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ERASMUS MODULE ON EUROPEAN STUDIES IN BUSINESS, ECONOMICS AND
FINANCE

EUROPEAN STUDIES IN FINANCE Guide



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The Guide on European Studies in Finance is devoted to the sustainable learning of European experience, current status and trend in the area of Finance that is the sub-module of EMESBEF.

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Additional information you can find on our web-site: <https://en.jeanmonnetmodule.uz/>

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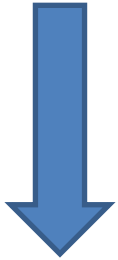
Content

- Introduction in European Union and its Financial Regulation
- European Union experience in derivative tools and their regulation
- Concept of Structured Finance. Securitisation
- European Venture Capital Funds
- Quantitative analysis in trade and innovation in European countries
- Approaches of European scientists to trade and innovation
- Foreign direct investments in European countries. Policy in attracting FDI and in investing
- EU direct investments to Uzbekistan
- Uzbek climate for European investments (regulatory base)
- European Union experience in taxation
- European Union experience in customs
- Role of European Union in trade facilitating. Trade Facilitation Agreement
- Corporate governance in European Union

Introduction in European Union and its Financial Regulation

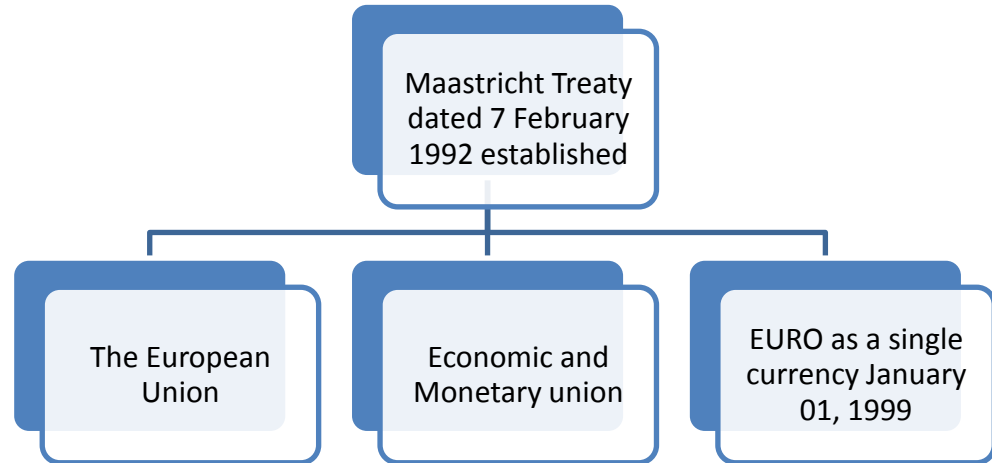
the European Coal and Steel Community based on European Coal and Steel Treaty, concluded on 18 April 1951 in Paris, and entered into force on 23 July 1952

the European Atomic Energy Community based on the European Atomic Power Treaty, which was concluded on 25 March 1957 in Rome



European Economic Community (EEC) founded by Treaty of the European Economic Community / Treaty of Rome on 25 March, 1957.

Six founding countries: France, Germany, Italy, Belgium, the Netherlands and Luxemburg. 28 EU Member States until UK left on 31 January 2020



The Treaties

The Treaty of Lisbon dated 13 December 2007 and entered into force on 1 December 2009 is based on 3 legal documents:

- The Treaty on the European Union (TEU)
- The Treaty on the Functioning of the European Union (TFEU)
- The Charter of the Fundamental Rights of the European Union (Charter)

TFEU enshrines four fundamental freedoms :

- Free movement of goods;
- Free movement of persons;
- Free movement of services; and
- Free movement of capital

Financial Regulation

European harmonisation, including harmonisation of financial regulation, is legally limited by the principles of proportionality and subsidiarity. Proportionality means that any EU action must be limited to what is necessary to achieve the objectives of the treaties and may not go any further.

Subsidiarity means that the EU may only take action if it is more effective to take such action at the EU level rather than at national, regional or local level (except in the areas where the EU has exclusive competence, and the EU may therefore always take action)

“EU passport”, a core concept of EU financial law that will prove to be of relevance not only for banks, but also for other types of financial institutions. Passporting enables firms that are authorised in any EU or EEA state to trade freely in any other with minimal additional authorisation. These passports are the foundation of the EU single market for financial services.

Results of De Larosiere Report

European Supervisory
Authorities (ESAs)

European Banking Authority (EBA)

Responsible to issue
binding RTS and ITS as
well as non-binding
guidelines and
recommendations :

European Insurance and Occupational Pensions Authority (EIOPA)

European Securities and Markets Authority (ESMA)

Financial supervision in the EU

De Larosere

creation of a European System of Financial Supervision (ESFS), the purpose of which is to ensure the coordinated supervision of the EU's financial system

Report led to:

creation of European Systemic Risk Board (ESRB), which now forms part of the ESFS

ESFS consists of three ESAs

- the EBA (European Banking Authority)
- ESMA (European Securities and Markets Authority). Responsible for credit rating agencies and trade repositories
- EIOPA (European Insurance and Occupational Pensions Authority)

European Systemic Risk Board (ESRB)

responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macroeconomic developments, so as to avoid periods of widespread financial distress

European Banking Union

The purpose of the banking union is to make European banking:

more transparent	by consistently applying common rules and administrative standards for supervision, recovery and resolution of Banks
unified	by treating national and cross-border banking activities equally and by delinking the financial health of banks from the countries in which they are located
safer	by intervening early if banks face problems in order to help prevent them from failing, and – if necessary – by resolving banks efficiently

The banking union has two pillars:

Single Supervisory Mechanism (SSM)

Single Resolution Mechanism (SRM)

The Single Supervisory Mechanism the ECB and the national supervisory authorities of the participating countries.

The main purpose of the Single Resolution Mechanism is to ensure the efficient resolution of failing banks with minimal costs for taxpayers and to the real economy

Questions

Please list the main results of Maastricht Treaty

What are the basic fundamental freedoms proclaimed by The Treaty on the Functioning of the European Union

Please disclose the idea of principles of proportionality and subsidiarity in regulation

Please disclose “EU passport” as a core concept of EU financial law

Which responsibilities have three European Supervisory Authorities (ESAs)?

Please disclose general purposes and main pillars of European Banking Union

Sources

This Lecture is cited and based on:

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2. <https://www.ukfinance.org.uk/sites/default/files/uploads/pdf/BQB3-What-is-passporting-and-why-does-it-matter-UKF.pdf>
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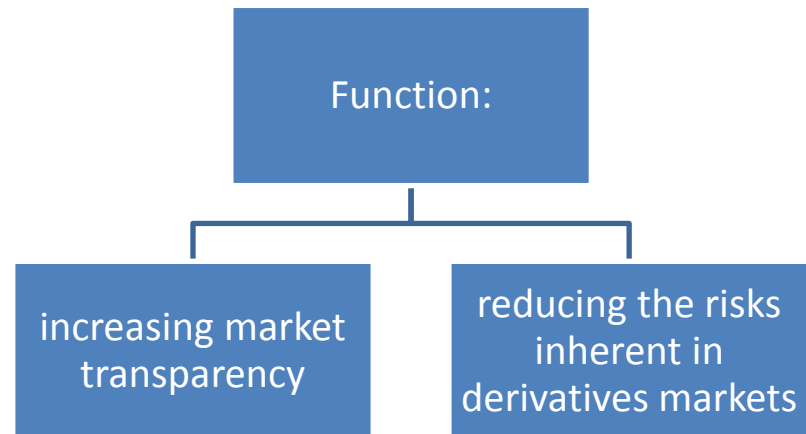
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2. SECURITIES MARKET REGULATION IN THE EU. <http://aei.pitt.edu/9561/2/9561.pdf>
3. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision_en
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European Union experience in derivative tools and its regulation

A derivative is a financial contract linked to the fluctuation in the price of an underlying asset or a basket of assets

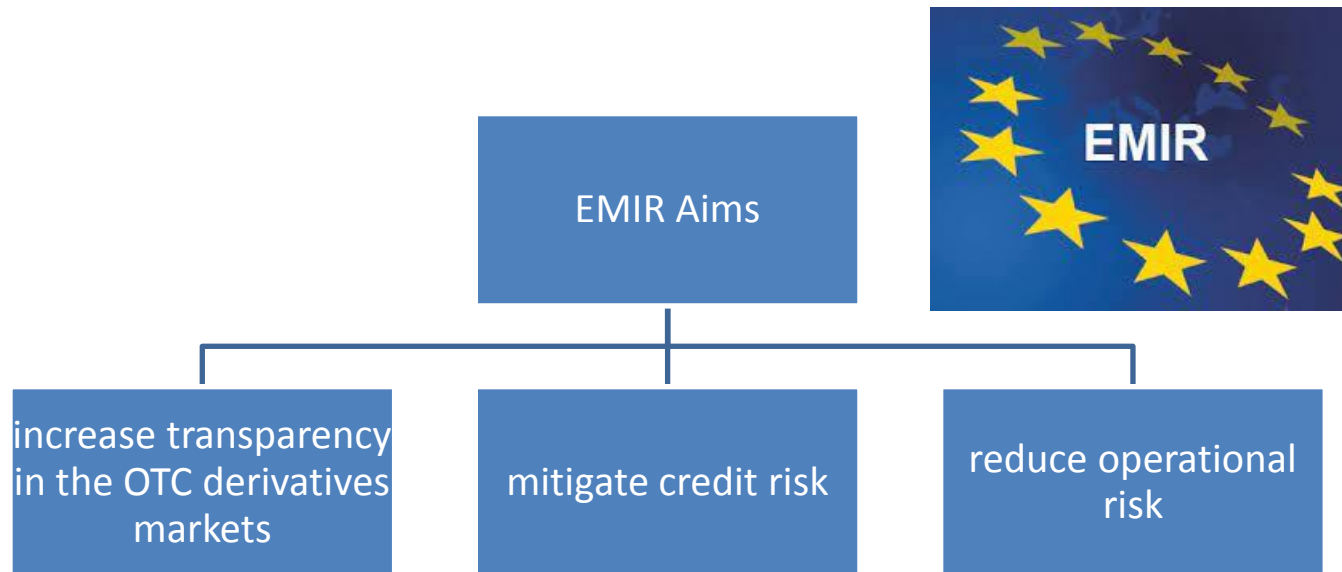
Central clearing counterparties (CCPs) - buyer to every seller and the seller to every buyer.



Trade repositories (TRs) are central data centres which collect and maintain the records of derivatives. They play a key role in enhancing the transparency of derivative markets and reducing risks to financial stability.

EU Regulation of derivatives

In 2012 the EU adopted the European Market Infrastructure Regulation (EMIR)



EU rules on derivatives contracts

EMIR provides

Enhancing transparency

EMIR introduces reporting requirements to make derivatives markets more transparent

- detailed information on each derivative contract has to be reported to trade repositories and made available to supervisory authorities
- trade repositories have to publish aggregate positions by class of derivatives, for both OTC and listed derivatives
- the European Securities and Markets Authority (ESMA) is responsible for surveillance of trade repositories and for granting and withdrawing accreditation

Credit risk mitigation

EMIR introduces rules to reduce the counterparty credit risk of derivatives contracts. In particular

- all standardised OTC derivatives contracts must be centrally cleared through CCPs
- if a contract is not cleared by a CCP, risk mitigation techniques must be applied
- CCPs must comply with stringent prudential, organisational and conduct of business requirements

Operational risk reduction

The regulation also requires market participants to monitor and mitigate the operational risks associated with trade in derivatives such as fraud and human error

EU rules on derivatives contracts

EMIR provides a mechanism for recognising CCPs and trade repositories based outside of the EU. Once recognised, EU and non-EU counterparties may use a non EU-based CCP to meet their clearing obligations and a non EU-based trade repository to report their transactions to

MiFID is the Markets in Financial Instruments Directive (2007)

The EU has established a comprehensive set of rules on investment services and activities with the aim to promote financial markets that are

- fair
- transparent
- efficient
- integrated



MiFID sets out:

- conduct of business and organisational requirements for investment firms;
- authorisation requirements for regulated markets;
- regulatory reporting to avoid market abuse;
- trade transparency obligation for shares; and
- rules on the admission of financial instruments to trading



2008 financial crisis it became clear that a more robust regulatory framework was needed to

further strengthen investor protection

address the development of new trading platforms and activities

MiFID (in force from 31 January 2007 to 2 January 2018) governed

provision of investment services in financial instruments by banks and investment firms

operation of traditional stock exchanges and alternative trading venues

In June 2014, the European Commission adopted new rules revising the MiFID framework. These consist of :

a directive (MiFID 2)

and a regulation (MiFIR).

