strategic importance. The definition of a limited set of innovation fields helps to direct all innovation activities towards the topics that matter most. At Merck’s finance function we defined the topics of “reporting & analytics” and “robotics & automation” as such. Because many ideas will often fail to deliver, being able to test fast and cheap (e.g. through rapid prototyping) and to subsequently scale innovative concepts across the organization is essential to generate enough viable projects, whose benefits ultimately justify the innovation-related investments.

5. Empower your people – develop employees and create a winning culture

Although technology will become an increasingly important element of the finance function, people will remain key in delivering value and in driving the necessary change of the organization. Thus, empowering people to perform best within the work environment of the future, fully leveraging the advantages of a more digitized finance function and the proposed new operating model, will be crucial. By comparing the desired target culture and skillset of the employees with the status quo, critical skill gaps can be identified and systematically addressed. In the case of Merck’s finance function for example, a lack of employees that are knowledgeable in finance and IT at the same time was revealed. In general, enhancing the digital and project management skills and creating a culture based on cross-functional collaboration, curiosity and the embrace of change are essential aspects to be addressed. While changing a culture takes time and resources, it is also one of the competitive advantages hardest to copy and is therefore a worthwhile investment.
6. Synergize and lead – live up to your responsibility as a leader

Many aspects need to be considered to prepare the finance function for the challenges of the future. However, those aspects should not be viewed in isolation, but rather be aligned and combined into one coherent strategy, in which the single elements create synergies with each other. To align the many stakeholders towards one common vision requires leadership and therefore puts the CFO and senior management in the driver seat. In addition, the transition towards the next generation finance organization represents a transformational change. Dealing with change on this scale might seem daunting to the organization and will probably face resistance of some sort. To convince the rest of the organization to follow suit it is imperative that senior leaders proactively manage this change through adequate communication and change-management initiatives.

Conclusion

Finding a holistic approach to develop the next generation finance organization seems challenging. Nevertheless, I firmly believe that such a comprehensive approach is needed and we as leaders need to tackle the challenge head on to seize the opportunities lying ahead. As Albert Einstein once put it: In the middle of difficulty lies opportunity.
Alexander Doll
Member of the Management Board for Finance, Freight Transport and Logistics
Deutsche Bahn
Logistics is the backbone of every single economy as the transport and exchange of goods only enables people to execute trades. Accordingly, the global logistics market with a size of €5.6 trillion has strong overall importance compared to a global GDP of €74.7 trillion in 2018\(^1\). The shift from a “just-in-case”\(^2\) to a “just-in-time”\(^3\) production over the last decades has led to a shift in the service requirement offered by logistics providers and changed the logistics industry fundamentally.
Developing from a market with low service provisions, classical full load deliveries and single function transactional relationships, the industry has emerged into a complex service orientated business with a global door to door coverage, strategic multi-functional partnerships and integrated IT solutions.

Today, the global logistics market is at a crucial point in its evolution with digital disruption of traditional fields being present everywhere. Besides changing customer demands towards a range of services instead of single elements of transportation or warehousing, the development of new technologies is driving the change in business models.

**Trend 1: Impact and development of e-commerce**

E-retailing has significantly changed the logistics industry predominantly through its tremendous growth and specific requirements. While off-line retailing has grown at low single-digit rates, e-commerce in different segments often shows double digit annual growth rates. Logistics players have to adapt their offering to changing consignment sizes, frequencies of transport and short delivery times, just to name some examples. Only via addressing the demand changes players are able to participate and further build market share in this high growth vertical. In 2018 alone, the e-commerce logistics globally grew by 18.2 percent and is forecast to annually expand by 11.8 percent until 2023 on a nominal basis. Tailored solutions for transportation, warehousing, last mile and reverse logistics are examples for logistics services that require e-commerce specific changes to the network and fleet. Additional add-on services like online-payment solutions increase complexity for providers but at the same time offer the potential to upsell and increase profit margins.

**Trend 2: New market entrants disrupting logistics sectors**

Considering the importance of improving both efficiency and up-scaling in order to meet increasing demand, the digital transformation already became a key element in the strategy of almost every logistics provider. Particularly on the more commoditized services like road transportation and forwarding the emergence of new e-solution providers (digital forwarders and market places) has been a key topic. Without the large global networks, complex structures and geographic organization, software solutions have been built from scratch mostly focusing on national markets or specific tradelanes targeting SME businesses as clients with lower volumes and less professionalized in-house logistics. European examples for IT based solutions are Transporeon as leading TMS platform to aggregate road capacity and more recently Freighthub who acts as e-forwarding solution for containerized volumes on the route Asia-Europe. Full supply chain visibility, speed and transparency are the key advantages of the disruptors while the traditional legacy players still control the market due to large and global volume based customer relationships and the perception of higher security and ability to act in emergency situations. If IT platforms of the established players will mid-term lack behind the new entrants, the classic freight forwarders and road brokers will take a back seat. Hence, today the legacy players are simultaneously investing heavily into their own e-solution which seems to still rank high in client rankings.

**Trend 3: Consolidation for scale and synergies**

A further very important trend in the traditional fields of transport next to IT differentiation is the continuing ambition to gain market share via volume expansion and synergies. DSV clearly is the most prominent example that via large scale M&A and rigorous integration strategy could increase its market position, diversify the business model, add substantial profit via add-ons and synergies and could thus achieve a strong valuation uplift over the last decade. Next to economies of scale and consolidation, M&A can also complement the existing service offering via focused transactions:

- Diversify business and add service orientated offers into the product portfolio
- To systematically expanding their networks, Asian players will be increasingly active on international markets. European and American logistics companies will not only be buyers, but instead become targets for takeovers
- Invest in digital structures and focus M&A activities on access to new technologies

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1. Source: Transport Intelligence
2. Manufacturing strategy based on economies of scale with long production cycles and high levels of stockholding
3. On demand manufacturing reducing stock level, reducing logistics lead time and increasing complexity of service
4. Source: Transport Intelligence
THE CONFLUENCE OF SUPPLY-SIDE AND DEMAND-SIDE TRENDS

Globalisation  Inventory reduction  Outsourcing  Supply chain complexity  Industry transportation  Wider service portfolio  Product differentiation  Liberalisation of markets  Enhanced value proposition

GLOBAL E-COMMERCE LOGISTICS MARKET SIZE GROWTH RATES

Source: Transport Intelligence
Trend 4: Regionalisation of trade networks

Manufacturing and retailing are retrenching globally to more regionally focused supply chains. As part of this process, traditional East-West and West-East flows are being disrupted and becoming complex networks that span both developed and emerging markets.

What is the evidence for this development?

Firstly, global flows of goods are becoming more disparate. In the early 1990s, two thirds of global flows of goods moved through the top 50 routes. Two decades later, only one half of goods travel along these trade lines anymore.

Secondly, cross-border flows of goods, services and finance from emerging markets account for approximately 40 percent of the world’s total, up from 14 percent in 1990.

Thirdly, south-south trade has grown from 6 percent of all goods flows in 1990 to around a quarter today.\(^5\)

At the same time, near-sourcing is becoming more important as well. This involves repatriating manufacturing from remote locations, such as China, to regions closer to the end consumer market. The reasons for near-sourcing are many-layered and comprise the reduction of transportation costs, the increased control over suppliers and the rising labor costs in Asia and especially China. This all drives the development towards back-shoring – the transfer of activities in the production line back to the home country. Automation and new robotic technologies further reduce the strategic advantage of countries with low labor costs. To meet customers’ expectations and needs, an increasing number of companies are forced to produce fast, individually and with high quality standards. This is often best realized at home.

The trends of near- and back-shoring indicate the industries’ re-balancing with obvious consequences to shipping lines, air cargo carriers and freight forwarders. The offering of intercontinental supply chain solutions becomes less relevant, while value-added services with highly digitized products are much more important to meet the growing challenges and increased demands of the market.
THE OFFERING OF INTERCONTINENTAL SUPPLY CHAIN SOLUTIONS BECOMES LESS RELEVANT, WHILE VALUE-ADDED SERVICES WITH HIGHLY DIGITIZED PRODUCTS ARE MUCH MORE IMPORTANT TO MEET THE GROWING CHALLENGES AND INCREASED DEMANDS OF THE MARKET.

SECTOR CONSOLIDATION COMES IN WAVES, EACH DOMINATED BY SINGLE PLAYERS

Deal Volume from 2006–2019 YTD

- Cluster based M&A
- Increase scale in service offering
- Building integrated solutions
- Build road, CI, forwarding, integrated players
- De-integration trend below top 5 players
- Deal activity smaller scale
- Only one integrator gets build via M&A (XPO)
- Vertical focus (e-commerce, healthcare)
- Focused M&A to gain scale and synergies (DSV)
- Technology disruption & M&A

Source: MergerMarket, FactSet, press, company reports, sample consists of selected transactions only
TOTAL LOGISTICS MARKET SIZE – GLOBAL FORECAST
2018 – 2023 CAGR (%)

- **3.8%**
  - Air freight
  - (managed by forwarders)

- **4.9%**
  - Outsourced warehousing and distribution
  - (contract logistics)

- **8.5%**
  - Domestic parcels

- **6.1%**
  - International parcels

- **4.6%**
  - Total logistics

- **4.7%**
  - Sea freight
  - (managed by forwarders)

Source: Transport Intelligence
Market and outlook

The market is overall expected to grow by 4.6 percent until 2023 while the global GDP shows an anticipated growth rate of 3.6 percent. Logistics segments will be impacted differently. Freight forwarding will grow closer in line with the global economy, parcels transportation will outperform due to e-commerce growth and contract logistics will benefit from higher value contracts due to increased level of specialization of services and from the e-commerce exposure of players.

While service requirements in the industry are changing and IT-based providers will gain in importance, there are still only four integrated logistics companies with global networks across the main logistics segments: DB Schenker, Kuehne + Nagel, DHL and now the combined DSV / Panalpina. On the long-run these industry leaders of today are facing fundamental questions that require consideration as they develop their future strategies:

- How to deal with the commoditized segment of the business?
- Is there a strategic benefit of owning assets or being the carrier?
- Will focused business models be the winners long-term or will clients continue to value an integrated platform?
- Have IT specialized providers the potential to disintermediate the established players and seamlessly combine services of different focused operators?
- Will networks remain barriers to entry for e-players in general?

Across the industry, however, there is no doubt that digital concepts and sophisticated IT platforms will continue to improve efficiency and performance and are at the centre of strategic considerations. In our view today, and specifically because the global leaders equally invest and improve their IT based offering, the large volume clients will continue to value the global platforms and will not move volumes away. The stickiness and integration into the clients’ value chains will support this thesis further. In the segment of traditional logistics providers, consolidation and improving market power will remain the major driver for the years to come.

With lower volume clients and smaller businesses, we expect the e-forwarders and TMS solution providers will have more traction to grow their market presence. We anticipate that specifically smaller logistics providers will lose market share, which ultimately will leave consolidation as the only long-term option for them.

6 Source: Transport Intelligence, shown as real growth
Financial regulation has left banks unwilling or unable to innovate and serve a growing need to address companies’ inventories and the increasing challenges of leaner supply chains. Non-bank lenders, particularly the ones with a supply chain focus, are taking over the borrowing market to the benefit of both industry and investors.
New Opportunities in Supply Chain Securities Through Structural Changes in the Finance Sector
Structural changes in the financial sector

The changes in the finance sector since to the financial crisis have been manifold. The ostentatious actions are the politically motivated ones, such as the caps on bonification or the total of US$243 billion in fines that banks have had to pay since. Undoubtedly, these actions have a major impact on the industry, but the actions that are leading to fundamental change are more subtle ones.

With the introduction of the Basel III and Dodd Frank frameworks, banks are encouraged to reduce their balance sheets and to scale back riskier and less transparent investments. Securitization transactions, the culprits of the financial crisis, have received an increase in risk weightings, leading to a marked increase in capital charges for these transactions. With the introduction of Basel IV, even core activities of banks, such as loans to SMEs, will require more capital and to these institutions. The result of these actions can be observed today.

Despite large and ongoing quantitative easing by central banks, banks are unwilling to deploy liquidity in industry and prefer to withdraw to the position of intermediator between issuers and institutional investors.

Free markets, however, tend to find ways to effectively adapt to any change in regulation and as Schlumberger has reminded us, the destruction of one player leads to the creation of the next. The rise of Fintechs and other non-banking lenders, and the associated innovation, can thus be viewed as a direct result of new regulations. These new players may not have the breadth of product offering, or the same quality of historical data, but their focus on specific products allows them to innovate faster than large institutions can. Since 2009, the share of non-bank loans as a percentage of all loan debt in the US has increased from 24 percent to just under 45 percent at the end of 2018. and in the unlikely absence of a major wave of deregulation this trend is likely to continue. This flotilla of agile but small players not only caters to the markets the banks are retreating from, but it is also offering innovative new products that offer more value to borrowers. Due to their lack of historical data for traditional credit exposure and the highly competitive pressure in the sector, new lenders look to monetize alternative risks. This is particularly apparent in the stellar rise of the supply chain finance market. At an approximate volume of US$450 billion in 2018 and a continued double-digit growth, the market is catching up with more mature collateral types such as CDO/CLO.
THIS FLOTILLA OF AGILE BUT SMALL PLAYERS NOT ONLY CATERS TO THE MARKETS THE BANKS ARE RETREATING FROM, BUT IT IS ALSO OFFERING INNOVATIVE NEW PRODUCTS THAT OFFER MORE VALUE TO BORROWERS.
Non-bank lenders are open to alternative assets

With pressure on corporates to maximize capital efficiency and rising borrowing costs for SMEs, large companies face conflicting goals of looking to slim down their own balance sheets and to support their suppliers financially to lower their total cost position. In the past few years, companies have increasingly turned to factoring and supply chain finance (SCF) to address these challenges. These solutions are attractive tools for improving the liquidity and working capital positions of both suppliers and buyers but have their drawbacks. Many programs rely on short-term funding and insurance products and are therefore difficult for management to integrate in their long-term strategic planning. There is also uncertainty around the issue of whether trade payables should continue to be classified as accounts payable or as another liability, such as debt finance. The collapse of Carillion brought increased focus to this issue. Rating agencies and analysts now routinely adjust a company’s total financial debt for any SCF programs.
A largely unaddressed component of working capital is the physical supply chain and the distribution of inventories between the players within. Historically, as banks have been unable to effectively finance inventories, assets were pushed upstream, leading to an almost 5 percent higher level of inventories as a percentage of total assets for SMEs compared to large caps. When lending spreads between SMEs and large caps were small, this allowed buyers to utilize suppliers’ balance sheets for a small surcharge compared to their own. With lending spreads increasing, novel solutions are needed to control the total cost.

Technological innovations such as ERP integration between suppliers and buyers, GPS tracking of loads and electronic bills of lading have created transparency and control in supply chains. Non-bank players have become comfortable with not just with financing receivables, but with owning and holding the inventories on their balance sheets as well. This allows buyers to use their purchasing power upstream by owning but raw materials throughout the upstream supply chain without having to account for them in their balance sheets. Corporates can thus focus their capital solely on fixed assets and value adding investments, increasing their capital efficiency. At the same time they can keep fully stocked supply chains, satisfying ever shorter delivery times that consumers expect today.

**New assets for old investors**

The implications of such concepts are important not only for corporates using them to deleverage their balance sheets but for investors seeking low volatility products.

Looking at the 19 percent price loss that Netflix incurred in October 2018 after missing their new subscriber target by 530,000 (about 0.3 percent of total subscribers), it is clear that equity prices are heavily influenced by algorithms and event driven investors the correlation to the real world performance is blurring. This is particularly problematic in times of negative interest rates as equities and correlated bonds are base of any investment portfolio.

The new supply chain assets that are flooding the market offer new kinds of risks. Instead of betting on the performance of an entire enterprise, with all its sub business cases and risks, these assets allow investors to separate the asset from the enterprise. A conservative investor might not be interested to invest in a speculative stock such as Tesla but may well be in interested to own a security backed by a finished Tesla car as the likelihood of the sale is statistically easy to quantify.
Financing the Energy Transition: Bonds to Save the Planet

How Finance Can be Harnessed to Help Us Solve Global Warming
Recently, Greta Thunberg challenged decision-makers around the world with these words:

“...I want you to panic. I want you to feel the fear I feel every day. And then I want you to act...I want you to act as if the house is on fire. Because it is.”

The 16-year-old Swedish militant is only telling the truth: our planet is in danger and it will soon be too late to save it if we do not quickly join forces.
Indeed, according to a special report by the Intergovernmental Panel on Climate Change (IPCC), investment of US$2,400 billion, or 2.5 percent of global GDP, is needed each year from 2016 to 2035 to renew energy systems. This is why, financial institutions must be approached as they have a key role to play in order to finance the energy transition.

The energy sector has always required massive investments. Therefore the financial sector is required to actively direct financial resources towards low-carbon technologies and projects with a positive impact on the environment.

This is also the vision shared by many investors today who emphasize that supporting the environment and contributing to the common good must be key elements in assessing corporate performance.

Green bonds for green future

If climate change seems to have become one of the central concerns of investors, it is now necessary to ensure that these main principles are applied in a concrete way, on the ground.

Some new tools currently developed to finance climate-friendly projects illustrate the appeal of green financing today. The main ones are green bonds: they resemble ordinary bonds, except that their proceeds are used to finance projects that aim at reducing emissions, e.g. financing electric vehicles. Only introduced in 2007, especially by countries such as Poland and France to encourage the development of renewable energies, but also increasingly used by municipalities, green bonds amounted to US$167 billion in 2018.

And this is just the beginning. Moody’s rating agency believes that green investments will grow further in the coming years. This acceleration will be facilitated by the emergence of new actors, following the impetus given to the market by the arrival of sovereign issuers. Just behind the United States and China, France is a world leader, with three main emitters: the French government, EDF and ENGIE.

1 IPCC Special Report on Global Warming of 1.5°C.
4 https://www.climatebonds.net/files/reports/france_report_final_20.04.18_0.pdf
GREEN BONDS NOW REPRESENT MERELY 1 PERCENT OF THE US$53 TRILLION GLOBAL BOND MARKET.

90 trillion dollars for 2°C

However, the market has not yet reached maturity. Green bonds now represent merely 1 percent of the US$53 trillion global bond market. It will take about US$90 trillion by 2030 to achieve the goal of limiting global warming to 2°C, according to the Climate Obligations Initiative. But this perspective offers great potential for green bonds. As a pioneer in green finance, ENGIE is one of the largest corporate issuers of green bonds in the world. Since 2014, the Group has carried out five bond issues for a total of €7.25 billion, with €1 billion issued in 2018 and another €1 billion issued in January 2019 alone.

Green bonds now account for one-third of ENGIE’s debt and help fund renewable energy generation activities and energy efficiency solutions, as well as a number of R&D projects, around the world. We have transformed our financing strategy, because our ambition is to lead the zero-carbon transition.

Example of a project financed by Green Bonds: ENGIE’s Kathu Solar Park in South Africa, a 100MW Concentrated Solar Plant and one of South Africa’s largest renewable energy projects.
So far, we have come a long way. However, given the urgency of the situation, our objective is now to help accelerate a global virtuous circle. In this perspective, I want to make three proposals:

According to Novethic, the Caisse des Dépôts group’s responsible investment research, socially responsible investment funds performed very well in the second quarter of 2018. In particular, the amounts managed by environmental funds increased by 12 percent to €20.8 billion.\(^5\) In other words, this illustrates that there is absolutely no need to choose between responsibility and profitability. They are inextricably linked! On the contrary ignoring environmental risk can become a strategic pitfall.

To be attractive, green bonds must generate financial benefits and reduced costs for eco-investor economic actors. They also represent an opportunity to encourage more reluctant investors to turn to green financing. Green bonds could then fully play their role as a vehicle for integration between financial objectives and CSR issues.

As there are not yet adequate standards for green financial products, there are risks of greenwashing. It is essential for companies and investors to develop a culture of transparency, and ensure investors’ trust. We therefore need to develop classifications and ratings for green financing products in order to build a common language and help investors to clearly distinguish between genuine and non-true green products.

One of the key factors for success in achieving a profitable energy transition is green finance. The challenge today is to have enough determination and courage to make the difficult decisions both in terms of investment choices and related financing systems.

The current climate situation has to push each company to contribute to the common good. The acceleration of the ecological transition will not be possible without the involvement of companies acting as responsible economic, social and ecological actors.\(^5\)

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Cybersecurity in a Changing Digital Economy: It’s a Question of Trust

As trust becomes central to the debate about how our digital economy should function, cybersecurity must become an essential component of nearly every aspect of business. Corporate leaders need to set the tone for their organizations and help steer the way between security lockdown and total business agility.
Trust in digital business has taken major blows these past couple years. From the Facebook data mining scandal to large-scale leaks of highly sensitive personal information, consumer confidence has been shaken by exposed vulnerabilities in cybersecurity systems and surprises about how companies are handling personal data.