MiFID 2 aims to reinforce the rules on securities markets by

ensuring that organised trading takes place on regulated platforms

introducing rules on algorithmic and high frequency trading

improving the transparency and oversight of financial markets – including derivatives markets - and addressing some shortcomings in commodity derivatives markets

enhancing investor protection and improving conduct of business rules as well as conditions for competition in the trading and clearing of financial instruments



MiFIR sets out requirements on

disclosure of data on trading activity to the public

disclosure of transaction data to regulators and supervisors

mandatory trading of derivatives on organised venues

removal of barriers between trading venues and providers of clearing services to ensure more competition

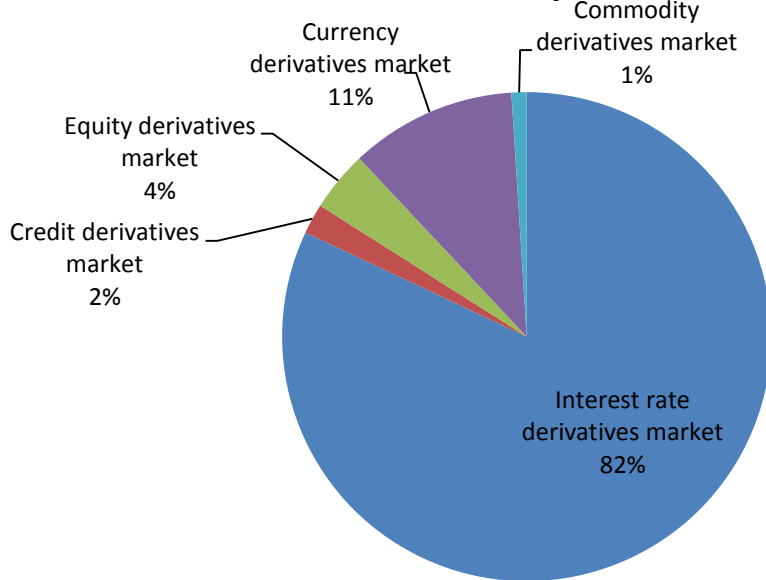
specific supervisory actions regarding financial instruments and positions in derivatives



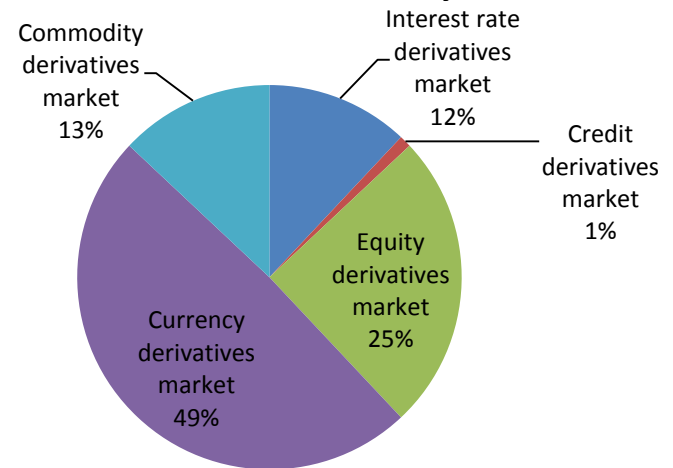
EU Derivative markets:

- Interest rate derivatives market
- Credit derivatives market
- Equity derivatives market
- Currency derivatives market
- Commodity derivatives market

Total notional amount by asset class



Number of derivative contract by asset class



Questions: Please give the definition of “derivative”, “Central clearing counterparties (CCPs)”, “Trade repositories”

What are the main aims of EMIR?

What are the EU rules on derivatives contracts?

What is the main aim and function of MiFID?

What is the main aim and function of MiFIR?

Please give review of EU Derivative markets.

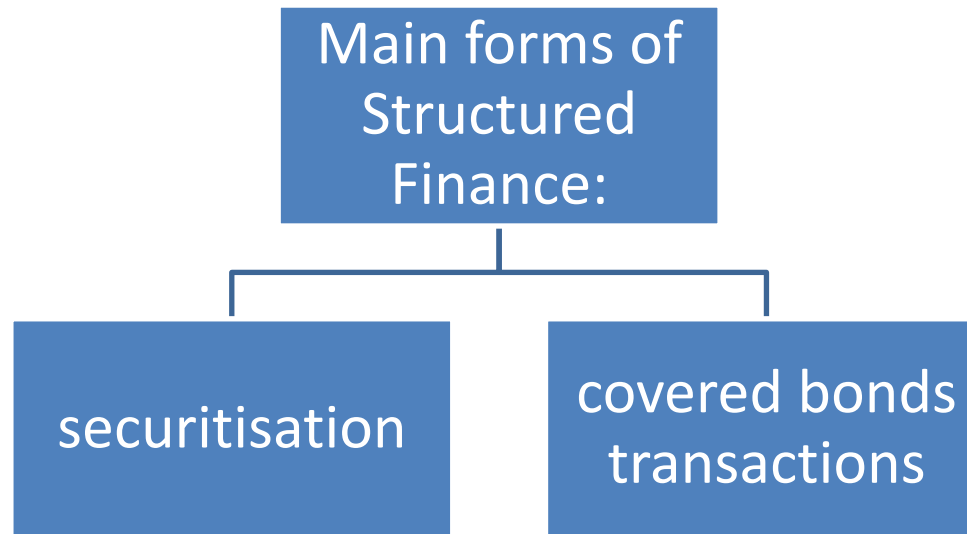
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Concept of Structured Finance

Securitisation

Concept of Structured Finance. Securitisation



The Securitisation Regulation (12 December 2017)

- Securitisation involves transactions that enable a lender or a creditor – typically a credit institution or a corporation – to refinance a set of loans, exposures or receivables, such as residential loans, auto loans or leases, consumer loans, credit cards or trade receivables, by transforming them into tradable securities. The lender pools and repackages a portfolio of its loans, and organises them into different risk categories for different investors, thus giving investors access to investments in loans and other exposures to which they normally would not have direct access. Returns to investors are generated from the cash flows of the underlying loans

It creates a special framework for simple, transparent and standardised securitisations (STS)

The most essential element of any securitisation transaction is the sale of assets, typically receivables, i.e. claims, from the originating party or Originator, to a special purpose vehicle (SPV). The SPV receives the purchase amount it has to pay for the receivables to the originator by issuing bonds, which are typically rated by a rating agency. The SPV pays the investors principal and interest on these bonds with the proceeds on the receivables, i.e. principal and interest, that have been transferred to the SPV.

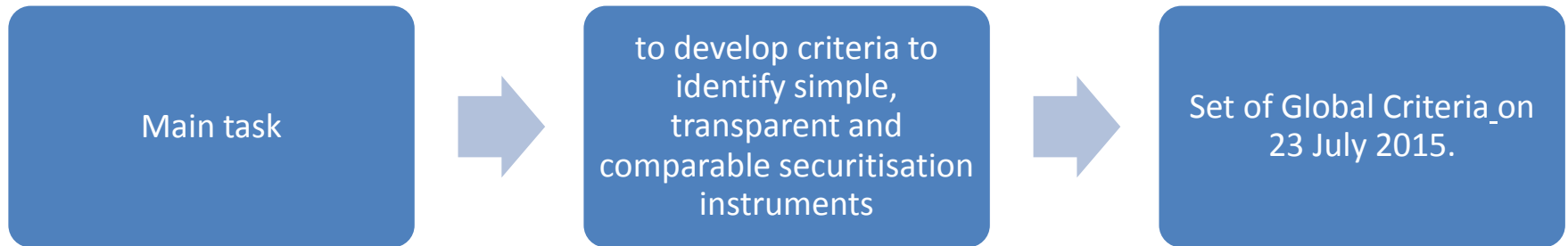
‘securitisation special purpose entity’ or ‘SSPE’ means a corporation, trust or other entity, other than an originator or sponsor, established for the purpose of carrying out one or more securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator;

Source: Matthias Haentjens and Pierre de Gioia Carabellese “European Banking and Financial Law” 2nd Edition , page 249

Source: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32017R2402> Article 2(2)

Background

The Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO) jointly lead a task force on the obstacles to securitisation.



The BCBS also published Revised Standards on the capital treatment of banks' exposures to securitisations with an effect from January 2018.

What does STC mean?

Simplicity

Simplicity refers to the homogeneity of underlying assets with simple characteristics, and a transaction structure that is not overly complex

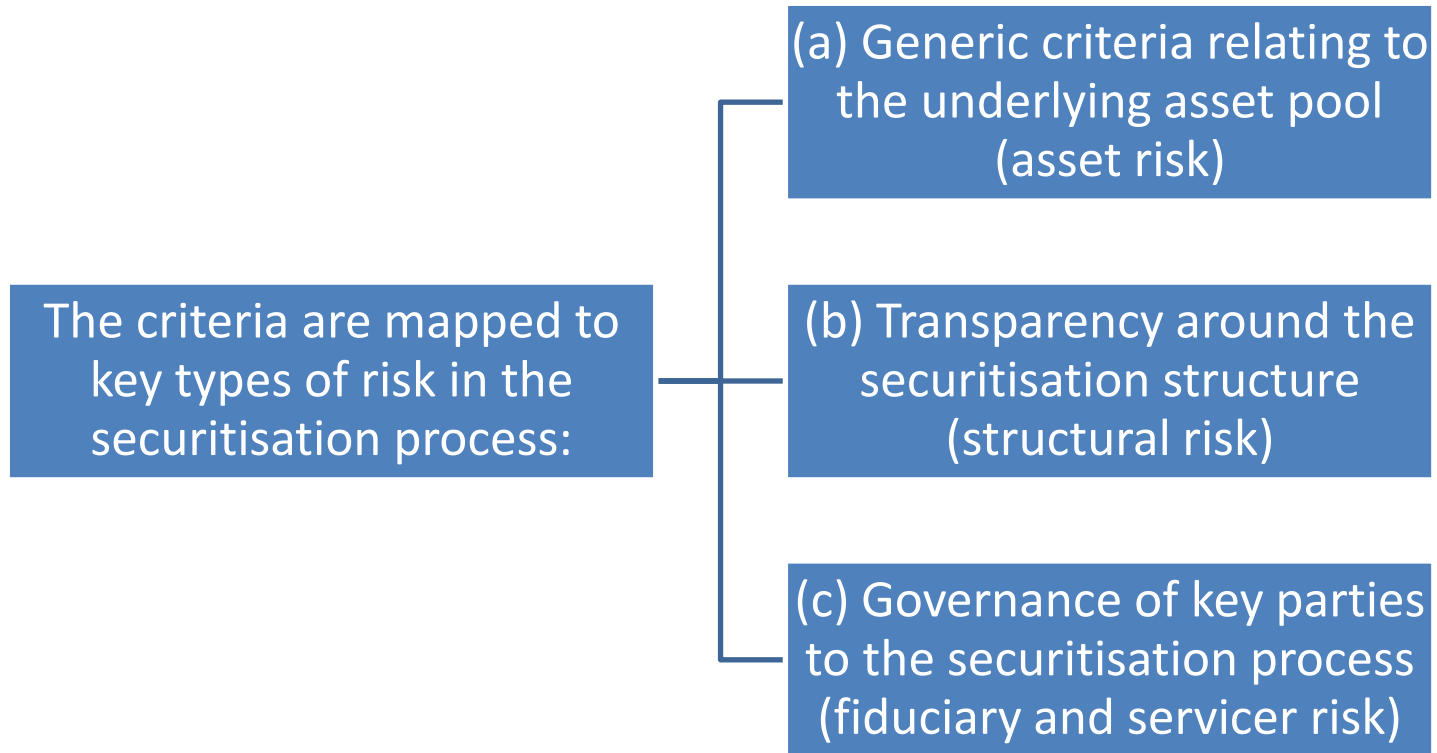
Transparency

Criteria on transparency provide investors with sufficient information on the underlying assets, the structure of the transaction and the parties involved in the transaction, thereby promoting a more comprehensive and thorough understanding of the risks involved. The manner in which the information is available should not hinder transparency, but instead support investors in their assessment.

Comparability

Criteria promoting comparability could assist investors in their understanding of such investments and enable more straightforward comparison across securitisation products within an asset class. Importantly, they should appropriately take into account differences across jurisdictions

Design of the STC criteria



Design of the STC criteria

Asset risk:

- Nature of the assets
- Asset performance history
- Payment status
- Consistency of underwriting
- Asset selection and transfer
- Initial and ongoing data

Structural risk

- Redemption cash flows
- Currency and interest rate asset and liability mismatches
- Payment priorities and observability
- Voting and enforcement rights
- Documentation disclosure and legal review
- Alignment of interest

Fiduciary and servicer risk

- Fiduciary and contractual responsibilities
- Transparency to investors

The reasons for entering into a securitisation transaction from the perspective of the investors:

Opportunity to invest (indirectly) in assets such as mortgage loans and credit card loans, that would otherwise not have been available for investment

Opportunity to invest in assets with a relative low credit risk and therefore high ratings, and relatively high returns

The objectives of the originator are:

financial

regulatory

The objectives of the originator to securitise its assets

off-balance treatment of the receivables, better leverage ratio. This can be achieved as the originating party no longer holds the credit risk of the receivables, but receives immediate cash, viz. the price the SPV pays for the receivables, rather than having to wait until the receivables mature

cheap funding. The costs of funding, i.e. the cash the originator receives from the SPV, are relatively low since the rating of the bonds issued by the SPV is usually higher than the underlying assets would have been rated without the securitisation transaction

securitisation enables the originator to offer its assets to a broader public, because the bonds are easier to trade than the underlying assets

A fourth reason for securitisation might be the regulatory capital relief that can be achieved by the transfer of receivables from the originator to the SPV

A fifth reason for a bank to securitise receivables may lie in the acceptance of the ECB of certain SPV bonds as collateral when providing loans to banks, whereas the ECB would not accept (a security interest in) the underlying receivables

As securitisation is based on receivables, it is essential to reduce the credit risk

Credit risk is the risk that the debtor of a receivable defaults on its obligation to pay principal and interest . The risk of non-payment of principal and interest on the claims

Way of credit risk mitigating:

- careful selection only receivables with a low default risk which can be transferred to the SPV
- Issuing a guarantee from the originator or a third party to the SPV
- pool insurance which means that payment of principal and interest on certain pools of claims are insured by a professional party

‘originator’ means an entity which:

- itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised; or
- purchases a third party’s exposures on its own account and then securitises them;

The originator, sponsor or original lender of a securitisation shall retain on an ongoing basis a material net economic interest in the securitisation of not less than 5 %

An entity shall not be considered to be an originator where the entity has been established or operates for the sole purpose of securitising exposures

Only the following shall qualify as a retention of a material net economic interest of not less than 5 %:

- the retention of not less than 5 % of the nominal value of each of the tranches sold or transferred to investors;
- in the case of revolving securitisations or securitisations of revolving exposures, the retention of the originator's interest of not less than 5 % of the nominal value of each of the securitised exposures;
- the retention of randomly selected exposures, equivalent to not less than 5 % of the nominal value of the securitised exposures, where such non-securitised exposures would otherwise have been securitised in the securitisation, provided that the number of potentially securitised exposures is not less than 100 at origination;
- the retention of the first loss tranche and, where such retention does not amount to 5 % of the nominal value of the securitised exposures, if necessary, other tranches having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total not less than 5 % of the nominal value of the securitised exposures; or
- the retention of a first loss exposure of not less than 5 % of every securitised exposure in the securitisation.