Cybersecurity is a central part of how we define and protect trust in our organizations, and it’s a crucial factor in how business is conducted in today’s digital economy. No longer “just an IT concern,” cybersecurity is becoming a necessary cornerstone across all industries and across organizations from infrastructure and finance to operations and supply chains.

But while cybersecurity is becoming a fundamental business pillar, existing systems and attitudes toward cybersecurity are lagging behind this emerging reality. Short-sighted approaches to cybersecurity can increase costs, reduce efficiency, and undermine innovation necessary to survive and thrive.

With the right corporate guidance, cybersecurity can be leveraged as a business and strategic enabler. Securing customers’ data and your important digital assets is just the beginning. Creating systems that inspire trust requires corporate leadership to establish cybersecurity as a key concern in all the traditional and emerging areas of business.
Cybersecurity has always been adversarial, complex, and messy. Now, shifting forces of digitization and hyperconnectivity are converging to make it increasingly asymmetrical. At a time when the stakes for protecting data privacy have never been higher, cyberattacks are easier, cheaper, and more coordinated, while defense remains fragmented and costly.

Worldwide information security spending is expected to exceed US$124 billion in 2019, but companies struggle to stay one step ahead of cybercriminals. Economic loss due to cybercrime is predicted to reach US$3 trillion by 2020, according to the World Economic Forum, and 74 percent of the world’s businesses can expect to be hacked in the coming year.

Digitization is growing faster than our tools to protect the data it creates. The number of apps, services, mobile devices and Internet-connected things (IoT) continues to explode: Mobile device subscribers increased from 500 million to 1.5 billion from 2000 to 2011, and IoT devices are projected to outnumber humans three to one by 2021.

This hyperconnectivity means an ever-expanding number of endpoints and attack surfaces, providing more avenues for cybercriminals to reach businesses’ important data assets. As we become more connected and interconnected, information is being shared between companies, partners, customers, devices, apps, subcontractors, etc., creating a world of ecosystems of ecosystems and networks of networks.

Corporate leaders today must not only develop their own effective cybersecurity, but also create processes to ensure their partners are just as trustworthy as they are when it comes to protecting data privacy. Data supply chains have become more like sprawling, complex data webs. This makes it impossible for any company to fully control its own data, and dramatically more complicated to track and protect data through multiple supply chains.

Last year’s massive mortgage and loan data leak and the 2013 Target data breach illustrate the old adage, “A chain is only as strong as its weakest link.” In the first case, millions of documents containing highly sensitive financial data on tens of thousands of people were leaked; in the second, cybercriminals stole credit and debit card information on 40 million people. In both cases, the breaches occurred because of security flaws in vendors’ or subcontractors’ systems or processes.
The problem with the “zero-trust” approach to cybersecurity

In response to such growing threats, corporations have retreated into cyber-lockdown. Many current cybersecurity strategies for large corporations adhere to the “zero-trust” model, which boils down to trusting no one – no network, no user, no device, no application – without first subjecting them to rigorous authentication checks. In other words: verify, verify, verify.

The appeal of the approach is understandable: It closes gaps in traditional cybersecurity architectures and examines every contact with your network and data systems. Unfortunately, the zero-trust approach is also contributing to the ballooning cost of transacting and conducting business with third parties, and it’s placing business leaders between a rock and a hard place.

Many of today’s security best practices such as two-factor authentication, browser isolation, virtual-private-networks (VPNs), and privileged access workstations can serve as double-edged swords. The practices do check the box for risk and controls, but they also reduce productivity. In a survey of chief information security officers (CISOs), 74 percent said employees have expressed frustration that security policies are preventing them from doing their jobs, and 81 percent said employees view security as a barrier to innovation.

The approach of trusting no one without first subjecting them to rigorous authentication will become unsustainable as digitization and hyperconnectivity continue to explode. In today’s competitive world, reduced productivity, and in turn reduced customer satisfaction, can be a high price to pay.

Redefining cybersecurity: beyond risk management to strategic advantage

Just as corporate boards direct how to capture the benefits of digitization and automation, they must take an active role establishing cybersecurity as an integral part of every aspect of business. Board conversations about cybersecurity must evolve from simple risk management to strategic interdisciplinary discussions. Creating secure systems and adapting to the evolving threat landscape depend on it.

Too often, security is still an afterthought considered in isolation. Leaders only look at it carefully after a cyber-incident, or after discovering massive security costs at the end of a project or deep into a partnership. Identifying internal leaders and promoting cross-collaboration and interdisciplinary work threads now will make your end products stronger and improve your bottom line over the long term. Whether it’s M&A, a new business line, or a strategic partnership, it’s never too early to include cyber as part of the conversation.

In a survey by the Global Center for Digital Business Transformation, respondents believe an average of roughly four of today’s top 10 incumbents (in terms of market share) in each industry will be displaced by digital disruption in the next five years, and all industries will see competitive upheavals as innovations become increasingly exponential.

Technologies such as cloud, artificial intelligence, and even blockchain offer unprecedented possibilities for efficiency and productivity. Adopting them may mean the difference between long-term success and business extinction. For corporate leaders, however, accelerating adoption of such technologies without the right security in place could be costly or even catastrophic. At Team8, we are focused on industrializing these technologies in a manner in which modern enterprise can operate “beyond-trust” and unleash collaboration in our all-digital futures.

To identify where your organization should be on the adoption curve, board discussions must address how cyber capabilities can be calibrated to meet the enterprise, customer, regulatory, and competitive needs of your business. Having holistic and interdisciplinary board-level cybersecurity discussions will help you assess business demands and risk tolerance to narrow in on a constantly moving target.

In your next board discussions, make security a priority. Inform yourself, involve relevant leaders within your organization, and take the lead on using cybersecurity to support innovation and growth.
Global Market Leadership via Employee Share Ownership: France is Leading the Way in Europe

At times when calls for “collectivization of businesses” – as recently made by a young German leftist shouting out for the nationalization of BMW – or, more broadly speaking, calls for “social justice” have moved center stage in the public debate, it might be worthwhile to highlight impressive achievements in the participation of employees across Europe. Whereas in Germany, economic prosperity is attributed not least to the achievements of corporate co-determination (*Mitbestimmung*), employee share ownership has established itself as another successful model of employee participation across Europe – with enormous unrealized potential.
According to the European Federation of Employee Ownership (EFES), €384 billion equity, or around 3 percent of the total capitalization of European companies, are in the hand of employees. This model thrives in particular in France. In fact, it is France which is the European champion of European employee shareholding: 3.2 million employee shareholders versus, for example, only 2 million in the United Kingdom or 700,000 in Germany. Only recently, France has further improved the framework for employee share ownership with the so-called “Loi Pacte”, which passed the French parliament in April 2019. It lifts a number of obstacles to the further development of employee savings. In particular it abolishes the social contributions on interest, participations and investments for companies with fewer than 50 employees and reduces it to 10 percent for all. In France, around 5 percent of the capital of French companies is held by employees. With the new law, the government hopes to facilitate the growth of employee shareholding across French companies to 10 percent.
Corporate co-determination – power to the employees

At a French company, Employee shareholding can be as much a company tradition as corporate co-determination (Mitbestimmung) is in Germany. Essilor, the global market leader in lense innovation started employee share ownership with the creation of the group in 1972. The two merger partner, the optical companies Silor and Essle, were routed in a cooperative heritage, hence facilitating employee share ownership. At that time, share ownership was mostly reserved to executives, which held 50 percent of the share capital of the new group. The inclusion of a much broader and more diverse group of employees developed over the last decades with regular, if not yearly shareholder programs, as Essilor expanded its worldwide presence and its number of partnerships establishing itself as a blue chip in the CAC 40 and the EuroStoxx 50. With an employee shareholding of 68 percent at the end of 2018, Essilor held a top position among CAC 40 companies, other leaders in the field being construction and infrastructure companies such as Bouygues (40.32 percent), Eiffage (21.79 percent), or Vinci (12.01 percent). However, while those companies have their shares mostly in France, Essilor achieved strong employee shareholding across its global workforce. At the end of 2018 more than 50 percent of Essilor’s worldwide employees had become shareholders. The 46,000 shareholder-employees represent 68 percent of employees in more than 60 countries, including Germany, the US or China. Nearly 100 percent of the French workforce are shareholders.

No surprise that employee shareholders also claim a strong voice in the corporate governance of French companies. When the Board of Directors of Essilor, in the spring of 2017 voted on the combination with the Italian premium eyewear giant “Luxottica” – the company behind iconic brands such as Rayban, Oakley or Prada sunglasses – forming a €48 billion powerhouse in eye care and premium eyewear, it was important that Essilor’s commitment to employee shareholding – reduced to 4.4 percent following the combination and the doubling of the workforce to 150,000 – would play a central role in the new company’s identity and culture, and yes, also in the merged company’s governance and business model.

Following the closing of the merger in October 2018, the employee shareholder association “Valoptec” – confirmed as the new group-wide structure to federate employee shareholders and organized as a French non-profit organization – holds one of three board seats representing employees on the 14 person strong board; the two others being workers’ council representatives. The Association
brings together a significant number of employee shareholders who can express their views and vote once a year on the Human Resources strategy, compensation as well as decisions such as the appointment and renewal of Executive Corporate Officers. Although the votes are of consultative nature, they provide an important communication channel between management strategy and employee interests. This creates a distinctive governance, where company specific employee interests are voiced and take precedence over ideologically driven debates as very often seen in other French companies. Valoptec is at the forefront in further developing this model of employee participation and to make it a success in one of the biggest European cross-border mergers: to combine a highly successful Italian company’s strong commitment to employee well-being routed in the paternalistic tradition of family owned companies with an entrepreneurial tradition of a decentralized listed company. The company has the unique opportunity to combine two of the finest models in European business culture.

**Percentage of Employee Shareholders outside of the executive ranks**

2007: 24%
2018: 21%
How to spread the system – democratize the shareholding

As mentioned at the beginning, employee share ownership has enormous unrealized potential. What it takes to make it even more prevalent as an employee participation model? Firstly, favorable legal parameters and the willingness to rather invest in saving schemes than consumption schemes. Secondly, employee stock ownership needs to be even further “democratized” across geographies and company ranks. According to the EFES, in 2018, 87 percent of European companies had employee shareholder plans and 62 percent had stock option plans. However, the percentage of employee shareholders outside of the executive ranks decreased from 24 percent in 2007 to just 21 percent in 2018. The participation of 3.11 percent of employees in listed companies shows 1.43 percent for the executive ranks of a company but only 1.68 percent for ordinary employees. Why not “democratize” the shareholding for ordinary employees even further? American companies, as recently witnessed by the IPOs of various “Unicorns” show the way. Wouldn’t such a “democratization” be an excellent promoter for a social market economy? Everyone should have the opportunity to participate. Economic models continuously need to prove themselves. Social market economy is a superior feature of democracy. For centuries, democracies showed superior economic innovation and performance because of the need for broad public acceptance. Not least because of the benefits for society as a whole, do I find it worthwhile to embrace employee equity ownership.
Four years ago, in 2015, a renewed effort began to come together, an almost reviverist’s approach to the key challenges we have collectively been facing. Financing for development (Addis Ababa), the adoption of the UN’s Sustainable Development Goals (New York) and the COP 21 climate conference (Paris) all buttressed one way or another by the billions to trillions principles of working together in a genuinely and much needed new way.
After an initial flurry of interest, the real progress that has been made and failure to do enough as well as the dangers we are running towards may all be drowned out by the immunity many seem to have developed to believing the repeated stark warnings.

We cannot spend more time debating whether the glass is half full or half empty because if we do not do enough now then there may not be a glass to worry about. We must get serious and we must put that ethos into action now.

Some important steps have been taken and things are happening. A cursory look at the continuous deluge of news may understandably lead us to conclude that enough is now being done, the course has been corrected and we will all be just fine. Not so. The underlying trends are extremely frightening. There is overwhelming evidence confirmed by the updated IPCC report earlier this year which also highlighted the disproportionate negative impact of achieving somewhere between 1.5 – 2°C rather than 1.5°C; we must, therefore, drive hard to hit the 1.5°C target.

OVER FOUR BILLION OF US DEPEND ON THE OCEANS FOR OUR FOOD AND LIVELIHOODS.
We have our backs to the wall

The recent IPBES report on nature and its critical importance to us was yet another wake-up call, echoing in many ways the original IPCC warnings from years ago. One million species are at risk of extinction because of our actions, one million. Over four billion of us depend on the oceans for our food and livelihoods, four billion. These trends of destruction are underway now. If we do not make hard decisions quickly and put them into action then the costs of trying to play catch-up later may well be completely insurmountable. The evidence is clear, there is no conspiracy and certainly no more space left for complacency.

The change needs to be comprehensive. For decades, most of the major economies have been driven by a form of capitalism which delivered considerable benefits. However, we are now struggling with the Friedman mantra which he famously articulated in 1970, paraphrasing, "the social purpose of business is to make profit" whereas "a business focused on social outcomes is pure, unadulterated socialism". This model of capitalism has long been central to our system, permeating accounting frameworks, tax systems, business schools' curriculum and corporate attitudes; more generally, it is the way we tend to see everything.

We have now, finally, reached a point where key participants in the system are questioning it. Books by Paul Collier (The Future of Capitalism), Joseph Stiglitz (People, Power and Profits), Raghuram Rajan (The Third Pillar: How Markets and the State Leave the Community Behind) and analysis by people like Ray Dalio and Larry Fink are all contributing strongly to the reassessment; this is being compounded by many more every passing day. There is a growing realization that a capitalist system which is not connected to the people or rooted to the territories in which it operates and simply floats is simply no longer acceptable. The working assumption that a model works until the moment it no longer works is not feasible. Systems do not work in isolation; inevitably, reality bites and previously unexpected factors such as trade tensions, Brexit or natural catastrophes all have significant impact. The consequences of the inherent flaws in what should become an erstwhile model have exacerbated huge problems and led to real social division and alienation. The explosion in inequality, the laser focus on the short term and a blinkered approach to what being responsible really means are all examples of a system which is orthogonal to what we need now. In fact, we are only just realizing that what we require is not what we have actually been using for a long time. Mounting criticism is drawing up a road map to an inevitable collision.
Reset the heart of the system

Avoiding a collision is in our hands. We can choose to embrace the social and environmental challenges and change our laser focus to the longer term whilst at the same time maintaining a well-functioning market economy which is supported by all stakeholders. Key participants have already made the choice and goodwill is building up. We need to channel all of the positive and constructive steps and actions that have been taken already and push this to get past the tipping point. Once we go through that point, we should have a feedback loop which becomes stronger and stronger and which might help reset the heart of the system.

We need to strike a balance between celebrating what we have achieved, but not sinking back into complacency. Short term tensions, such as the current trade issues, will inevitably capture people’s and governments’ attention. However, as has been said before, the tree of the current tension of the day cannot be allowed to hide the forest of the impending environmental and social crisis. The impetus for continuing change cannot just be expressing fear about the looming crisis. It is real and the facts are frightening, but said enough times and people become immune to the reality. Long term change needs to be forced through a readjustment to the market (i.e. consumers, investors, other participants all need to keep educating themselves and others so that they in turn can
educate the system) and the regulatory framework (i.e. there needs to be a thorough and rapid re-examination of the previously accepted norms which have formed the backbone of the current capitalist model). We need to put in place real consequences for participants not changing behaviours, really meaningful financial consequences which will drive people and companies to act immediately. It is not about superficial qualitative changes in speeches or commentaries in annual reports where marginal changes are hailed as huge successes. The market economy is a force, but a force which needs a goal. A combination of market pressures and regulation should help and be the compass to set the direction. Direct financial and economic incentives and penalties will drive change. It really is time to be serious and fill the glass right up.
Serbia Completes the Picture: The EU’s Final Enlargement Could Be Its Best
Serbia is a European nation. Our location, culture, language and history places us at the heart of many of Europe’s most important stories. Serbia is putting extensive effort into our preparations for EU accession because we fully appreciate that the terms of our membership will determine our future as well as the destiny of the EU project.
When Serbia and our neighbours join the EU, the peace project that started in the 1950s will be complete. The six founding members vowed to unite themselves economically and politically to avoid ever going to war against each other again. Successive enlargements have added new members to this cause of a shared vision for peace. One by one nations across the continent have joined, and the final piece of the project is the accession of the Western Balkans to the European Union. This stage is certainly complicated. It will take leadership, creativity, patience and most importantly the explicit support of our citizens to strengthen economic cooperation in the region and ultimately integration into the broader union.

Just as the original six nations tied their fates together, the final six economies in the Western Balkans have our fates tied together too. That is why Serbia is demonstrating regional leadership in several policy areas. We are developing our economies and our prospects alongside each other. For example, we have led efforts within the region to remove roaming charges. The agreement was signed in Belgrade earlier this year and will bring down barriers, help stimulate innovation, and make it easier than ever for all our citizens to work, travel and study across the region. Additionally, we have introduced specific measures to develop and support the SME sector, such as tax incentives for research and development and digitised services. A regional growth strategy for entrepreneurship and the tech industry is creating prosperity with more high-quality jobs and start-ups across the Western Balkans.

Will EU membership benefit Serbia?

Any nation joining a larger coalition faces an important calculation: is it worth it? For Serbia the short answer is yes, but at the right time. Successive enlargements of the European project have weighed up the benefits of a wider union, often at the cost of a deeper union. Each country, a new member or an existing one, must calculate the benefits and sacrifices of enlargement and accession. In my view, joining the EU is, on the whole, going to be good for the citizens of Serbia. However, no country should be willing to join at any cost. The conditions must be right, we must truly be ready, and the EU must also be prepared to accept us.

Joining the European Union should strengthen political and economic cooperation and the bonds of peace and stability, promote economic opportunity for our citizens, and should strengthen the community of European nations, not weaken it. Ultimately, it will bring many of the benefits of globalisation to Serbia, including increased trade, robust environmental standards and a range of consumer rights.

Apart from economic benefits – what is the value of the EU for potential members?

The largest and most important benefit of EU membership is peace and stability. For me, the EU project has always been about bringing peace to the continent, and until the Western Balkans are included, this peace project is not complete. This region has spent the last 20 years searching for lasting peace and stability, and in more recent times this has included preparing ourselves for EU membership.

Currently, our economy is much stronger and more diverse, and our public administration is going through significant reforms and digital modernisation. These preparations are essential to progress, not for the goal of membership, but for the difference we can make to people’s lives, the improvements we are making to the country. The focus of accession preparations has meant progress across the board.
When is the right time to join?

We must learn from the lessons of other countries that have joined the EU and join when both we and the EU are ready. Recent enlargements have demonstrated that if the accession timeline is rushed, countries open up their economies and their skilled people to the Union too soon, which left them struggling to compete.

The EU may not have been fully prepared for these accessions either. Recent enlargements have called into question the preparedness of the older members to welcome the new and has not answered the question about whether Europe believes that this diversity is an asset or a burden. The expansion of the EU has been one of the factors growing anti-EU and anti-establishment sentiment. Eurosceptic parties have gained ground and political support across the continent. This has demonstrated that acceptance is not guaranteed and may lead to additional restrictions on the freedom of movement. Balancing continental cohesion and the challenges of both external and internal migration have created a debate on the purpose of the EU project and its definition of success. These challenges should be resolved fairly but not lead to ‘second class’ membership.

Can one find areas of improvement in the EU while still working towards accession?

I agree with many EU leaders we have an obligation to reform the EU project. When it comes to some of the biggest challenges of our time – the migration crisis, climate change, trust in politics – the EU has not been able to find solutions to allay the concerns people have. Serbia seeks to play a constructive role to bring about that necessary reform because I do not believe we can just be critical without also being a part of the solution. I believe this is the moment to have an honest dialogue about the purpose as well as the shortcomings of the EU.

AT ALL COSTS WE MUST AVOID THE SPREAD OF FEAR OR MISUNDERSTANDING ABOUT SERBIA.
What will Serbia bring to the EU?

Over the next six years Serbia has a unique opportunity to accelerate the growth of a winning, future-forward economy, so that we will join the European Union in the best possible circumstances. As Prime Minister it is essential to lead these preparations in a holistic way, covering all parts of the economy so no one is left behind. The entire government is moving in this same direction. We are making major investments in our transportation and energy infrastructure, connecting Southern and Central Europe. We are making record levels of investment in education and digital skills that prepare young people for the jobs of the future and attract foreign investment. These investments will lay the foundation for a strong entry into the EU.

My aspiration is for Serbia to be an example of how to welcome a new member to the EU family as an equal and valued partner. We must all learn the lessons of recent enlargements, we must anticipate the issues and head them off. For example, how do we avoid a brain drain of talent when freedom of movement is suddenly available. So, by the time we are ready to join the EU, and EU countries are ready for enlargement, Serbia must be a place that not only retains skilled and educated people, but also attracts talent from elsewhere. Our recent membership to the European Organization for Nuclear Research (CERN), which is one of the world’s largest and most respected centres for scientific research, is a sign that we are on the right track.