The Special Purpose Vehicle (SPV) or Securitisation Special Purpose Entity (SSPE)

‘securitisation special purpose entity’ or ‘SSPE’ means a corporation, trust or other entity, other than an originator or sponsor, established for the purpose of carrying out one or more securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator;

The SPV principally serves to isolate the assets or receivables from the originator’s estate, so that these assets are securely available for recourse by the investors.

The SPV’s shares are not held by the originator and is not consolidated on the originator’s balance sheet. The SPV must be “bankruptcy remote”, i.e. has a low risk of going bankrupt, because the SPV’s assets must be securely available for recourse by the investors.

Bankruptcy remoteness is achieved by the following ways:

the objects of the Articles of association are limited in such a manner that the SPV is not allowed to conduct any business that does not regard the securitisation transaction

all possibilities for counterparties to initiate liquidation proceedings against the SPV are excluded by incorporating a covenant in all its contracts that prohibits the contracting party to initiate liquidation proceedings against the SPV

the SPV does not hire employees and retains the number of creditors to a minimum

independent directors are appointed, e.g. by contracting a corporate service provider

Requirements for SSPEs

SSPEs shall not be established in a third country to which any of the following applies:

the third country is listed as a high-risk and non-cooperative jurisdiction by the FATF;

the third country has not signed an agreement with a Member State to ensure that that third country fully complies with the standards provided for in Article 26 of the Organisation for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital or in the OECD Model Agreement on the Exchange of Information on Tax Matters, and ensures an effective exchange of information on tax matters, including any multilateral tax agreements

The risk of the SPV's inability to pay principal and interest on the bonds qualifies as a credit risk for the investors

Ways of risk mitigation:

the credit risk on the SPV is mitigated by tranching. Because junior notes are subordinated to the senior ones and thus bear the first losses, the credit risk on notes with more seniority is mitigated

Overcollateralisation. The originator transfers more receivables to the SPV than are needed to pay the investors. Also, the interest the SPV receives on the receivables from the debtors is usually higher than the interest the SPV has to pay to the investors. The surplus that follows can be credited to a so-called Reserve Account.

The structure is set up so that the investors may take recourse on the receivables by exercising the security interest(s) that the debtors have granted to the originator to secure the receivables.

the credit risk on the SPV is mitigated by a subordinated loan from the originator to the SPV: a loan that is only to be paid back to the originator if, should the SPV fall insolvent, all investors' claims (including junior bonds), have first been satisfied. This loan is therefore also called the "equity piece"

a liquidity facility is entered into between the SPV and a "liquidity provider", under which facility cash must be provided to the SPV enabling it to always pay its bond holders

True sale

The transfer of the receivables from the originator to the SPV must qualify as a “true sale”, because under the laws of various jurisdictions, the amount payable by the SPV to the originator may otherwise be recharacterised as a loan secured by the receivables

Measures to prevent recharacterisation for a securitisation transaction:

- the originator must have no remaining liability for the assets that are transferred to the SPV
- it is paramount that the SPV obtains exclusive control over the assets and is allowed to take all sorts of actions that a regular owner would be allowed to do
- the assets must be isolated from the originator in case of its bankruptcy

Circumstances for determining whether a securitisation transaction qualifies as a secured loan

- First, a security taker is allowed to benefit only from the proceeds of the realisation of his security interest to the extent that the proceeds do not exceed the initial secured debt. He must transfer any surplus on the proceeds back to the debtor. Also in a classic securitisation, the SPV transfers back some surplus to the originator for profit extraction purposes, while other surplus is for the benefit of investors.
- Second, an originator sometimes has a right to repurchase any surplus receivables. Whether this is considered as material also depends on the particular conditions of a transaction. In any case: the repurchase of the receivables cannot be without consideration, i.e. gratis, due to the recharacterisation risk.
- Third, if the originator continues to service and collect the receivables after their transfer to the SPV, this could be an indication for recharacterisation since in a true sale, the selling party is usually not committed to collect.
- Fourth, the originator could to some extent continue to be liable for the underlying receivables, as it usually would have made a subordinated loan to the SPV that bears losses on the receivables prior to the SPV's bondholders

Synthetic securitisation

'synthetic securitisation' means a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator

In a synthetic securitisation structure, receivables are not transferred to the SPV.

it is not the receivables themselves that are transferred to the SPV, but it is only the credit risk of those receivables that is transferred to the SPV by means of a credit default swap or CDS

when credit risk on the receivables materialises as debtors default, the SPV must pay those losses to the originator under the CDS.

Covered bonds transactions

A typical covered bonds transaction it is the bank itself that issues bonds to investors, rather than the SPV as in a securitisation transaction.

In a covered bonds transaction, the bank's payment obligation of principal and interest to the investors is secured by a guarantee of a bankruptcy remote special purpose vehicle usually denoted as a Covered Bonds Company (CBC).

Questions

- What are the main elements of structured finance? Please give brief characteristics
- Which securitization can be considered as simple, transparent and standardised?
- What does STC mean? Share the main idea of simplicity, transparency and comparability
- Please list key types of risk in the securitisation process
- Explain criteria for (a) asset risk, (b) structural risk and (c) fiduciary and servicer risk
- What are the interests of involving into securitisation transactions from the part of Originator and Investor?
- What is the credit risk in securitisation and ways of its mitigating?
- What is the mission of the Special Purpose Vehicle (SPV) or Securitisation Special Purpose Entity (SSPE)?
- Please list and explain the ways of credit risk mitigation appeared for SSPE
- Please give the meaning of “true sale” definition
- What is the difference between securitisation and synthetic securitisation?
- Please compare covered bond transaction and securitisation

Sources

This Lecture is cited and based on:

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- Karolin Kirschenmann, Jesper Riedler and Tobias Schuler European Financial Integration through Securitization. EconPol Europe: www.econpol.eu 10/2018 November Vol. 2

European Venture Capital Funds

Regulation (EU) No345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds

Date of entry into force: 15 May 2013



Aims of Regulation

- to **boost the growth and innovation** of companies in the EU, including small- and medium-sized enterprises (SMEs).
- It introduces a **European Venture Capital Funds label**, also known as **EuVECA**, and measures to allow managers to set up and market their funds across the EU using a single set of rules. This single rulebook will permit investors to know exactly what they can expect when investing in EuVECA.
- It enables venture capital funds to be **better positioned** to attract more capital commitments and expand.

EuVECA label

To register for the EuVECA label and market their funds across the EU, managers of venture capital funds must set up a fund that:

- invests 70% of the capital it receives from investors in supporting eligible companies, such as young and innovative SMEs;
- provides equity or quasi-equity finance (i.e. fresh capital) to these companies;
- does not use leverage (i.e. the fund is not indebted, because it does not invest more capital than is committed by investors).

Regulation
(EU)

No345/2013
consists of 4
chapters and
28 articles:

CHAPTER I SUBJECT MATTER, SCOPE AND DEFINITIONS

CHAPTER II CONDITIONS FOR THE USE OF THE DESIGNATION
'EuVECA'

CHAPTER III SUPERVISION AND ADMINISTRATIVE COOPERATION

CHAPTER IV TRANSITIONAL AND FINAL PROVISIONS

Regulation lays down uniform requirements and conditions for:

- managers of collective investment undertakings that wish to use the designation 'EuVECA' in relation to the marketing of qualifying venture capital funds in the Union, thereby contributing to the smooth functioning of the internal market.
- the marketing of qualifying venture capital funds to eligible investors across the Union, for the portfolio composition of qualifying venture capital funds, for the eligible investment instruments and techniques to be used by qualifying venture capital funds as well as for the organisation, conduct and transparency of managers that market qualifying venture capital funds across the Union.

Some definitions from Regulation

‘qualifying venture capital fund’ means a collective investment undertaking that:

- intends to invest at least 70 % of its aggregate capital contributions and uncalled committed capital in assets that are qualifying investments, calculated on the basis of amounts investible after deduction of all relevant costs and holdings in cash and cash equivalents, within a time frame laid down in its rules or instruments of incorporation;
- does not use more than 30 % of its aggregate capital contributions and uncalled committed capital for the acquisition of assets other than qualifying investments, calculated on the basis of amounts investible after deduction of all relevant costs and holdings in cash and cash equivalents;
- is established within the territory of a Member State;

‘qualifying investments’ means any of the following instruments:

- equity or quasi-equity instruments
- secured or unsecured loans granted by the qualifying venture capital fund to a qualifying portfolio undertaking in which the qualifying venture capital fund already holds qualifying investments, provided that no more than 30 % of the aggregate capital contributions and uncalled committed capital in the qualifying venture capital fund is used for such loans;
- shares of a qualifying portfolio undertaking acquired from existing shareholders of that undertaking
- units or shares of one or several other qualifying venture capital funds, provided that those qualifying venture capital funds have not themselves invested more than 10 % of their aggregate capital contributions and uncalled committed capital in qualifying venture capital funds

'equity' means ownership interest in an undertaking, represented by the shares or other forms of participation in the capital of the qualifying portfolio undertaking, issued to its investors;

'quasi-equity' means any type of financing instrument which is a combination of equity and debt, where the return on the instrument is linked to the profit or loss of the qualifying portfolio undertaking and where the repayment of the instrument in the event of default is not fully secured

Some definitions from Regulation

‘qualifying portfolio undertaking’ means an undertaking that:

- at the time of an investment by the qualifying venture capital fund (is not admitted to trading on a regulated market or on a multilateral trading facility, employs fewer than 250 persons, has an annual turnover not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million)
- is not itself a collective investment undertaking;
- is not one or more of the following: a credit institution relating to the taking up and pursuit of the business of credit institutions, an investment firm, an insurance undertaking, a financial holding company, a mixed-activity holding company
- is established within the territory of a Member State, or in a third country provided that the third country: is not listed as a Non-Cooperative Country and Territory by the Financial Action Task Force on Anti-Money Laundering and Terrorist Financing; has signed an agreement with the home Member State of the manager of a qualifying venture capital fund and with each other Member State in which the units or shares of the qualifying venture capital fund are intended to be marketed to ensure that the third country fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements

'qualifying investments' means any of the following instruments:

- equity or quasi-equity instruments
- secured or unsecured loans granted by the qualifying venture capital fund to a qualifying portfolio undertaking in which the qualifying venture capital fund already holds qualifying investments, provided that no more than 30 % of the aggregate capital contributions and uncalled committed capital in the qualifying venture capital fund is used for such loans;
- shares of a qualifying portfolio undertaking acquired from existing shareholders of that undertaking
- units or shares of one or several other qualifying venture capital funds, provided that those qualifying venture capital funds have not themselves invested more than 10 % of their aggregate capital contributions and uncalled committed capital in qualifying venture capital funds

Under the 2014-2020 Multiannual Financial Framework, EU is supporting SMEs and small mid-caps' access to venture capital through various programmes:

The **Single EU Equity Financial Instrument** supports European businesses' growth, research and innovation (R&I) from the early stage, including seed, up to expansion and growth stage.

The **European Fund for Strategic Investment (EFSI)** also has an available equity instrument.

The Pan-European Venture Capital Fund-of-Funds programme (**VentureEU**) aims to further address Europe's equity gap by investing in VC Funds-of-Funds.

The European Scale-up Action for Risk capital (**ESCALAR**) programme is a risk/reward mechanism to support scale-ups with venture capital and growth financing.

The Single EU Equity Financial Instrument

The Single EU Equity Financial Instrument supports European enterprises' growth, research and innovation (R&I) from the early stage up to expansion and growth stage.

The Single EU Equity financial instrument is financially supported by Horizon 2020 and COSME (Programme for the Competitiveness of Enterprises and Small and Medium-Sized Enterprises).

The EIF is managing the Equity Facility for Growth (EFG) under COSME and InnovFin Equity under Horizon 2020.

To mitigate the economic consequences of the COVID-19 pandemic, the EIF and the European Commission (EC) have launched specific support measures under InnovFin Equity. These are a continuation of the EC's commitment to bring immediate relief to hard-hit enterprises, and are part of the package of measures announced by the EIB Group on 16 March 2020 to mobilise support for Europe's SMEs and mid-caps in a timely manner.

The European Fund for Strategic Investment (EFSI)

Under the umbrella of the Investment Plan for Europe, the EC, the EIB and the EIF have pooled together resources and aligned their objectives for the implementation of the European Fund for Strategic Investments. Under EFSI, the EIF provides financing for the benefit of more vulnerable entities within the EU ecosystem, encompassing micro, small and medium-sized enterprises, social enterprises, social sector organisations and small mid-caps, in specific EU policy areas.

EFSI is working on further initiatives with the European Commission in the private equity and venture capital space to support SME financing directed to further development of innovations in the fields of artificial intelligence, blockchain, space technology, impact investing and blue economy.

With these initiatives, the EC and the EIF are stepping up their efforts in areas of strategic relevance for the EU, supporting the transition towards a new digital era, and contributing to promoting sustainability and impact entrepreneurship in the European investment ecosystem.

The European Fund for Strategic Investment (EFSI)

The Economy initiative **Blue** is designed to stimulate investments and sustainable growth in the marine and maritime sectors. Through this initiative, the EIF shall invest in equity funds whose investment strategies target partially or fully economic activities including natural or cultural capital, ocean energy, climate action, inclusion of coastal communities and better coastal protection.

The Investing initiative **Impact** aims to promote an investment approach where social and/or environmental goals are intrinsic to the strategy of our financial intermediaries. Investments will target enterprises offering entrepreneurial solutions to societal issues and generating benefits to society alongside economic value creation.

The Artificial Intelligence and Blockchain Technologies initiative **Artificial** is dedicated to financial intermediaries specialising in financing for Distributed Ledger Technology and blockchain. Europe is home to world-leading research communities and a vibrant industry, which are both increasingly relying on artificial intelligence – therefore, it is crucial that we build up an ecosystem that can fuel the development of such technologies on home ground.

The Initiative **Space** shall support investments in capital funds whose strategies target increasing exposure in the area of *upstream* and *downstream space technologies* and project a path to commercialisation and market uptake for the benefits of the EU citizens. This is in line with the strong commitment across EU Member States to develop a globally competitive and innovative European space sector.

Source: https://www.eif.org/what_we_do/equity/single_eu_equity_instrument/

Source: https://www.eif.org/what_we_do/equity/efsi/index.htm

In this context, the EIF is implementing a set of equity instruments, aiming at:

- **Enhancing access to financing for SMEs, small mid-caps, social enterprises and social sector organisations** established or doing business in EU Member States during their entire lifecycle, from the pre-commercial phase up to their expansion and growth stage of development;
- Ensuring adequate contribution to market development in areas such as **technology transfer, business angels, venture capital, fund-of-funds, social impact, impact investing and blue economy**;
- **Catalysing private investments into the private equity and venture capital markets** to contribute to the development of the European equity ecosystem.

EFSI Equity is deployed in the form of two windows:

Expansion and Growth Window


the EIF provides equity investments to or alongside funds or other entities focusing directly or indirectly on later stage and multi-stage financing of SMEs and small mid-caps. Furthermore, under this window, the EIF provides investments with the intention of **generating social impact, targeting social enterprises and social sector organisations** established or doing business in EU Member States.

Early Stage Window (InnovFin Equity)

the EIF provides equity investments and co-investments to or alongside funds focusing on early stage financing of **SMEs and small mid-caps operating in innovative sectors covered by Horizon 2020**. InnovFin Equity will remain available to serve Financial Intermediaries, which do not meet the EFSI requirements, including those established or operating in all Horizon 2020 Participating Countries under terms and conditions set out in the Single EU Equity Instrument.

Venture EU

The Pan-European Venture Capital Fund(s)-of-Funds programme (VentureEU) was designed to further address Europe's equity gap, the fragmentation of the VC market and the need to attract additional private funding from institutional investors into the EU venture capital asset class.



Under the Pan-European VC FoF programme, the EIF was targeting to:



invest into private-sector led, market-driven Pan-European VC Fund(s)-of-funds, using resources of the Horizon 2020 InnovFin Equity facility, EFSI Equity Instrument, COSME Equity Facility for Growth and EIF's own resources,.

ESCALAR Programme

The European Scale-up Action for Risk capital (ESCALAR) is a new pilot programme launched by the EIF using EFSI resources to address the financing gap experienced by high growth European companies (scale-ups)

ESCALAR invests in funds with an investment focus on scale-ups. It can support both

- new funds needing to achieve a larger critical mass to support such companies in their future portfolio,
- and existing funds seeking additional capital to make follow on investments in scale-ups in their existing portfolio.

ESCALAR's investment is intended to substantially increase fund resources, thus allowing larger investment tickets and creating greater capacity for making (follow-on) investments in scale-ups

The evolution of venture capital investments

The increase in VC financing in the EU market would lead to at least two complementary beneficial effects:

the diversification of the funding portfolio of companies

and professional support in their earlier stages of development to new and innovative SMEs

VC investment
2008 EUR 30 bln

VC investment
2018 EUR 380 bln

VC investments are mainly allocated at the domestic level (2/3 of the total) and just a 1/5 of all transactions takes place entirely across borders

VC investment in EU target companies is concentrated in a few macrosectors: research and development, pharma, information and communication technology), and the euro is the most adopted currency for VC-backed transactions in EU

Impact of VC investments on three measures of growth of the target company common in the empirical literature:

- total assets,
- total sales
- number of employees

Investment strategies of venture capitalists

The increase in VC in the EU market can lead to:

- **diversification of the funding portfolio** of companies
- **professional support** in their earlier stages of development to **new and innovative SMEs**

After VC investment:

- 70-80% of companies stay independent
- less than 30 % of cases a different subject owns the target company
- the venture capitalist becomes the ultimate owner of the target company only in fewer than 10 % of cases
- Other investors than the venture capitalist gain ownership in approximately 15–25 % of cases

Public grants and venture capital investments

Public grants and venture capital investments

Under the Horizon 2020 SME Instrument more than EUR 1 billion is flowing to SMEs and small midcaps. This support consists of:

- A debt facility providing loans, guarantees and other forms of debt finance to entities of all forms and sizes, notably research and innovation-driven SMEs: [InnovFin SME Guarantee](#). This facility has been reinforced thanks to the advent of the [European Fund for Strategic Investments](#) in 2015. The facility has allowed to increase the portfolio of loans available for SMEs and small midcaps established across the EU and Horizon 2020 associated countries to be increased by more than EUR 10 billion since its launch in 2014.
- Equity facilities providing finance for mainly early-stage investments, with a particular focus on early-stage SMEs with the potential to carry out innovation and grow rapidly: [InnovFin Equity](#).

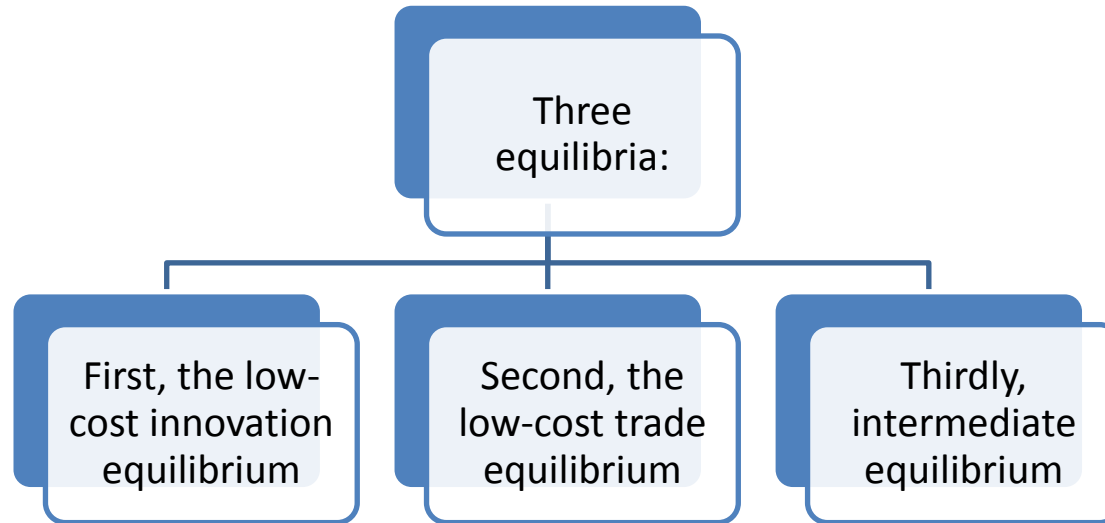
Questions

- What is the aim of European Venture Capital Funds Regulation?
- What are the main programs which through EU is supporting SMEs and small mid-caps' access to venture capital under the 2014-2020 Multiannual Financial Framework?
- What are the main direction of The Single EU Equity Financial Instrument Program?
- Please narrate the main channels of financing by The European Fund for Strategic Investment (EFSI) Program
- What for is designed The Pan-European Venture Capital Fund(s)-of-Funds programme (VentureEU)?
- What for is addressed The European Scale-up Action for Risk capital (ESCALAR) programme?

Sources

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Quantitative analysis in trade and innovation in European countries



Low-cost innovation equilibrium, where the activity of exporting is relatively costly in comparison to innovation, and therefore only the most productive firms will carry out both activities, middle productivity firms will innovate but not export and the lower productivity firms will neither innovate nor export.

The low-cost trade equilibrium, where the activity of innovation is relatively costly in comparison to exporting and therefore only the most productive firms will carry out both activities, middle productivity firms will export but not engage in innovation and the lower productivity firms will neither innovate nor export.

Intermediate equilibrium where firms are either very productive and can undertake both activities or do not perform any of them

Approaches of European scientists to trade and innovation

Melitz approach

As in Hopenhayn (1992) and Melitz (2003), productivity differs across varieties. Firms in the differentiated good sector allocate labor to the production of a specific variety and to innovation activities aimed at reducing their production costs. Each variety is produced by a small number of identical firms, operating in an oligopolistic market; thus quantities produced and innovation activities result both from the strategic interaction among firms.

Melitz (2003) constructed a model in which only a few highly productive firms are engaged in export. The underlying idea in Melitz (2003) is that only highly productive firms are able to make sufficient profits to cover the large fixed costs required for export operations

New New Trade Theory emerges to correct this shortcoming, Melitz (2003) combines Hopenhayn's (1992) model of heterogeneous firms in closed economy with Krugman's theory. By doing this, he can account for the stylized fact in trade data that firms widely differ in terms of size, productivity and exporting decisions. Opening up to trade induces not only a boom in varieties but also an increase in aggregate productivity through a more efficient reallocation of labor. The existence of fixed overhead export cost and heterogeneity in productivity implies that only a subset of firms enter exporting markets. When trade barrier moves downward, besides consumers' gain in intensive margin, they also enjoy an enlargement of the set of exporters, which is referred as the extensive margin of trade. The mark-ups are constant in both Krugman's (1980) and Melitz's (2003) model, which is not realistic since firms do change mark-up in response to variations in marginal costs.

Source: Trade, Innovation and Productivity: A Quantitative Analysis of Europe. Crespo Aranzazu https://mpra.ub.uni-muenchen.de/57162/1/efige_wp62_111012.pdf

Source: Macroeconomic Analysis on the Basis of Trade Theory: A Review Essay, Gao Xiang. <https://mpra.ub.uni-muenchen.de/18380/>

Source: https://www.rieti.go.jp/en/columns/a01_0286.html

Melitz approach

Melitz (2003) indicated the new source of trade gains. When lowered trade barriers stimulate competition on a global scale, low-productivity firms that had been protected theretofore by the trade barriers are forced to withdraw from the market, replaced by the increased production volume of high-productivity firms. As a consequence, the average productivity of a country on the whole rises. This rise in average productivity means a rise in people's real income; people become wealthier through the natural selection of firms on a global scale. It can be understood from Melitz (2003) that heavy protection given to a domestic industry can inhibit the functioning of natural selection and block a rise in productivity.

Costantini and Melitz approach

In Melitz's (2003) model, free entry condition brings in new varieties whenever new firms enter domestic market and start producing. The innovation to create new firms (varieties) is thus called product innovation. However, firms have to either live with their initial productivity draw forever or exit the market after they enter the market. Several studies offer individual firms the opportunity of process innovation, and investigate how trade liberalization affect endogenous selection into exporting, innovation decisions and, consequently, aggregate growth. Process innovation refers to investment designed to reduce marginal cost, thereby making the firm more productive.

Costantini and Melitz (2008) introduce a one-time binary technological upgrading choice that raises the likelihood that the firm will realize higher levels of productivity in future. They then examine the transition dynamics between two steady states from high to low trade costs, and find that productivity effects depend on whether liberalization is anticipated and on how quickly it is implemented

Crespo exercises

Crespo (2012) exercise consists of quantifying the effect of a reduction in variable trade costs on aggregate productivity. It captures the productivity that is relevant for welfare. Apart from the direct cost savings effects of a drop in variable trade costs, the theory predicts that there are a number of indirect effects.

- First, it induces the exit of less productive firms and the reallocation of market shares towards the more productive firms. This is the selection effect described in Melitz (2003).
- Second, the innovation intensity increases with the participation in foreign markets, so the effect through the intensive margin of innovation should be positive.
- Third, the theory predicts that the effect through the extensive margin of innovation can be positive or negative. In the low cost trade equilibrium and the intermediate equilibrium, all innovators are exporting. In that case a decrease in variable trade costs increases the incentives to be an exporter (and to be an exporter innovator), so that the effect through the extensive margin of innovation is positive. In contrast, in the *low cost innovation equilibrium*, some of the innovators do not export. In that case, a drop in trade costs makes it harder for domestic firms to innovate, so that the effect through the extensive margin of innovation is negative

Crespo exercises

A second quantitative exercise of Crespo (2012) focuses on the effectiveness to increase productivity of lowering the fixed costs of trade or innovation. While our first exercises focused on a reduction in variable trade costs, we now show that a reduction in fixed trade or innovation costs may also have very different effects, depending on the equilibrium the economy is in. While in general the effect of lowering the fixed cost of trade is positive, we find that in the low cost trade equilibrium it is negative. In such equilibrium, there are many exporters, but only the most productive innovate. Since all innovators are also exporters, by increasing the incentives to enter the export market, a drop in the fixed costs of trade pushes up real wages, reducing the incentives to innovate. As a result, both the number of innovators and the intensity of the remaining innovators decline, which translates in the final effect on welfare being negative.

Work by Atkeson and Burstein (2010) has suggested that the indirect effects of trade liberalization on productivity are negligible. That is, liberalizing trade improves productivity through the standard direct effect of saving resources on trade, whereas the indirect effects coming from changes in firms' decisions related to exit, trade and innovation are essentially zero. Welfare gains from trade do not depend on how a change in variable trade costs affects firms' exit, export and innovation decisions, if the extensive margin of innovation is not affected by the policy.

On the one hand, there is the literature that focuses on how firms make joint decisions on exporting and innovating. Yeaple (2005) and Bustos (2011) consider models in which there is a binary technology choice, and highlight how firms decide to both enter the export market and adopt the new technology. The cost of innovation is therefore modeled as a fixed cost

Costantini and Melitz (2008) extend this type of joint decision to a dynamic framework where firms face both idiosyncratic uncertainty and sunk costs for both exporting and technology adoption.