At the same time, we must consider how to avoid any backlash against this phase of enlargement. This is where courage and honesty are key. Europe and Serbia must match the expectations of our citizens to manage this correctly. Europe and Serbia must match the expectations of our citizens and who we are as a nation in the 21st Century.

I am absolutely determined that Serbia will join from a position of strength. I am less anxious about the accession timetable than the vital work we are doing to prepare the country for membership. If there are concerns about migration, I would assure member states that Serbia is planning for this. We are thinking differently about education and creating the kinds of jobs that will keep people here in Serbia, because we don’t want to lose our talent to the brain drain when the EU doors open.

In terms of a unique offer to European nations, we are positioning Serbia as a world class destination for creative industries, innovation and technology. This is attracting investors, businesses and entrepreneurs to Serbia because they can tap into that human creativity. My job is to help all our citizens realise their potential, through education and creativity, making Serbia a positive contributor to the whole of the EU.

WE ARE LOOKING TO THE FUTURE WITH RENEWED OPTIMISM.

Serbia is changing, and we want the world to know it

I was incredibly proud to be a Serbian citizen during the migration crisis of 2015. We opened our arms and welcomed refugees in desperate need. These were tough decisions, which took leadership and courage to explain to our citizens and our neighbours that what we were doing was right. Serbia demonstrated in that crisis that we have the values, courage and the strength to take responsibility for ourselves as well as others in need. At a time when Europe was failing in its response to this crisis, Serbia was a leader.

There is great human capital, innovation and ingenuity in Serbia. We are looking to the future with renewed optimism. Joining the European Union as an equal and valued partner is possible when we believe in the best of ourselves. If this enlargement is well-managed and prepared with the expectations of our citizens in mind, this could also be the most successful EU enlargement.
CHANGE VS. MORE OF THE SAME. IT'S STUPID AND DON'T FORGET HEALTH CARE.
Is it Still the Economy, Stupid?

The hand-lettered sign, posted on the wall of the Clinton War Room in 1992 by my partner James Carville, has become almost mythic. It said:

Change vs. More of the Same
It’s the Economy, Stupid
And Don’t Forget Health Care
In 15 words Carville summarized Clinton’s campaign strategy. Over time, the first and third lines have been forgotten, and his genius has been truncated to those famous four words in the center of the sign.

A quarter-century ago, Carville’s maxim helped propel the first Democrat to the White House in 16 years. A man dismissed by the GOP as “the failed governor of a small state” defeated a World War II hero who had driven Saddam Hussein out of Kuwait in just 100 hours. It truly was the economy, stupid. But don’t forget health care. And more than anything, the election was a referendum on change.
The macroeconomic data are strong

Predictions, the saying goes, are difficult – especially about the future. Yet many prognosticators are confidently predicting that the strong economy will propel Donald Trump to a second term. They have a strong macroeconomic case. Yale economist Ray Fair looked at economic data, modeled the 2020 election, and told Politico: "Even if you have a mediocre but not great economy – and that's more or less consensus for between now and the election – that has a Trump victory and by a not-trivial margin," winning 54 percent of the popular vote to 46 for the Democrat, he said. No presidential candidate has garnered 54 percent of the popular vote since Ronald Reagan's "Morning in America" landslide in 1984. Can it be possible that Donald Trump, who has never commanded majority support in any poll in his entire presidency, will somehow attain a Reaganesque landslide?

Some say yes. “The economy is just so damn strong right now and by all historic precedent the incumbent should run away with it,” said Donald Luskin, chief investment officer of TrendMacrolytics, told Politico, “I just don't see how the blue wall could resist all that.” Luskin, by the way, was one of the few who correctly predicted Trump's 2016 victory.¹

Luskin and Fair have plenty of favorable macroeconomic data to point to.

- Unemployment is at record lows. At this writing, in the middle of 2019, unemployment is 3.8 percent. America is as close to full employment as it can get.
- GDP Growth was 3.2 percent for the first quarter of 2019 – marking a full year in which the American economy has grown at 3 percent.
- The stock market has hovered near all-time highs for much of Trump's presidency.
- Interest rates remain low, and Trump continues pressuring the Federal Reserve to keep them low.

The economy is strong, most Americans believe. In fact, a March CNN poll found 71 percent of Americans describe the economy as strong. That's good news for Mr. Trump. But here's the bad news: in the same poll only 42 percent of Americans approve of the job Trump is doing as president.² A gap of nearly 30 points between those who like the economy and those who like the president is unheard of. Fairly or not, American presidents usually get the credit when the economy is strong and the blame when it is weak.

¹ https://www.politico.com/story/2019/03/21/trump-economy-election-1230495
With the economy so strong, why is Trump so weak?

How can it be that Mr. Trump, in presiding over a strong economy, has lost ten percent of the 46 percent of the vote he won in 2018? Indeed, a solid majority of Americans (55 percent) told an April ABC News/Washington Post poll they will definitely not vote for Mr. Trump. How can that be in such a strong economy? A couple of reasons.

First, other matters can overwhelm a strong economy. In 1968 unemployment was a mere 3.4 percent, GDP growth was a robust 4.9 percent and inflation was 4.7 percent. Yet Lyndon Johnson, facing likely defeat in his own party, declined to run. The war in Vietnam had made economic issues recede. It may be that Mr. Trump’s frequent Twitter tirades, the near-constant specter of scandal, and the President’s emphasis on divisive issues like immigration are suppressing the support he would otherwise be enjoying in a strong economy.

Second, the economic gains have been unevenly distributed, both in terms of geography and class. Hillary Clinton only won 487 of the nation’s 3,141 counties. But she got more votes in those 487 counties than Trump did in 2,626 counties. So it may not come as a surprise to learn that the majority of jobs created in the Trump economy (58.5 percent) were in counties Hillary carried. This differs little from Obama’s economy, where 58.7 percent of job gains were in counties Democrats carry. Even in a growing economy, the

3 https://www.thebalance.com/unemployment-rate-by-year-3305506
4 https://www.factcheck.org/2016/12/clinton-counties/
Go micro, not macro

Analysts study the macroeconomy, but people live in the microeconomy. Despite overwhelmingly positive macroeconomic data – unemployment, inflation, interest rates, stock prices and more – barely over one in three Americans believes their country is moving in the right direction.11 This is virtually unchanged since the day Donald Trump rode a wave of discontent to the White House.12 Recall that first line in Carville’s sign: Change vs. More of the Same.

Rather than bow to the strong macroeconomic news, Democrats would do well to run hard on the troubling microeconomic sentiment. The Trump tax cut – his signature economic accomplishment – is unpopular, with only 36 percent of Americans expressing approval. More troubling for Mr. Trump, just 17 percent of Americans believe the Trump tax cut actually reduced their taxes. Far more Americans (28 percent) think they’re seeing a tax increase under Trump.13 So where do they think the US$2 trillion tax cut went? Overwhelmingly, Americans believe the Trump economy benefits those in power, rather than average working families. Nearly two-thirds of Americans feel the Trump economy is stacked against them, according to a recent ABC News/Washington Post poll, including 68 percent of Independents. That same poll found that more Americans oppose his trade policies than support them, and his handling of the economy makes only 39 percent of voters more likely to support him.14 Perhaps it is still the economy, stupid.
The coming debate over socialism

Mr. Trump has already signaled that he will paint his Democratic opponent as a socialist. And the popularity of Democratic socialists like Vermont Senator Bernie Sanders (a leading candidate in the crowded Democratic field), and Rep. Alexandria Ocasio-Cortez (D-NY) give that argument some credence. Democratic strategists fear the suburban voters who powered Democratic congressional candidates to a landslide in the 2018 elections will reject socialism of any kind.

They are wise to have such concerns. As the successful presidencies of Bill Clinton and Barack Obama demonstrated, Democrats are strongest when they push incremental, market-based economic progress for the middle class. If Democrats can shift the debate away from advancing socialism and onto defending wildly popular entitlement programs, they will have a chance to blunt Mr. Trump's charge of socialism.

Middle-class Americans do not want socialism, but they love Medicare, Medicaid and Social Security. When those entitlements are threatened, voters rise up. Knowing this, Mr. Trump campaigned on a pledge to protect entitlements from cuts. “I'm not going to be like every other Republican,” he said in his 2016 campaign, “and I'm not going to cut Medicare or Medicaid.” But Mr. Trump's 2020 budget proposal does just that – calling for eye-popping cuts of US$1.5 trillion in Medicaid spending, US$845 billion in cuts to Medicare, and US$25 billion in cuts to Social Security.15

The Democrats' strategic imperative will be to steal Mr. Trump's populist economic thunder and make the case to Middle America that Donald Trump cut US$2 trillion in taxes for the wealthy and for corporations, and wants to pay for it by cutting US$2 trillion from sacrosanct middle-class programs like Medicare, Medicaid, and Social Security. Mr. Trump, on the other hand, would rather the debate be about socialism in general, and the massive taxes that would be necessary to pay for socialist programs like universal health care, free college educations, and no-cost child care. This will likely be a major theme of 2020: Trump wants to argue generalities, and make the macro case; Democrats will want to argue specifics, and make the micro case. The side that captures the high ground in this debate will control the economic terrain, and in turn will be in a strong position to win the White House.

Perhaps the Democratic nominee will want to hang a slightly updated sign in her/his 2020 War Room:
Change vs. More of the Same
It's the Micro-Economy, Stupid
And Don't Forget Medicare, Medicaid and Social Security.

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“WE ARE JUST SIMPLE PRODUCERS WANTING TO SELL OUR PRODUCT.”

In an interview with CNN’s Emerging Markets Editor and Abu Dhabi based anchor, John Defterios, Emmanuel Ibe Kachikwu, Nigeria’s Minister of State for Petroleum, talks about Nigeria’s role within the internal power structure of OPEC and his efforts to develop Nigeria’s oil infrastructure and refineries.
“Interview “We are Just Simple Producers Wanting to Sell Our Product.”

Emmanuel Ibe Kachikwu is a graduate of Law from the University of Nigeria, Nsukka and Nigerian Law School. Moreover, he obtained a Masters and Doctorate Degree in Law from Harvard University. In August 2015, he was appointed as the Nigerian National Petroleum Corporation Chief Executive to wide public acclaim in August, 2015 and removed as the GMD of the NNPC by President Muhammedu Buhari a year later. During this time he was able to completely restructure the organisation. Since November 2015 he has served as his country’s Minister of State for Petroleum. In this interview from April this year, Emmanuel Ibe Kachikwu shares his insights on Nigeria’s energy sector, the oil price development and if the OPEC plus agreement will stay intact.