On the other hand, there is the literature that focuses on examining the impact of trade on the intensity of innovation. Vannoorenberghe (2008) and Rubini (2011) consider models in which firm productivity is endogenously determined through innovation, and highlight that innovation is affected by the existence of foreign markets. Closely related to these is the work of Atkeson and Burstein (2010). They propose a dynamic trade model to include a process innovation decision by incumbent firms following Griliches (1979)'s model of knowledge capital

Atkeson and Burstein: International Relative Price Co-movements

Atkeson and Burstein (2009) introduces innovation as both a continuous process and a continuous choice, and show that a reduction in trade costs exerts a positive effect on process innovation over time, which can be offset by negative effects on product innovation

Atkeson and Burstein (2008) remove the assumptions on free entry and exogenous death. Instead, they add two extra assumptions, which are finite number of firms within each sector and hierarchy in good aggregation

Atkeson and Burstein show that deviations from purchasing power parity (henceforth PPP) at the aggregate level arise as a result of the decisions of individual firms to sell in both home and foreign market with endogenous pricing-to-market

PPP theory suggests that producer price index (henceforth PPI) based exchange rates should move identically with the terms of trade (henceforth TOT), or the ratio of export and import price indices (henceforth EPI and IPI). It also suggests that fluctuations in consumer price index (henceforth CPI) based exchange rates should be smoother than its PPI based counterpart. Empirical results turn out to be different from above traditional PPP theoretical predictions. The truth is that PPI based real exchange rates are more volatile than TOT, and they are as volatile as their PPI based counterpart. These discrepancies can be explained by PPP deviations, and the deviations are generated in this model because firms price discriminate between home and foreign country. When dig deeper, you will find that the discrimination behavior comes from endogenous mark-up, which is a direct result from that two extra assumptions they made about finite firms and hierarchy

Atkeson and Burstein: Innovation and Growth

One of the key features of process innovation in Atkeson and Burstein (2009):

- innovation outcome is stochastic and the other feature is that firms already differ in their initial productivity before innovation opportunity arises

In the model of Atkeson and Burstein (2009), firms have productivity dynamics due to innovation option but exit and export decisions are independent of size. Their central finding is that, despite the fact that a change in trade costs can have a substantial impact on individual firms' exit, export, and process innovation decisions, the firms' free-entry condition places a constraint on the overall response of aggregate productivity to the change in trade

They show that the steady-state response of product innovation largely offsets the impact of changes in firms' exit, export, and process innovation decisions on aggregate productivity. They also find that the dynamic welfare gains from a reduction in trade costs are very similar to the welfare gains that arise directly from the reduction in trade costs. Although the microeconomic evidence on individual firms' response to changes in international trade costs may account for international relative price fluctuation and co-movements as in the above two sections, it may not be informative about the macroeconomic implications of changes in these trade costs for aggregate productivity, growth and welfare.

Yeaple approach

A considerable amount of literature differentiates between exporting and non-exporting firms based on their productive capacity, their ability to pay higher wages to attract high-skilled labor, and to undertake high costs to exploit new and improved technology

Yeaple introduces a more coherent and elaborate explanation of firm heterogeneity than the existing literature, that differentiates firms into exporters and non-exporters by randomly assigning productivity levels to each firm

Yeaple distinguishes domestic and exporting firms on the basis of technological differences and skill level of individual workers. This new definition of firm heterogeneity provides a more comprehensive insight into the economic implications of magnitude and costs of international trade on the labor remuneration, firm revenues and inter- and intra-industry labor movements

Yeaple approach: Equilibrium Under Closed Economy

Assuming labor is paid technology-specific efficiency wage, better technology yields higher wage for the labor, higher revenue for the firm and eventually higher average revenue per worker. In other words, the firms using H-technology (hiring high-skilled labor and producing X_h) pay higher wages to the labor and yield higher revenues

This reflects that technology influences the entrepreneurs' decision of selecting labor type, and once a certain kind of labor is hired in a specific technology, the workers are given their skill-specific wages.

Yeaple further stresses that a worker employed in wrong technology yields lesser wage as compared to the wage he could earn had he been employed in right technology.

Yeaple has created a relationship between skill and wages under the scenario of ex-ante homogeneous firms, contrary to the firms having ex-ante comparative or absolute advantage in earlier models. The result therefore appears to be interesting since the firms that are identical in the beginning, derive wage- and skill heterogeneity based on their decisions of technology adoption.

Yeaple approach: Open Economy and the Impact of Trade Costs

Yeaple proposes that even homogeneous countries can benefit from international trade. It is suggested that a decline in trade barriers between ex-ante homogeneous countries brings about a positive change in revenue per worker and average skill level of labor in both X and Y industries, and the relative demand for skilled labor rises. Decline in trade barriers is more specifically referred to as a decline in trade costs, i.e. marginal cost of trade, or fixed cost. However, given that marginal cost of trade is easily quantifiable, Yeaple examines the impact of decline in marginal cost of trade and purports that change in fixed cost will have similar results.

This proposition provides a unique relationship between the labor share in each industry, distribution in wages in accordance with the worker quality and the firm revenues given a change in trade costs. The basic intuition behind these results lies in the fact that a reduction in trade costs immediately raises the relative demand for labor in the industry using H-technology, which in turn makes the skilled labor dearer and the wage level rises in this industry. This incline in wages has dual effect. i. H-tech industry becomes more attractive for low-skilled labor currently employed in L-tech industry. They are induced to switch to industry offering higher wages. Incline in wages in H-tech industry leads to the rise in overall expenditure (E) in the economy, and thus an increase in demand for good-Y. This eventually increases the demand for labor in Y-industry and the wage level in this industry goes up.

Yeaple approach: Open Economy and the Impact of Trade Costs

These two effects, when coupled, shrink the labor share in L-tech firms, since the least skilled labor in L-tech firms switches to the Y-goods industry, and the most skilled labor in L-tech firms switches to H-tech firms

It is noteworthy that the workers switching to Y-industry are of above average productivity and hence the overall level of productivity in this sector increases. Given the zero-profit condition, extra revenue generated in this industry, is distributed amongst the workers which raises the overall revenue per worker in industry-Y

On the other hand, the least skilled workers in X-industry have moved out of the industry, and some of the moderate skilled workers have now become more skilled. Therefore the average revenue per worker is bound to increase in both H- and L-tech factions of industry-X

The discussion above relates to the intuition of proposition-VII that suggests an increase in wage level in H-tech industry and a probable decline in wages in L-tech industry, given the decline in trade costs

X is a composite differentiated good that follows Constant Elasticity of Substitution over a continuum of varieties, and Y is a homogeneous good that follows basic Cob-Douglas production function

Source: file:///C:/Users/user/Desktop/CriticalReview.pdf

In Melitz's (2003) model, free entry condition brings in new varieties whenever new firms enter domestic market and start producing. The innovation to create new firms (varieties) is thus called product innovation. However, firms have to either live with their initial productivity draw forever or exit the market after they enter the market. Several studies offer individual firms the opportunity of process innovation, and investigate how trade liberalization affect endogenous selection into exporting, innovation decisions and, consequently, aggregate growth. Process innovation refers to investment designed to reduce marginal cost, thereby making the firm more productive.

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Questions:

- Please describe the main idea of Melitz research in the Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity
- What are the key features of process innovation in Atkeson and Burstein 2009
- Please unveil Yeaple approach to Model of firm heterogeneity, international trade, and wages
- Please unveil critical reviews and approaches of young scientists (Crespo Aranzazu, Atif Syed Muhammad)

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Additional reading:

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**Foreign direct investments in European countries.
Policy in attracting FDI and in investing**

2 main types of foreign investment:

Foreign direct investment (FDI) – where an investor sets up or buys a company (or a controlling share in a company) in another country, and;

portfolio investment – where an investor buys shares in, or debt of, a foreign company without controlling that company.

FDI is usually a smaller share of total foreign investment flows than portfolio investment for advanced economies and occurs through the establishment of subsidiaries of multinational corporations

Objectives of EU investment policy

EU investment policy aims to:

- secure a level playing field so that EU investors abroad are not discriminated or mistreated;
- make it easier to invest by creating a predictable and transparent business environment;
- promote investment that supports sustainable development, respect for human rights and high labour and environmental standards. This includes encouraging corporate social responsibility and responsible business practices;
- attract international investment into the EU, while protecting the EU's essential interests, and;
- preserve the right of home and host countries to regulate their economies in the public interest

EU investment rules

EU investment rules cover:

- allowing and facilitating the setting up of enterprises by making sure investors can access the market and do not face discrimination between EU and non-EU investors;
- creating a favourable regulatory framework, both when the investor enters the market and when the investor does economic activities in the country, and;
- protecting established investments/investors through commitments to fair treatment for investors or guarantees of compensation in case of expropriation.

The EU adopted in 2012 Regulation creating a set of rules for bilateral investment agreements between individual EU members and non-EU countries, to make sure that they are consistent with EU law and with the EU's investment policy.

Investment agreements between EU members and non-EU countries

Following the entry into force of the Treaty of Lisbon, foreign direct investment is included in the list of matters falling under the common commercial policy. In accordance with Article 3(1)(e) of the Treaty on the Functioning of the European Union ('TFEU'), the European Union has exclusive competence with respect to the common commercial policy

TFEU lays down common rules on the movement of capital between Member States and third countries, including in respect of capital movements involving investments. Those rules can be affected by international agreements relating to foreign investment concluded by Member States.

Regulation addresses the status of the bilateral investment agreements of the Member States under Union law, and establishes the terms, conditions and procedures under which the Member States are authorised to amend or conclude bilateral investment agreements.

Investment agreements between EU members and non-EU countries

For the purpose of this Regulation the term ‘bilateral investment agreement’ means any agreement with a third country that contains provisions on investment protection. This Regulation covers only those provisions of bilateral investment agreements dealing with investment protection

Investment agreements between Member States should not be covered by this Regulation

To protect EU strategic interest related to foreign investment, the EU regulation of March 2019:

- created a cooperation mechanism for Member States and the Commission to exchange information and if necessary raise concerns related to specific investments;
- allows the Commission to issue opinions when an investment poses a threat to the security or public order of more than one Member State, or when an investment could undermine a project or programme of interest to the whole EU, such as Horizon 2020 or Galileo;
- sets deadlines for cooperation between the Commission and Member States, and among Member States, observing non-discrimination and strong confidentiality requirements;
- establishes certain core requirements for Member States who maintain or adopt a screening mechanism at national level on the grounds of security or public order;
- encourages international cooperation on investment screening, including sharing of experience, best practices and information on issues of common concerns.

Conditions for investment agreements

The regulation sets the conditions for applying the more than 1400 bilateral investment agreements currently in force, as well as the conditions for EU members to modify existing agreements and negotiate or conclude new ones. Those conditions are:

- that the agreement is not in conflict with EU law;
- that the agreement is consistent with the EU's principles and objectives for external action;
- that the Commission did not submit or decided to submit a recommendation to open negotiations with the non-EU country concerned, and;
- that the agreement does not create a serious obstacle to the EU negotiating or concluding bilateral investment agreements with non-EU countries.

Investment facilitation

Through investment facilitation, the EU seeks to encourage the setting up of a more transparent, efficient and predictable business climate for investors.

This includes, for instance:

- making information on investment rules public and easily available,
- or reducing delays in obtaining government permits and approvals.

Investment facilitation contributes to unlocking investment opportunities notably for small and medium enterprises. This should also benefit developing countries by making it easier for domestic and foreign investors to invest, conduct their day-to-day business, and expand their existing investments.

EU proposal-WTO investment facilitation for development

This Agreement applies to measures adopted or maintained by Members affecting the establishment and operation of foreign direct investments.

Measures by Members include those of general and sector-specific application that affect foreign investors and their investment.

This agreement does not create new or modify existing commitments relating to the liberalisation of investments, nor does it create new or modify existing rules on the protection of international investments or investor-state dispute settlement.

EU proposal-WTO investment facilitation for development

A Member's obligations under this Agreement shall apply to measures adopted or maintained by:

- a. the central, regional and local governments and authorities of that Member;
- b. non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities.

In fulfilling its obligations and commitments under this Agreement, each Member shall take such reasonable measures as may be available to it to ensure their observance by regional and local governments and authorities and non-governmental bodies within its territory.

The EU sees value in applying the most-favoured-nation (MFN) principle to the provisions of this Agreement

Screening of foreign direct investment

In March 2019, the EU adopted a regulation setting up a framework for the screening of investments from non-EU countries (foreign direct investment) that may affect security or public order.



The regulation's objective

The diagram consists of two blue chevron-shaped boxes pointing to the right. The first box contains the text 'The regulation's objective'. The second box contains the text 'to make sure that the EU is better equipped to identify, assess and mitigate potential risks for security or public order, while remaining among the world's most open investment areas.' A horizontal line is positioned below the second box.

to make sure that the EU is better equipped to identify, assess and mitigate potential risks for security or public order, while remaining among the world's most open investment areas.

On 25 March 2020, as part of measures taken in connection with the Covid-19 emergency, the European Commission provided Guidance to Member States on how to use foreign direct investment (FDI) screening in times of public health crisis and economic vulnerability in the EU

The EU framework for screening of foreign direct investment (FDI) became fully operational as of 11 October 2020.

It is now instrumental in preserving Europe's strategic interests while keeping the EU market open to investment.

Executive Vice-President
Valdis **Dombrovskis** said:

- *“The EU is and will remain open to foreign investment. But this openness is not unconditional. To respond to today's economic challenges, safeguard key European assets and protect collective security, EU Member States and the Commission need to be working closely together. If we want to achieve an open strategic autonomy, having an efficient EU-wide investment screening cooperation is essential. We are now well equipped for that.”*

Necessary operational requirements for the full application of the Regulation starting 11 October 2020 included:

- the notification by EU Member States of their existing national investment screening mechanisms to the Commission
- the establishment of formal contact points and secure channels in each Member State and within the Commission for the exchange of information and analysis
- developing procedures for Member States and the Commission to quickly react to FDI concerns and to issue opinions
- updating the list of projects and programmes of Union interest annexed to the Regulation

The New EU Regime

The new EU FDI regime establishes minimum standards for Member States' review systems, creates an information sharing channel between the EU Commission and Member States, and institutes a formal mechanism for the EU Commission and Member States to provide feedback on FDI that occurs within the European Union.

The FDI Regulation does not require Member States to implement FDI reviews at the national level or to screen particular types of investments. Member States remain free to choose whether to adopt domestic review systems

However, the FDI Regulation requires Member States that elect to implement a national security/public interest screening system to meet certain minimum standards. For example, all Member States' review mechanisms must establish transparent criteria that “do not discriminate between third countries,” protect confidential information, and authorize third parties to seek recourse against screening decisions made by competent authorities

Relevant Criteria to be Assessed by Member States

The FDI Regulation specifies illustrative criteria that the Commission and Member States may consider when assessing the potential effects of a foreign investment on security and public order, including:

- Critical Infrastructure;
- Critical Technologies (including dual use technologies);
- Supply of Critical Inputs;
- Access to Sensitive Information; and
- The Freedom and Pluralism of the Media.

The EU Commission and Member States also will consider other factors, including whether:

- (i) the foreign investor is owned or controlled by a foreign government;
- (ii) the foreign investor has already been involved in activities affecting security or public order in a Member State;
- (iii) there is a serious risk that the foreign investor engages in illegal or criminal activities

The FDI Regulation creates an information sharing mechanism pursuant to which EU Member States must inform the EU Commission and other Member States of FDI that occurs in Member States that is subject to review at the national level

For such FDI transactions, Member States are obligated to share with the EU Commission and other Member States information regarding:

- the ownership structure of the foreign investor;
- the value of foreign investment;
- products, services, and business operations of the foreign investor; and (iv) the date of the transaction.

Covid-19 Related Developments

In light of the Covid-19 pandemic, in March 2020 the EU Commission issued a guidance note for screening FDI in companies and critical assets located in the EU, including those operating in the fields of health, medical research, biotechnology and infrastructures deemed essential for security and public order

The Guidance notes that “today, more than ever, the EU’s openness to foreign investment needs to be balanced by appropriate screening tools”. The Guidance states the pandemic has exemplified the importance of preserving and sharing healthcare and research capacities between Member States and other countries. In addition, the Guidance reiterates that acquisitions, especially in the healthcare sector, may have an impact that transcends national borders, and urged Member States to monitor FDI that occurs within their territories.⁷

Source: https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf

Source: <https://www.kirkland.com/publications/kirkland-alert/2020/10/eu-fdi-regulation#ref7>

Emerging Issues

What Transactions Will be Subject to Review? The FDI Regulation is designed to address “foreign direct investment.” However, this term is not expressly defined, leaving open questions regarding the types of transactions that are covered. Similarly, “portfolio investments” are not defined either, which creates further ambiguity about the scope of covered transactions

What Role Will Transaction Parties Play? The FDI Regulation does not specify a mechanism for parties involved in a FDI transaction subject to review to interact directly with the EU Commission or Member States that are not reviewing the transaction at the national level. As a result, it is unclear whether such parties will play a formal or informal role during the review process

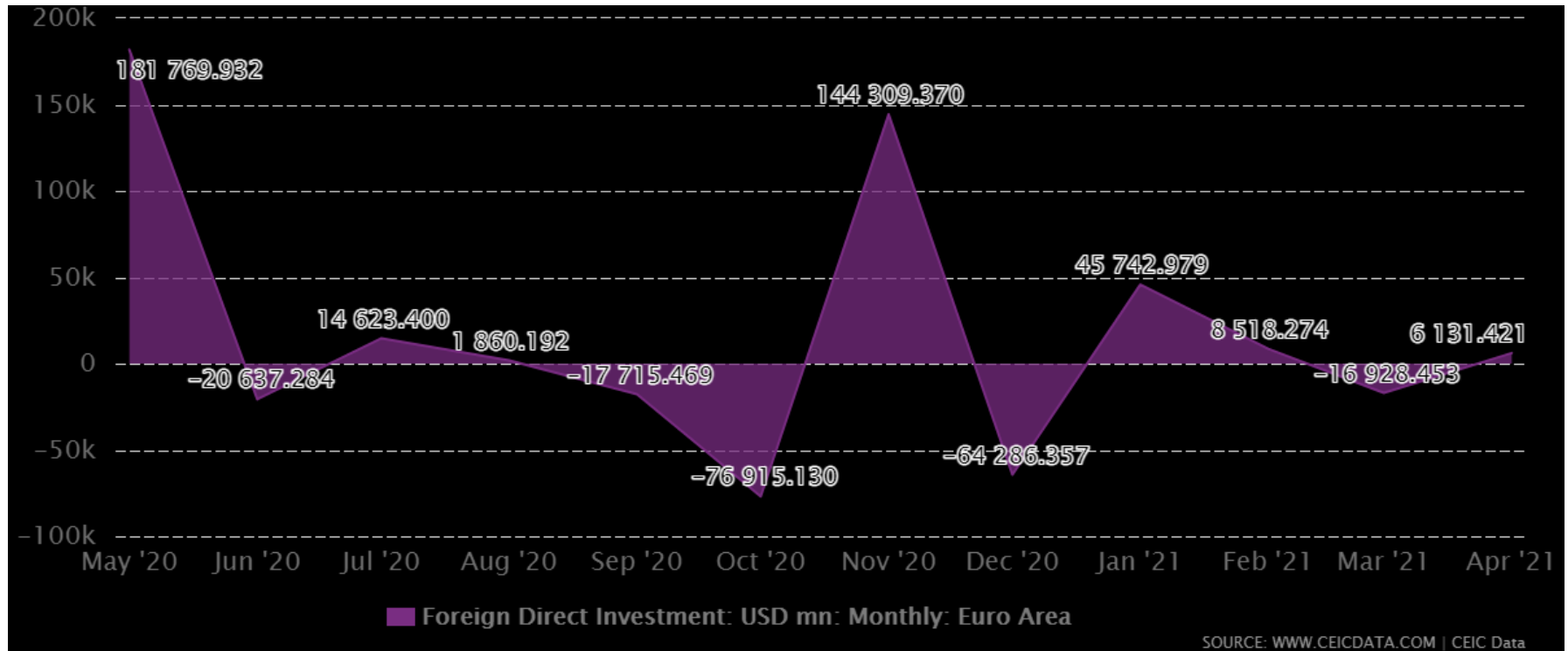
How Political Will the EU Process Be? EU Commission opinions and Member State comments regarding FDI technically are only permitted to address national security and public interest considerations. Nevertheless, it is possible — and perhaps likely — that political considerations outside of those areas will inform EU Commission opinions and lead Member States to issue comments regarding proposed transactions.

How Will Multi-Jurisdictional Investments Be Reviewed? FDI frequently involves cross-border transactions that touch multiple Member States. Assessing foreign investments that involve multiple Member States will present challenges and complications at both the EU and Member State level.

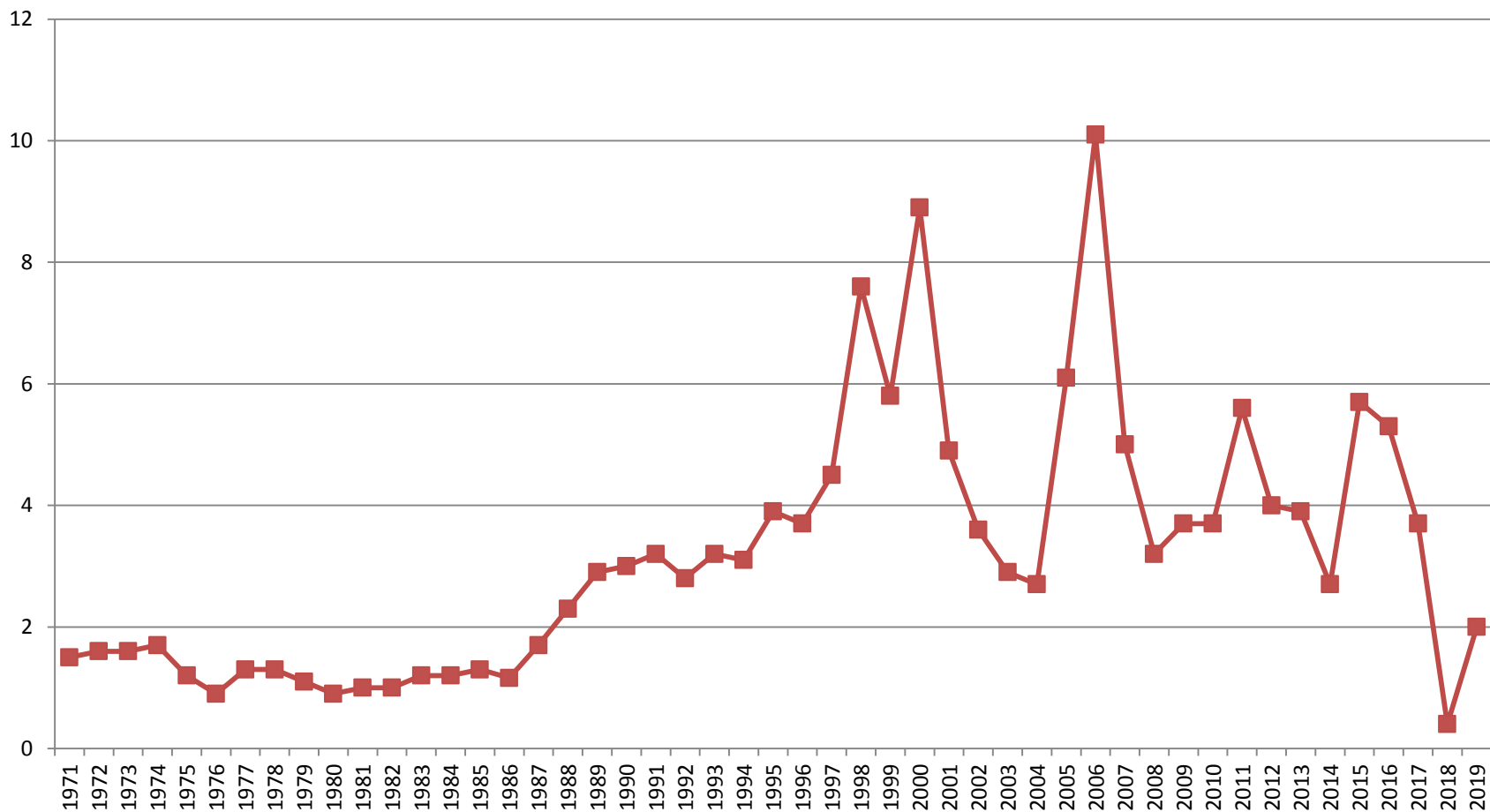
View European Union's Foreign Direct Investment for 10 years in the chart:



View European Union's Foreign Direct Investment for 10 years in the chart:

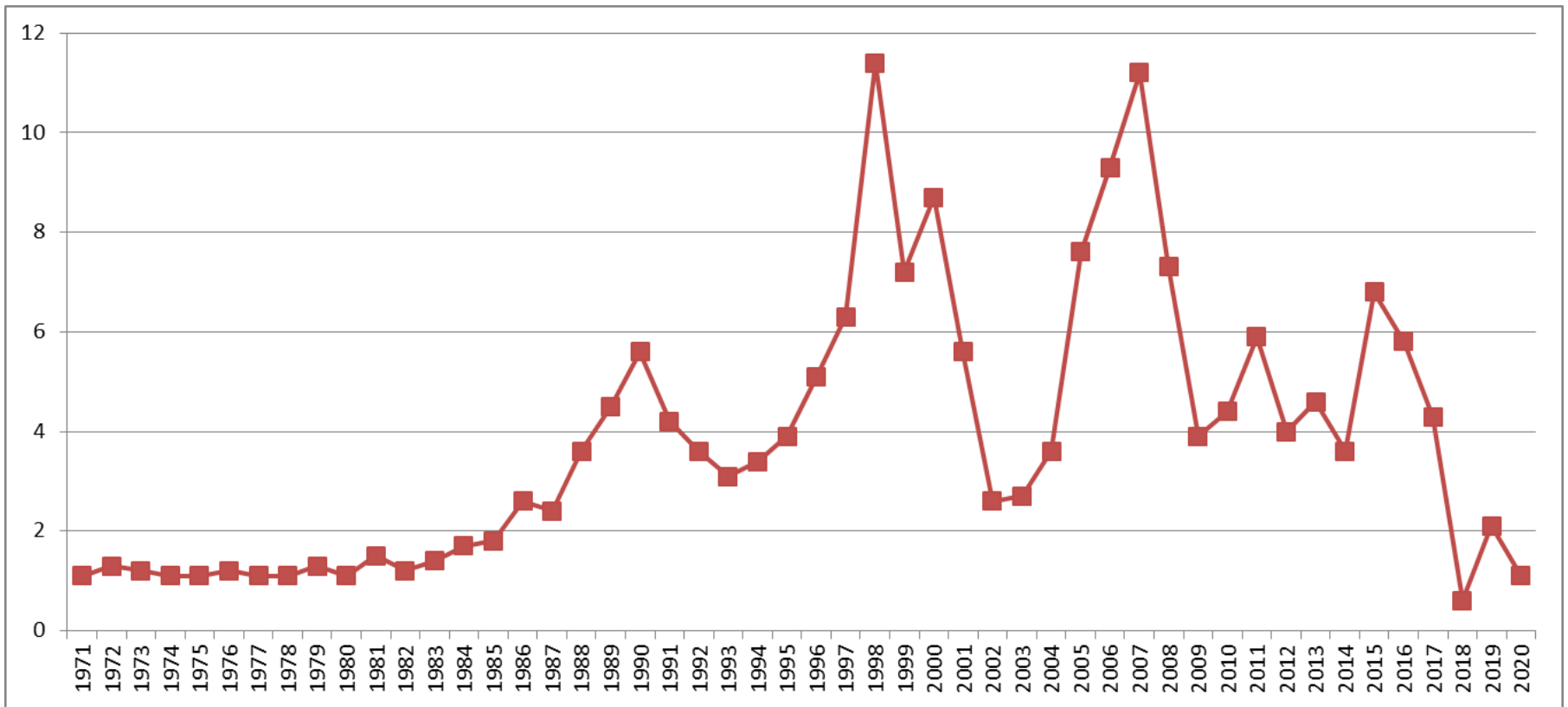


Foreign direct investment, net inflows (%of GDP)-European Union



Source: <https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS?locations=EU>

Foreign direct investment, net outflow (%of GDP)-European Union



Source: <https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS?locations=EU>

Questions

- Please describe objectives of EU investment policy
- What is the coverage of EU investment rules?
- How do work investment agreements between EU countries and non EU members?
- How does EU use Investment facilitation for development?
- Which framework does EU regulation sets up a framework for the screening of investments from non European members?
- Please describe New EU Investment Regime

Sources

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EU direct investments to Uzbekistan

European Investment Bank

The European Investment Bank is the lending arm of the European Union. It is the biggest multilateral financial institution in the world and one of the largest providers of climate finance

The European Investment Bank (EIB) provides: long-term project funding, guarantees and advice. It supports projects both within and outside the EU. Its shareholders are the Member States of the EU. The EIB is the majority shareholder in the European Investment Fund (EIF), and the two organisations together make up the EIB Group.