Emmanuel Ibe Kachikwu (right)
John Deferios (left)
**Interview**  “We are Just Simple Producers Wanting to Sell Our Product.”

**John Defterios:** Mr Kachikwu, you’ve held strategic talks with the minister of energy, Khalid Al-Falih, of Saudi Arabia. Do you see them coming into Nigeria and using it as a springboard to the rest of the continent? And if so, why would it be a good place for them to start in Africa?

**Emmanuel Ibe Kachikwu:** We’re certainly hoping that Nigeria should be. We’ve got very strong historical links, a considerable Muslim population. We are talking about an important part of our country’s population, religious Muslims, many of whom regularly go to Hajj. So, our relationship is both historical and religious. What is more important, we have the resources. We are not only the biggest gas power in Africa, we have the highest oil resources, as well. This makes us the biggest energy country in the whole of Africa.

However, we need investments for expanding our infrastructure and building up our refineries. We estimate that something between 15 and 20 billion dollars are needed to meet these requirements. And finally, if you look at just the location, it is easy to see that Nigeria is also the perfect fit from a strategic point of view, being right at the tip and edge of west Africa and east Africa. So, in terms of getting at a market that is basically not yet mature but with a lot of potential, no other African country offers so many arguments.

**John Defterios:** Saudi Aramco has gone into Pakistan. They’ve gone into India. Logically, if they come into Nigeria, you need that refining capacity. Strategically, just on the energy front, it seems like a pretty good marriage.

**Emmanuel Ibe Kachikwu:** Yes, absolutely. If you look at the actions that Aramco has taken so far, it becomes clear that Saudi Arabia has so far done everything with its own crude oil. In other words, they take their crude oil to an area and they refine it. Nigeria is a different cup of tea because we have our own crude now. That’s probably where the challenge lies. We need to fashion this in a way that it will be a win-win for both sides.

**John Defterios:** What’s the timeline, do you think, to a real concrete structure of collaboration between Saudi Arabia and Nigeria, realistically speaking?

**Emmanuel Ibe Kachikwu:** Quite frankly, we don’t really discuss timelines. Both sides are in a similar hurry to get this done. I am hoping that within the next one year, we will have all the agreements, all the MOUs signed, and the physical investments will begin. Our oil refineries can’t wait that long. We are in the process of bringing in private-sector interests into them to let them grow and let them be revamped. We will have to look at short-term measures to enable them to participate, or longer-term measures that enable them to take over after you have rebuilt or introduce their own individual refineries as the case may be.

**John Defterios:** Many are seeing the lifting of the waivers by the Trump administration as a break-up of the OPEC plus agreement. That includes Russia, of course, as well. Do you see that agreement staying intact after nearly two and a half years?
Emmanuel Ibe Kachikwu: I think it will stay intact. The reality is that even though this will affect production out of Iran, oil is going to come from some other sources than Iran. The U.S. itself is producing quite a bit. There are lots of idle capacities within the OPEC countries that can be brought up, but this of course needs the ability to manage it properly. If everybody goes back to the situation before 2014/15, when the only rule was to produce whatever one can, I think, you won’t find anyone to wish this situation coming back. Oil went down to US$28 a barrel. Nobody in OPEC wants that, so we would like to see the agreement is extended when it comes to June. At present, we are unable to provide any information on an expected timetable or on any quantities. Will there be some volumes that are going to be taken out of the market? Probably not. We’ll see how it goes. We’ll have to watch the tightness of the market.

John Defterios: You have to be flexible to respond to the drop in Iranian production, but do you actually see Iran going to zero as Washington intended? Is that realistic? Because they’re hovering around a million barrels in terms of exports.

Emmanuel Ibe Kachikwu: No, I don’t think so. It’s like asking a nation to vacate its space. It’s not possible. That’s what they have, so they’re going to sell oil somehow. Whether it’s to small third parties, whether it is through alignment with countries that are much more receptive to their causes, they will sell oil. They will struggle to sell the same volumes that they are selling today, but they will definitely sell oil.

John Defterios: How about Russia’s role, perhaps with North Korea after the (G20) summit? China seems determined to say that this is a legitimate agreement. Why should they go to zero in terms of imports? Do you agree with them?

Emmanuel Ibe Kachikwu: Yes, absolutely. There are countries having very strong ties with Iran who worry about this, even members of OPEC. Because of our broader economic interests, we are concerned about the economic development in general, because one economy down in OPEC has this effect on the entire OPEC, just like what we are seeing in Venezuela. So, we are sympathetic to these countries. Therefore, whatever they can do to keep oil going, helps us in terms of loosening the market; and it avoids the feeling that there’s some sort of conspiracy amongst investment banks to bring Iran down. There are challenges that we’ll have to look at, both on the commercial side and on the political side.

John Defterios: In March 2018, we had US$86 a barrel when the Trump administration was talking about getting out of the nuclear agreement. Do you see that happening again, or is the OPEC plus team managing to keep this Goldilocks price around US$75 at the top?

Emmanuel Ibe Kachikwu: What we see at this time is that the market has gotten much more stable. Oil sources have gotten much more diverse. Despite the shortage, even despite the challenges out of Venezuela, out of Libya, and out of now potentially Iran, America has a million to a million point five million barrels that it can fairly quickly bring back into the market and increase their production.
WE ARE CONCERNED ABOUT THE ECONOMIC DEVELOPMENT IN GENERAL, BECAUSE ONE ECONOMY DOWN IN OPEC HAS THIS EFFECT ON THE ENTIRE OPEC.

**John Defterios:** Saudi-Arabia has that spare capacity if they need it, right?

**Emmanuel Ibe Kachikwu:** Saudi has spare capacity. Russia has spare capacity, even Nigeria has growing spare capacity. Frankly, I do not see that momentum in the market that you had initially when we got to US$86, so I think it will probably, at best, see prices in the 70s.

**John Defterios:** As you know, President Trump has gotten very Twitter-happy when oil went above US$70 a barrel, touching US$75 now, but he only has himself to blame. He can’t look at anybody else and say, “You’re being greedy.” What do you think will be his response, when the time comes?

**Emmanuel Ibe Kachikwu:** The reality is the Trump administration is very conscientious about the U.S., and I understand and appreciate it. The only problem might be that other countries are beginning to implement their own versions of an America first policy, resulting in rising nationalism, that creates its own problems. At the end of the day, there are some policies that conflict. He took away Iran, and you have the problem in Venezuela, and the uncertainties in terms of governance and where the big powers stand. These are self-inflicted crises.
Interview  “We are Just Simple Producers Wanting to Sell Our Product.”

I don’t know if OPEC is the right place to correct these mistakes. At the end of the day, OPEC was formed as a cartel to look after its members’ interests. Quite frankly, we can’t play that sort of game. Most of us are not that big. We are just simple producers wanting to sell our product. At some point in time, I’ve already said, there has got to be post-OPEC plus dialogue, in other words, much more than OPEC plus. We’ve got to begin to have companies that are heavily invested, corporations all around America, around Canada, begin to join in this for global stability for the oil industry. Unless we do that, OPEC will never be in a position to 100 percent deliver.

**John Defterios:** I cover OPEC consistently, but most don’t know the role that you’re playing within the geopolitical nature of OPEC, and the OPEC plus with Russia in there. Are you going to serve as a member of the monitoring committee as a bridge between Saudi Arabia and Iran, to keep that stability? Can you serve that role as an independent voice from Africa?

**Emmanuel Ibe Kachikwu:** Yes. **John Defterios:** You think so?

**Emmanuel Ibe Kachikwu:** Yes, I do. Incidentally, I’ve also just been elected as the president of the African producers, so that gives us a bit of strength as a group. I think the reason why Nigeria was brought it is, like you rightly said, we serve as a bridge. We’re at home with Russia. We’re at home with Iran. We’re at home with the Saudis. We understand the concerns of everybody. We’re not competing, we’re not threatening anybody. We’re able to bring things into the mix that enables people to feel comfortable with us. My job will be to try and create that balance, make sure that OPEC rules are well complied with, make sure that we look at both the consumers and the producers, make sure that the big players in OPEC and OPEC plus, Russia, Saudi Arabia, and the rest, have a commonality of interests that is balanced. That’s what we’re going to do.

**John Defterios:** Thank you very much for the interview.

**Emmanuel Ibe Kachikwu:** It was my pleasure.
After a bold, but premature declaration last year to afflict maximum economic pain on Iran, U.S. President Donald Trump is delivering on his promise and tightening the vice on a country that seemed full of promise after the signing of the 2015 nuclear agreement.

It has been an aggressive three-stage affair; targeting oil exports, the financial sector and eventually the country’s industrial metals industry. Iran’s President Hassan Rouhani advised Iranians to fasten their seatbelts and prepare to resist “unprecedented pressure” matching the sanctions imposed during the eight year Iran-Iraq war back in the 1980’s.

They are a resilient population, a trait I witnessed first-hand while on assignment in the country. From the grand bazaar in Tehran to the oil fields in Azadegan in the country’s southwest, traders and energy field managers told me decades of on-again, off-again sanctions taught them how to survive.

While basking under the halo of the nuclear agreement, Iran’s oil exports surged to three million barrels a day in the autumn of 2016. According to the Energy Information Administration in the U.S., that dropped to just 1.1 million barrels in March. Using a conservative estimate of US$50 a barrel, the sanctions are already costing Iran about US$35 billion a year in lost oil revenues alone. The question remains, can the Trump administration take that down to zero exports this year. “I don’t think so,” said Emmanuel Ibe Kachikwu, Nigeria’s Petroleum Minister during an interview in Dubai. “That is what they have, so they are going to sell somehow.”

Kachikwu, the newest member of the Joint Ministerial Monitoring Committee in the OPEC plus apparatus bringing together 24 members to rebalance oil markets, said there are countries sympathetic with Iran’s position and therefore will continue to purchase its crude.

Of Iran’s top five customers, Japan, South Korea and India quickly cut back their orders; while China and Turkey, representing over 800 thousand barrels of daily demand, have remained steadfast so far in the face of the U.S. pressure.

The full weight of the U.S. sanctions is heavy, regardless of limited support from Iran’s allies. The International Monetary Fund’s regional economic outlook estimates Iran will contract by six percent in 2019, the second year in a row of recession. This calculation however was done before the Trump administration lifted its waivers for oil exports, in April this year.

“Look, the risks are on the downside because production will go further down. This will have a more negative impact of course,” said Jihad Azour, regional director of the IMF.

While the spotlight remains on Iran’s oil and gas exports, the desire by Washington to target industrial metals will hit family trading groups and deepen widespread unemployment of 12 percent, double that amongst its youth. Iran ranks 15th in the world in terms of auto manufacturing and in the top ten of global steel producers.

Then, in early May, there is the impact of financial sanctions, which pushed the Iranian rial to a seven-month low, with inflation projected to hit 40 percent before the end of the year according to the IMF.

As Rouhani suggested in his economic call to arms, “giving in is not consistent with our culture...thus we should not accept submission and we should try to find a solution.” It is difficult at this stage to imagine what that solution might involve.

A day after the U.S. President said he would like Iranian leaders to “call me”, a top commander from Iran’s Revolutionary Guard Corps rejected that option outright, even as the U.S. carrier Abraham Lincoln was deployed to the Middle East as a warning to Iran, along with a full array of military hardware.

In between the post-Cold War era and before the full rise of China, the U.S. is behaving like the last bully on the block, with superior military capabilities, a US$20 trillion economy and control of the world’s reserve currency.

That hardline approach is coupled with a bold play to support ExxonMobil’s US$53 billion proposed oil and gas deal in southern Iraq, that could ultimately be worth about ten times that amount to the government over the next thirty years. It is an aggressive call that seems consistent with the playbook of President Trump’s National Security Advisor John Bolton. He never liked the nuclear deal signed by his boss’s predecessor and has been empowered to do something about it. Putting a wedge between Iran and Iraq looks to be part of that strategy.

After covering this region for the past thirty years, one begins to feel they have read this script before and it may not conclude with a quiet ending.
The Return of Great Power War?

For most of modern history, there has been at least one major war amongst two or more great powers every generation.

James Davis
Professor of International Politics and Dean
School of Economics and Political Science
University of St. Gallen
Between the defeat of Napoleon in 1815 and the outbreak of the Spanish-American War in 1898, there were at least seven wars where two or more great powers faced one another on the battlefield. These turbulences of the 19th Century prepared the way for the two World Wars of the first half of the 20th.

However, we have now experienced more than seven decades without a war between the great powers. What accounts for the long period of great power peace? More importantly, is this ahistorical but rather happy state of affairs likely to persist?

1 Russo-Turkish War 1898–29; Crimean War 1853–56; Second Italian War of Independence 1859; Franco-Mexican War 1861–67; Austro-Prussian War 1866; Franco-Prussian War 1870–71; Russo-Turkish War 1877–78.
Absence of great power war

Six developments since the end of the Second World War explain the absence of war amongst the great powers.2

1. **The costs of modern industrial warfare between great powers outweigh the likely benefits.** Modern conventional weapons are fast, precise and can be quite destructive. The weaponization of new technologies and the militarization of new spaces such as the internet have made it possible to wreak havoc on countries from a distance.

2. **Nuclear weapons.** Modern conventional war would be horrible, but nuclear war would be horrible beyond belief. Fear that conventional war between them might escalate makes leaders of nuclear powers risk averse in times of political crisis.

3. **The attenuated relationship between control over territory and the economic well-being of a country.** Modern industrial and post-industrial economies rely less on agriculture and raw materials than on a complex system of skilled labor and services, which is not directly tied to control of territory. You can be small and rich. This point is related to but not completely the same as my fourth point.

4. **The benefits of economic integration would be sacrificed by warfare.** The fact that most large economies have sizable direct foreign investments means that there is a strong domestic lobby for peace, and for much of the post-war period, the great powers have enjoyed the lion’s share of the benefits of integration.

5. **The emergence of a security community amongst the most developed states in the international system.** The United States, Western Europe and the advanced industrial democracies of the Pacific share a core set of common democratic institutions and values. This shared identity means that war amongst them is simply unthinkable.

6. **American leadership.** The economic and value integration of the great powers rests on a web of international institutions that were created through American leadership and the willingness of Washington to pay the disproportionate share of the costs for their operation.

   Although each of these developments exerts an independent pacifying influence on international relations, they also reinforce one another. Together, they comprise the six pillars of the great power peace.

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2 The argument in this section was inspired by Robert Jervis, “Theories of War in an Era of Leading Power Peace,” American Political Science Review 96, 1 (March 2002), pp.1–14.
Alarming trends

The stability of the great power peace is at risk. Numerous trends are eroding each the pillars on which it rests. Because these processes are simultaneous and ongoing, they portend more than just erosion. Indeed, the possibility for catastrophic collapse is on the rise.

1. **High-tech weaponry supports the illusion of surgical warfare.** Stealth technology, precision guided munitions, stand-off weapons platforms, drone aircraft and cyber weapons support the illusion of surgical warfare with limited collateral damage, few civilian casualties and extremely low risks of casualties for one’s own soldiers. When the perceived risks of war recede, leaders throw caution to the wind.

2. **Beliefs about nuclear weapons are changing.** For some analysts, technological developments in the fields of remote sensing and targeting imply that nuclear weapons can be used in ways that minimize collateral damage, civilian deaths and environmental catastrophe. Recent surveys suggest the public is willing to accept the use of nuclear weapons if doing so would prevent harm to their own soldiers. Russia and the United States are modernizing their nuclear forces and contemplating first use scenarios. Both have taken steps to weaken the arms control regime that was developed to stabilize nuclear deterrence by diminishing the benefits of a nuclear first strike.

3. **Beliefs regarding the importance of controlling territory are changing.** Russia’s invasion of and subsequent annexation of the Crimean peninsula and China’s increasingly bellicose claims to rocks, reefs and islands beyond its internationally recognized territorial waters point to a renewed focus on the control of territory as central to states’ security and economic prosperity. Populist calls for economic self-sufficiency in the US and parts of Europe suggest a renewed belief in the importance of territory, as self-sufficiency implies political control over territory and resources.

4. **The domestic dislocations caused by global economic integration are more salient than the manifest benefits.** Donald Trump is perhaps the loudest voice stressing the jobs lost to globalization, but he is by no means alone. Meanwhile the benefits of globalization – the dramatic drop in the price of consumer goods, the service sector jobs created, and the billions who have been lifted out of poverty – are forgotten or perceived to accrue to others. As a result, we can no longer assume that people in the advanced industrial democracies will continue to support free trade and open markets. When goods cannot cross borders, the risk rises that armies will.

5. **The security community is weakening.** On any number of issues – the death penalty, data privacy, global warming, whaling – it seems that European, American and Japanese values are diverging. Although the diversity of opinion on these issues within individual countries and regions is greater than often recognized, the perception that the members of the security community are drifting apart is widely held. The fact that the generations who shared dramatic common experiences – the World War II generation and the generation that successfully managed the Cold War – are passing from the scene only exacerbates this tendency. Younger generations share fewer common memories to hold them together and create the glue of a common identity.

Meanwhile, we are witnessing the emergence of great powers that are not members of the security community. China has not been quick to adopt the values of the security community, indeed has claimed to be providing an alternative to the western liberal democratic model. Moreover, whatever the reason, efforts to integrate Russia into the security community after the collapse of the Soviet Union clearly failed.

6. **The United States is withdrawing from global leadership and its role as the provider of public goods.** The doctrine of “America First” is perhaps the worst indication of the trend, but it predates the election of Donald Trump. Given the many domestic challenges facing the United States – health care, education, infrastructure, a weak social safety net, etc. – it is increasingly difficult to explain to American’s why they should continue to pay a disproportionate share of the costs for maintaining the institutions of the global order.
IT SEEMS THAT EUROPEAN, AMERICAN AND JAPANESE VALUES ARE DIVERGING.

Implications

The obvious implication of this analysis is that great power war no longer is as unthinkable as it was for most of the past seventy years. The analysis also suggests that the international system has become far more complex and confronts leaders with a series of difficult paradoxes. Reducing the lethality of conventional and nuclear weapons paradoxically may increase the chance that they are used and cause more people to die as leaders take greater risks in times of crisis. Escaping American dominance paradoxically may leave Europe weaker and with less freedom of choice. If export markets dry up, a competition amongst member states for market share would put the EU under renewed internal stress at the very moment Europe would have to engage in an unwelcome geopolitical competition over who will write the new rules of the game. And precisely when international politics is becoming more complex and dangerous, democratic leaders paradoxically are turning inward.
A Holistic Approach
Toward a Digital Nation
The Catalytic Role of Government

Rabih Abouchakra
Managing Director
Crown Prince Court Abu Dhabi

Michel El Khoury
Senior Director
Crown Prince Court Abu Dhabi

Andrew Archer
Associate Director
Crown Prince Court Abu Dhabi
In recent years we have seen the emergence of a new frontier of digital technologies with enormous potential to transform people’s lives. Developments in artificial intelligence, cloud, 5G, advanced analytics, fintech, autonomous vehicles, robotics, genomics will collectively change what we do, how we think, our relationships with each other and how we define ourselves as a society. They will disrupt how we do business, our supply chains, products and services, how we innovate and the competitiveness of the economy as a whole.
The adoption and mainstreaming of these technologies have the potential to unlock massive benefits. The World Economic Forum estimates benefits of US$100 trillion over the ten years to 2025, as technologies such as mobile, cloud, artificial intelligence, sensors and analytics reinforce and integrate with each other. McKinsey estimates that AI alone will create US$13 trillion in value by 2030.

Against this landscape of exponential technological development and adoption, governments must assess their own progress — namely how are they meaningfully enabling and harnessing digital technology nationally, for the benefit of citizens, society and the economy?

Unfortunately, we often see governments falling short of real progress; they struggle to navigate the growing complexity — at times overwhelmed by the pace of change and the evolving synergies among technologies. As a result, we see unambitious, siloed or duplicative efforts to leverage technology; stale regulatory environments that hamper development and struggle to remain fit-for-purpose; sub-par services that fall well-below tech-savvy citizens’ expectations; piecemeal collaborations with the engines of innovation in the private sector and academia.

And yet, this is precisely a time when governments should use their “toolbox” to catalyze digital transformation on a national scale – planning, regulating, funding, building infrastructure, developing human capacity, incubating, delivering services. Failure to do so not only puts at risk national competitiveness and security — even worse, governments through inaction may gradually isolate themselves from, and lose the ability to influence, development and deployment of future technology.

Nevertheless, we can look for inspiration at countries that take an ambitious, strategic approach to digital transformation. Estonia is a good example. Twenty years ago, the Estonian government set out to bundle all government services onto a new digital platform. Today, more than 90 percent of public services are available online, 24 hours a day. Recently the country opened the world’s first “data embassy” — a high-security center in Luxembourg that will store copies of the country’s most critical data.