Objectives of EIB

The EIB, in all sectors of the economy, facilitates the funding of projects that:

Seek to develop less-developed regions;

Seek to modernise or convert undertakings, or develop new activities which cannot be completely financed by means available in individual Member States;

Are of common interest to several Member States.

The task
of the EIB

to contribute to the balanced and steady development of the internal market in the interest of the Union

EIB activities focus on six priority areas:

- climate and environment;
- development;
- innovation and skills;
- small businesses;
- infrastructure;
- cohesion

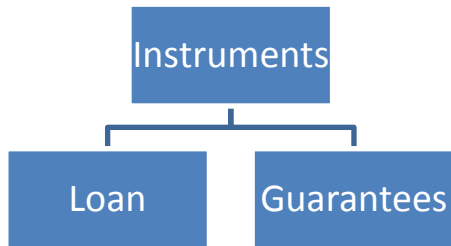
Resources

Own resources

The own resources are provided by the members of the EIB, i.e. the Member States. The EIB's total subscribed capital now amounts to EUR 248.8 billion.

Capital markets

The EIB raises the greater part of its lending resources from international capital markets, mainly through the issuing of bonds. The EIB generally finances one third of each project, but supportive financing can reach 50%.



The EIB uses a wide range of different instruments, but mainly loans and guarantees. However, a number of other, more innovative instruments with a higher risk profile have also been developed. Further instruments will be designed in cooperation with other EU institutions. Financing provided by the EIB may also be combined with financing from other EU sources (inter alia the EU budget), a process known as blending. Besides financing projects, the EIB also operates in an advisory capacity.

Lending is mainly provided in the form of direct or intermediate loans. Direct project loans are subject to certain conditions, e.g. the total investment costs must exceed EUR 25 million, and the loan can only cover up to 50% of the project costs.

The EU's 'climate bank'

The EIB's new energy lending policy, which will govern its activities in the energy sector, is based on five principles:

Prioritising energy efficiency with a view to supporting the new EU target under the EU Energy Efficiency Directive;

Enabling energy decarbonisation through increased support for low or zero carbon technology, with the aim of achieving a 32% renewable energy share throughout the EU by 2030;

Increasing financing for decentralised energy production, innovative energy storage and e-mobility;

Ensuring the grid investment that is essential for new, intermittent energy sources like wind and solar, as well as strengthening cross-border interconnections; and

Increasing the impact of investment to support energy transformation outside the EU.

Response of EIB to the COVID-19 crisis

In 2020, as part of the EU's response to the economic consequences of the COVID-19 crisis, the EIB created a EUR 25 billion guarantee fund to enable the EIB Group to scale up its support for companies in all EU Member States by mobilising an additional amount of up to EUR 200 billion.

This came on top of an immediate support package of up to EUR 40 billion, which consists of:

Dedicated guarantee schemes for banks based on existing programmes, for immediate deployment, mobilising up to EUR 20 billion of financing;

Dedicated liquidity lines for banks to ensure an additional EUR 10 billion of working capital support for SMEs and mid-caps; and

Dedicated asset-backed securities (ABS) purchasing programmes to allow banks to transfer risk on portfolios of SME loans, mobilising another EUR 10 billion of support.

European Investment Bank in Uzbekistan

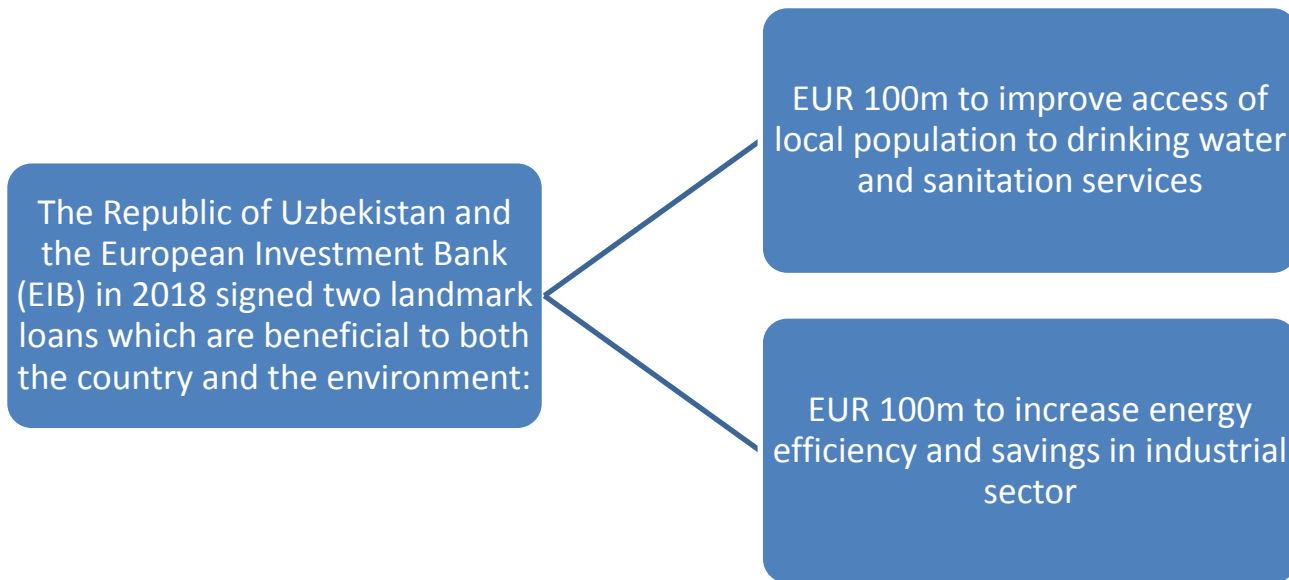
The European Investment Bank (EIB) and the Republic of Uzbekistan signed in 2017 in Washington a framework agreement establishing the legal basis for the EIB's activities in Uzbekistan:

In the provision of finance

in technical assistance

The EU bank can now support public and private sector projects in the areas of infrastructure, energy and energy efficiency and assist SMEs in the country

The Republic of Uzbekistan is the fourth state in Central Asia to establish a partnership with the EIB.



A EUR 100m loan will finance water and wastewater projects within the framework of the EU-sponsored Climate Action and Environment Facility. This operation will help Uzbekistan to better address its high external water resource dependency and the scarcity of locally available freshwater resources. Some 80% of the water used in Uzbekistan originates from neighbouring countries.

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EIB and Uzbekistan in investment program for the recovery of the Aral Sea

EIB and Uzbekistan`s Ministry of Investment and Foreign Trade sign Memoranda of Understanding to save Aral Sea from extinction;

MoU paves way for EUR 100m investment program in irrigation systems and land remediation in Karakalpakstan region home to 1.8 m people;

EIB`s investment program aims to increase inflow of water from the Amu Darya River in to the Aral

As the EU Climate Bank, EIB will support the Uzbek Government achieve one of its national priorities and protect the environment in the Aral Sea region, home to around 1.8 million people, and facilitate transition to a greener economy.

UZBEKISTAN SOLAR IPP (signed in April 2021)

Description

- 100 MW solar photovoltaic (PV) plant located in Samarkand region promoted by Total Eren.

Objectives

- The development of solar energy will support national targets for renewable energy generation and contributes to the Bank's Environment (renewable energy) and Climate Action objectives. The project is fully in line with the strategic objectives set for the Bank's ELM 2014-2020 Mandate since it will contribute to reducing the growing electricity supply gap in Uzbekistan using renewable energy resources



The European Bank for Reconstruction and Development (EBRD)

The European Bank for Reconstruction and Development (EBRD) was established to help build a new, post-Cold War era in Central and Eastern Europe. It has since played a historic role and gained unique expertise in fostering change in the region - and beyond - investing almost €150 billion in a total of more than 6,000 projects

The EBRD is owned by 69 countries, as well as the European Union and the European Investment Bank

EBRD and Uzbekistan

EBRD re-engaged in Uzbekistan in 2017

Country Strategy 2018 identifies the following operational and strategic priorities for the EBRD's work in Uzbekistan:

- Enhancement of competitiveness by strengthening the role of the private sector's role in the economy
- Promotion of green energy and resource solutions across sectors
- Support increased regional and international cooperation and integration.

The Bank's new phase of engagement with the country was prompted by a major reform programme launched by the authorities in February 2017 moving towards a more open, integrated market economic model, improving international relations, strengthening the rule of law and judicial independence and achieving the liberalisation of the foreign exchange rate. Reducing the state's presence in the economy, improving the business environment and facilitation of foreign direct investments are among the top priorities of the Uzbek authorities.

Uzbekistan:

Joined the EBRD on: **30 April 1992**

Capital Subscription (€ 000) **44,120**

MoU 2017

EBRD and
Uzbekistan
signed in 2017
Memorandum
of
Understanding

WHEREAS the EBRD acknowledges and supports the important economic reforms and democratic processes pursued by the Republic of Uzbekistan, including the measures taken to improve public governance, the business and investment climate, the liberalisation of all sectors of the economy, as well as, comprehensive support for development of small business and private entrepreneurship;

WHEREAS the Republic of Uzbekistan recognises the significant experience of the EBRD in supporting structural economic reforms and attracting investment to its countries of operation and welcomes EBRD investments and activities on the territory of the Republic of Uzbekistan aimed at. (i) modernising and enhancing the competitiveness of the economy, (ii) attracting foreign investment and technical assistance, (iii) introducing modern and effective methods of corporate governance, (iu) facilitating innovation and modern technology transfer, and (v) continued introduction of international quality standard

According to MoU 2017

The EBRD will focus its involvement and financing on the territory of the Republic of Uzbekistan in the short term mainly on the following areas:

- (a) development of micro and small businesses as well as private entrepreneurship in Uzbekistan, including through increasing their access to finance and supporting development of financial sector;
- (b) provision of advisory services for small businesses and raising market awareness;
- (c) modernisation and development of the agribusiness sector;
- (d) development of the manufacturing and services sectors;
- (e) support of environmental clean-up operations for the uranium legacy sites under the framework of the Environmental Remediation Account for Central Asia. administered by the EBRD;
- (f) "green" projects in all the above sectors and resource efficiency and waste minimization;
- (g) support for reforms undertaken by the Government of the Republic of Uzbekistan in such areas as: improvement of business climate and private sector development; strengthening of the banking sector; foreign exchange market regulation; development of local capital markets; promotion of green economy; support for gender, youth and regional inclusion; improvement of corporate governance and procurement; and other areas with the objective to improve competitiveness of the economy and ultimately provide support in fostering sustainable development of the Republic of Uzbekistan.

EBRD projects in Uzbekistan

In 2020, the EBRD responded to the challenges of the Covid-19 pandemic in Uzbekistan by committing US\$ 521 million (€429 million equivalent) through 18 projects in various sectors of the national economy. The EBRD funds were used to support the country's banking sector and private small firms' access to finance, upgrade key infrastructure and promote the development of renewable energy.

To date, the EBRD has invested more than €2.4 billion through 97 projects in the economy of Uzbekistan.

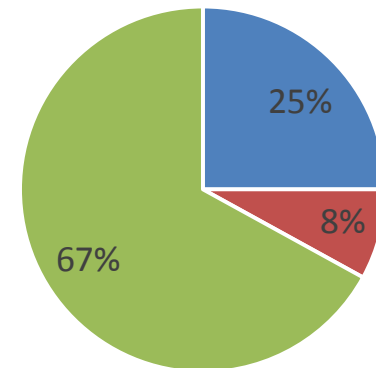
EBRD projects in Uzbekistan

EBRD activity in Uzbekistan to date

Number of projects	97
Cumulative EBRD investment	€2,400 million
Cumulative disbursements	€965 million
Private sector share of portfolio	48%
Number of active portfolio projects	46
Current portfolio of projects	€1,401 million
Operating assets	€340 million
Equity share of portfolio	1%

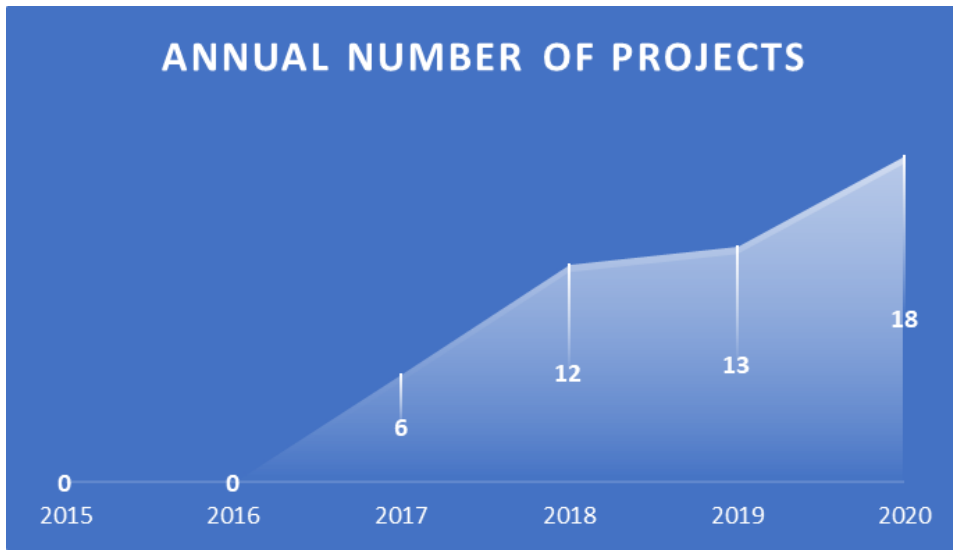
Data valid as of: 31 May 2021

Portfolio composition
Current portfolio¹ €1,401 million

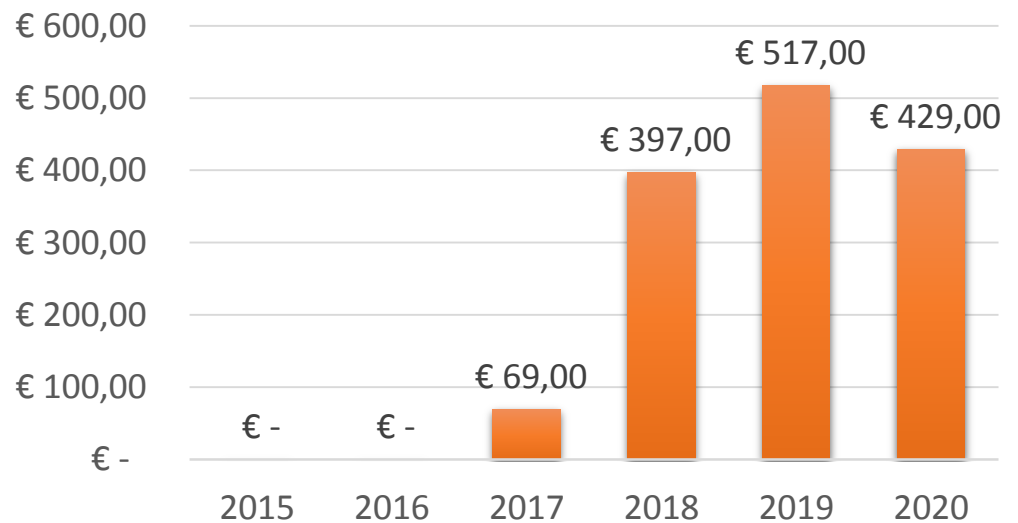


- Financial Institutions € 353 million
- Industry, Commerce & Agribusiness € 113 million
- Sustainable Infrastructure € 935 million