Based on our study of country examples worldwide, a catalyzing approach to national digital transformation seems to require that governments address three broad domains concurrently: public sector (the business of government itself and its touch-points with citizens); society (the public goods and wider services that society relies upon) and economy (the workforce, infrastructure and wider ecosystem that enables and drives economic growth). Each warrants a more in-depth discussion.

DOMAINS
for digital transformation: public sector, society and economy

PUBLIC SECTOR
INCORPORATE CITIZEN SATISFACTION, INCREASED EFFICIENCY AND REDUCED COSTS

SOCIETY
INCORPORATE WELLBEING AND QUALITY OF LIFE ACROSS ALL GROUPS IN SOCIETY

ECONOMY
INCORPORATE PRODUCTIVITY, GDP GROWTH AND CONSUMER SATISFACTION

FOCUS AREAS

DIGITAL TRANSACTIONAL SERVICES

DIGITALLY CONNECTED INDIVIDUALS

DIGITAL WORKFORCE

DIGITALLY CONNECTED GOVERNMENT ENTITIES

DIGITALLY PROTECTED INDIVIDUALS

DIGITAL INFRASTRUCTURE

DIGITAL CAPABILITIES

DIGITAL SOCIETAL SERVICES

DIGITAL ENTERPRISES

GOVERNMENT ROLES
across all domains and focus areas

THINKING AND PLANNING

REGULATING

FUNDING

BUILDING PHYSICAL INFRASTRUCTURE

DEVELOPING HUMAN CAPACITY

RESEARCHING, INCUBATING AND TESTING

ADMINISTERING AND DELIVERING
1. Public sector

Here, digitally transformation is about improving the quality of transactional services and making government operating models more innovative, productive and cost-efficient. Policymakers may focus on digital transactional services, digitally connected government entities, and digital capabilities.

Digital transactional services

Governments are designing user-centric transactional services – the traditional realm of governments, everything from applying for a passport to filing a new will or registering a property transaction – that can be delivered entirely online in ever more innovative ways. For example, in 2009, India assigned 12-digit unique identification numbers to all residents, based on their biometric data. That program is now the world’s largest biometric ID system, with nearly 1.2 billion enrolled members. The card is mandatory for access to a growing range of services, including opening bank accounts, verifying mobile connections, accessing domestic liquefied petroleum gas subsidies and accessing ration cards. In 2017, India launched a system that uses the ID numbers for banks, as well as a supporting application for merchants and consumers, which allows cashless transactions through linked bank accounts using fingerprint verification. The goal is to make government services more efficient and inclusive, and to reduce fraud and identity theft.

Digitally connected government entities

In addition to transactional services, policymakers are trying to ensure that all government entities use common hardware and software platforms and communicate using digital tools. Government entities should not only share data with one another but also make it available online, to boost efficiency, transparency and innovation.

In Estonia, for example, paramedics can instantly access a patient’s medical history and other data from hospitals during an emergency. Similarly, the UK government has outlined a vision called Government as a Platform (GaaP), which aims to get government bodies sharing and reusing common data, code, web-hosting services, payment solutions and security protocols. As of March 2018, about 200 government services were available through common platforms, and the country’s centralized payment system had taken more than US$53 million in payments. Moreover, the UK has also established a cloud-based hosting platform for government bodies launching new services.

Digital capabilities

Much of governments’ digitization transformation will require non-traditional skill sets, such as user experience design, programming, machine learning and cybersecurity. To that agencies need to draw on digital specialists, digital managers and technical experts.

To develop these kinds of digital capabilities, the US government is launching new hiring programs to attract leading digital technology minds to the public sector. Specifically, the government systematically transformed its recruitment program to incorporate best practices from the technology industry. It built a new team of experienced digital recruiters to conduct targeted outreach and identify a diverse set of qualified applicants. The hiring process is focused on creating a high-quality candidate experience, competitive with the private sector, in terms of fast timelines, ease of application, and frequent communication of application status. To attract leading applicants, the US government also emphasizes the potential social impact that USDS employees can have. In 2017, it met its target of hiring 200 digital experts, well in advance of its original deadline.

2. Society

The second domain for digital transformation is society. Digital transformation can empower individuals to create new communities and devise solutions to pressing social ills, such as social immobility and inequality; societal services such as health, education, transport and justice can become more personalized and effective, leading to improved wellbeing and quality of life. Accordingly, policymakers may focus on digitally connected individuals, digitally protected individuals, and digital societal services.

Digitally connected individuals

To create a digital society, governments need to ensure that all citizens can enjoy affordable access to key technolo-
gies, make sense of digital content, and navigate the digital world. Physical infrastructure – such as broadband, WiFi, mobile, and satellite networks, and data centres – is a key driver of digital connectivity. Some countries charge state-owned monopolies with investing in the necessary physical infrastructure, while other countries take a more market-based approach, often with a mix of public and private funding.

In late 2016, the EU created a €500 million broadband infrastructure fund as part of a wider digital agenda that aims to ensure access to a 30Mbps “superfast” broadband connection for all homes by 2020. However, this is a small share of the estimated €500 billion that is needed to meet this goal. To increase private investment, governments are examining their telecoms regulations closely.

Similarly, Singapore is continuing to expand its network of public WiFi stations – 5 Mbps hotspots can be found in public spaces such as train stations, libraries, shopping centres and restaurants – and seeking to better integrate existing fixed lines, mobile networks and public WiFi more effectively. The goal is to create a scenario in which citizens use the best connection available at a given time, regardless of where it comes from, ultimately leading to cost savings for carriers (and thus consumers).

**Digitally protected individuals**

To ensure that they digitize society in a safe manner, governments are trying to better protect individuals from digital threats by keeping their data secure and tackling emerging problems, such as cybercrime and cyberharassment. A key element of this is regulation, which requires facilitating the emergence of innovative new services, while also ensuring the safety of personal data and providing transparency over its use.

In 2015 Dubai enacted a Data Law that aims to support innovation and economic development, foster competition and help Dubai achieve its vision of becoming a “smart city”. The EU’s new General Data Protection Regulation (GDPR) features stricter obligations for companies and other organizations storing data, along with a wide range of data privacy rights for individuals. These include the right to be forgotten (known as “erasure”), the right to data portability and the right not to be profiled. The GDPR does not just target companies. It also has provisions to regulate the processing of personal data by EU institutions and agencies – and the sharing of such data – and violations carry heavy fines.

**Digital societal services**

One area with clear transformation potential from digitization is the delivery of core societal services, notably education, healthcare, transport and justice. For example, digital health initiatives typically aim to increase access to care in underserved areas, while also delivering services that are more targeted, cost-effective and personalized.

Telemedicine is one area of focus; it uses technology to deliver healthcare at a distance – for example, through remote telemonitoring of patients and remote consultations. Despite its promise, the use of telemedicine remains low in most countries. The government of New South Wales in Australia aims to make telehealth a core part of the state’s suite of healthcare services by 2021. The strategy identifies priority areas to systematically address impediments to the use of telemedicine, such as existing laws and payment systems that have been designed for face-to-face care, and the need to keep patient data secure and private.

Transport is also ripe for digitization, such as Germany’s forward-looking strategy for automated vehicles (AVs). The strategy outlines a plan for the country to become the leading supplier of, and market for, automated and connected vehicles in the world. On a societal front, the strategy outlines goals to use AVs to cut emissions, improve road safety, reduce congestion and improve the quality of public transport. Key objectives of the strategy include intelligent highway design, new vehicle standards regarding cybersecurity and data protection, and new rules for driver testing, among others.

### 3. Economy

Digital transformation of the final domain, the economy, may usher in new and innovative products, services, industries and operating models, leading to an increase in productivity, GDP growth and consumer satisfaction. To achieve this, policymakers should focus on a digital workforce, digital infrastructure, and digital enterprises.

**Digital workforce**

To create a digital economy, policymakers want to ensure that businesses can draw on a labor force that is rich in both broad and specialized digital skills. Policymakers are also trying to support businesses that want to experiment with new hiring models – such as those found in the gig economy – while protecting consumers from market abuse.
In the EU, Finland, the Netherlands and Sweden have all launched digital skills strategies that place increasing emphasis on “hard” science, technology, engineering and mathematics (STEM) skills, as well as “soft” skills such as critical thinking, communication and collaboration.

Other countries are improving digital skills among those already in the workforce. In 2016, Egypt’s Ministry of Communications and Information Technology established a platform from which any Egyptian citizen can access nanodegrees offered by leading international universities and private companies (including IBM, Udacity and Coursera). The goal is to create a new generation of programmers, user experience architects, data scientists, cybersecurity experts and project managers, among others. The program currently offers 40 courses, along with coaching and mentoring. The program currently has 1,109 students – all of whom receive grants to cover course costs – and has produced 1,181 graduates.

Digital enterprises

While the private sector is ultimately responsible for designing new digital products, services and operating models, governments can create a supportive digital economy ecosystem – i.e. an environment that brings together a set of interconnected elements and thus encourage innovative digital enterprises and ideas to flourish. These ingredients include clear regulation, incentives to work with academics and researchers, and funding support.

In 2015, China’s State Council launched the “Made in China 2025” strategy, with the goal of becoming a world leader in advanced manufacturing. Although focused on industry as a whole, the strategy identified 10 priority sectors, including robotics, high-tech shipping and biopharma. In addition to supporting start-ups, the strategy recognizes inefficiencies among existing manufacturers that are ripe for large-scale digital disruptions. Through this program and several others like it, China is starting to close the “digitization gap” with advanced manufacturing leaders.

Conclusion

Our study highlights many ambitious examples of how governments have sought to catalyze digital transformation at a national level. The landscape of domains and focus areas, which the examples collectively illustrate, serves as a comprehensive basis for any government to assess their current efforts and identify future opportunities in this regard.

We may observe that what precisely a country chooses to do will be driven by its own circumstances. Nevertheless, we may say that the most ambitious governments have clearly sought to influence and steer digital transformation proactively and strategically – deploying the full range of tools at their disposal across multiple domains. We think this approach is a hallmark of these governments’ recognition of the need to catalyze digital transformation nationally and also an indicator of their likely future success.
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The Stern Stewart Institute e.V.
1330 Avenue of the Americas
Suite 23
New York, NY 10019
United States
T +1 212 653 0636
F +1 212 653 0635
E info@sternstewartinstitute.com

Salvatorplatz 4
80333 Munich
Germany
T +49 89 242071 0
F +49 89 242071 11
E info@sternstewartinstitute.com

sternstewartinstitute.com
tssi.org

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