EBRD projects in Uzbekistan



Annual EBRD Investments € million



EBRD projects in Uzbekistan

EBRD expanding Green Economy Financing Facility in Uzbekistan	US\$ 25 million GEFF loan to country's second-largest lender Uzpromstroybank
	US\$ 20 million risk-sharing facility to promote private sector lending

The European Bank for Reconstruction and Development (EBRD) is expanding its Green Economy Facility Financing (GEFF), launched in Uzbekistan in 2019, to support green finance for small private-sector companies investing in green technology solutions

UzPSB will receive an EBRD loan of up to US\$ 25 million for on-lending to domestic small and medium-sized enterprises (SMEs) willing to invest in climate mitigation and adaptation technologies and services. With a network of 45 branches and 170 outlets across Uzbekistan, UzPSB is well placed to support SMEs across the country, including in small villages and remote rural areas

EBRD projects in Uzbekistan

With the facility, the EBRD is contributing to Uzbekistan's long-term decarbonisation strategy, jointly being developed with the Bank and designed to achieve carbon neutrality of the power sector by 2050

The GEF programme operates through a network of more than 145 local financial institutions across 27 countries, supported by more than €4.6 billion of EBRD finance for 190,000 clients to date. These projects have led to annual CO₂ emission reductions exceeding 8.6 million tonnes so far.

Questions

- Please give brief historical overview on EIB
- Describe objectives and principles of EIB activity
- Please disclose the sources of financing the investments
- How is reflected EIB appearance in Uzbekistan?
- Please describe EIB investment projects in Uzbekistan
- Please designate objectives of EBRD in Uzbekistan
- What are the main priorities of EBRD in Uzbekistan?
- Please list and characterize main EBRD projects in Uzbekistan

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Uzbek climate for European investments (regulatory base)

Law of the Republic of Uzbekistan “On investments and investment activity”

Adopted by the Legislative Chamber on December 9, 2019 Approved by the Senate on December 14, 2019

The main principles of investments and investment activity are:

- legality;
- publicity and openness;
- freedom to implementation of investment activity;
- justice and equality of subjects of investment activity;
- non-discrimination against investors;
- presumption of investor conscientiousness;
- The basic principles of the legislation on investments and investment activity are applied at all stages of the investment process and investment activity

According to the Law of the Republic of Uzbekistan “On investments and investment activity”

Forms of investments implementation are:

- establishment of legal entities or equity participation in their authorized funds (authorized capital), including through the acquisition of property and stocks (shares);
- acquisition of securities, including debt instruments issued by the residents of the Republic of Uzbekistan;
- the acquisition of concessions, including concessions for exploration, development, production or use of natural resources, as well as participation in the production sharing agreement;
- acquisition of property rights, including ownership of intellectual property, copyrights, patents, trademarks, utility models, industrial samples, brand names and know-how, business reputation (goodwill), as well as objects of trade and services along with land plots in which they are located;
- acquisition of the right to own and use land (including on a rental basis) and other natural resources

According to the Law of the Republic of Uzbekistan “On investments and investment activity”

An investor has the right to:

- freely carry out investment activities, determine the volumes, types, forms, scope and directions of investment, not contradicting the legislation of the Republic of Uzbekistan;
- conclude agreements with legal entities and individuals to carry out investment activity;
- own, use and dispose of income received as a result of investment activities, as well as sell and export of income received as a result of investment activity;
- independently and freely manage the income received as a result of investment activity, after paying taxes, fees and other payments stipulated by legislation (hereinafter — taxes and payments);
- to use property and any property rights belonging to him by right of ownership as security for all types of obligations undertaken by him, including obligations aimed at attracting borrowed funds;
- to receive adequate compensation in case of requisition (expropriation) of his investments and other assets;
- raise funds in the form of loans and borrowings;
- receive compensation for losses caused as a result of illegal actions (inaction) and decisions of state bodies, local government bodies and their officials.

According to the Decree on the procedure for applying tax incentives for businesses that attract direct private foreign investment

Enterprises, including joint-stock companies, attracting direct private foreign investments, specializing in the production of goods (provision of services) in sectors of the economy according to the fixed LIST to the Regulation are exempt from payment:

- corporate income tax;
- property tax;
- single tax payment

According to the Decree on the procedure for applying tax incentives for businesses that attract direct private foreign investment

Specified tax incentives:

a) provided with the volume of direct private foreign investment equal (equivalent):

- from 300 thousand US dollars to 3 million US dollars inclusive - for a period of 3 years;
- over 3 million US dollars up to 10 million US dollars inclusive - for a period of 5 years;
- over USD 10 million - for a period of 7 years;

b) are applied under the following conditions:

- placement of enterprises in all cities and rural settlements of the republic, with the exception of the city of Tashkent and the Tashkent region. This territorial restriction does not apply to enterprises operating in the field of tourism and waste management;
- implementation by foreign investors of private direct foreign investments without providing a guarantee of the Republic of Uzbekistan;
- the share of foreign participants in the authorized capital of an enterprise must be at least 33 percent, and for joint-stock companies - at least 15 percent;
- foreign investment in the form of freely convertible currency or new modern technological equipment;
- direction of at least 50 percent of the income received as a result of the provision of these benefits during the period of their application for reinvestment for the purpose of further development of the enterprise

Decree of the Cabinet of Ministers of Uzbekistan dated from 04/01/2019 #4 “ABOUT ADDITIONAL MEASURES ATTRACTING DIRECT FOREIGN INVESTMENT IN INFRASTRUCTURE DEVELOPMENT OF TASHKENT CITY” identifies:

- FORECAST PARAMETERS attracting investments, including foreign investments, in the context of districts of Tashkent in 2019-2020
- List of projects implemented in Tashkent with foreign investments
- PRIORITY AREAS in development of Tashkent districts to attract investments, including FDI
- List of international investment and business forums, exhibitions organized in the city of Tashkent in 2019

President Decree dated from 04/29/2019 N PP-4300 “ABOUT MEASURES FOR FURTHER IMPROVEMENT MECHANISMS FOR ATTRACTING FDI TO THE ECONOMY OF THE REPUBLIC” identifies:

- List of state packages of shares in the charter capital of business entities, offered for sale to investors
- List of perspective investment proposals, offered to foreign investors

Questions

- Which document is the base in regulation of FDI?
- Which incentives do you know in attracting FDI?
- How does the government supports FDI from the legal perspective?

Sources

- Law of the Republic of Uzbekistan “On investments and investment activity”, 2019
- Decree on the procedure for applying tax incentives for businesses that attract direct private foreign investment
- Decree of the Cabinet of Ministers of Uzbekistan dated from 04/01/2019 #4 “ABOUT ADDITIONAL MEASURES ATTRACTING DIRECT FOREIGN INVESTMENT IN INFRASTRUCTURE DEVELOPMENT OF TASHKENT CITY”
- President Decree dated from 04/29/2019 N PP-4300 “ABOUT MEASURES FOR FURTHER IMPROVEMENT MECHANISMS FOR ATTRACTING FDI TO THE ECONOMY OF THE REPUBLIC”

European Union experience in taxation

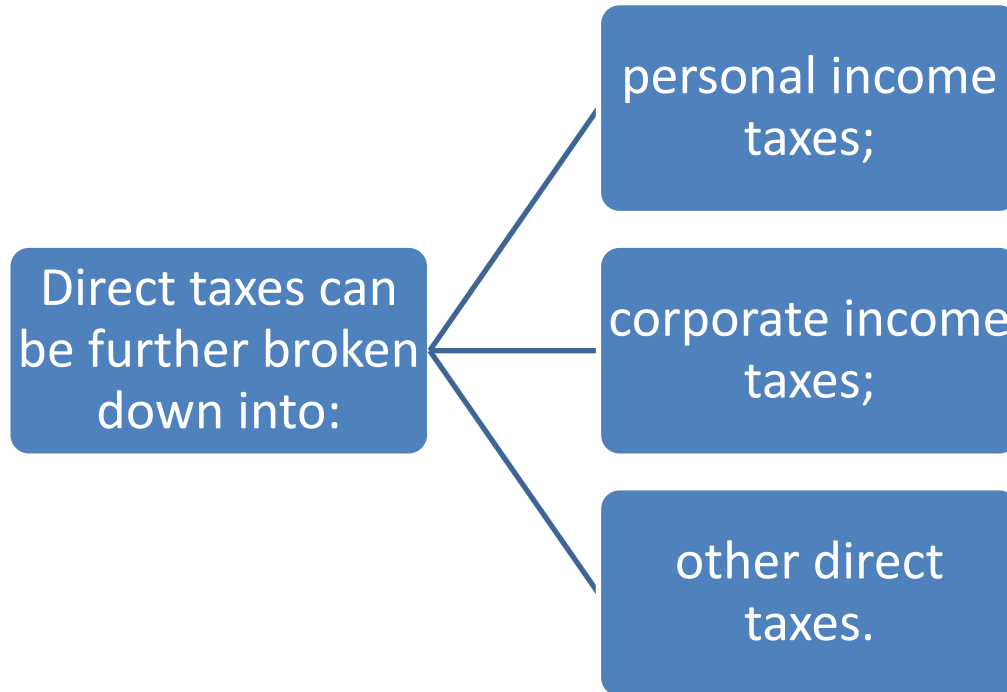
The EU does not have a direct role in collecting taxes or setting tax rates. The amount of tax each citizen pays is decided by their national government, along with how the collected taxes are spent

The EU does however, oversee national tax rules in some areas; particularly in relation to EU business and consumer policies, to ensure:

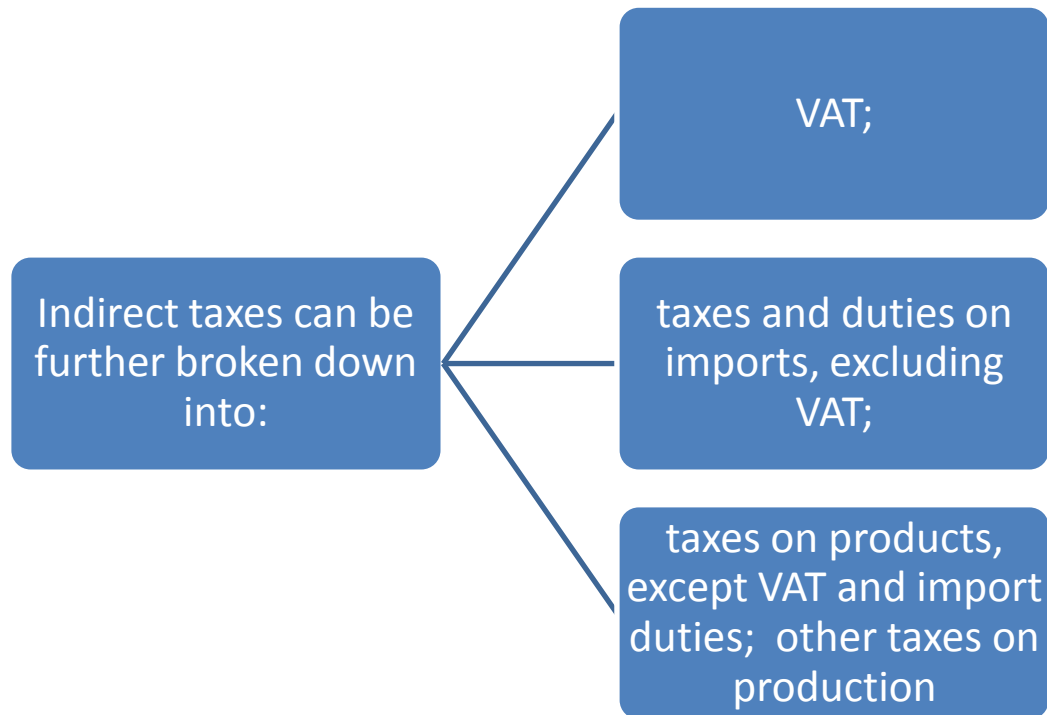
the free flow of goods, services and capital around the EU (in the single market)

businesses in one country don't have an unfair advantage over competitors in another

taxes don't discriminate against consumers, workers or businesses from other EU countries



A large proportion of revenue from direct taxes (over 70 % in the EU as a whole) comes from personal income taxes. Cyprus is the only Member State where revenue from corporate income taxes is higher than that from personal income taxes



Indirect taxes can be further broken down into:

- VAT;
- taxes and duties on imports, excluding VAT;
- taxes on products, except VAT and import duties;
- other taxes on production.

Over half of the revenue from indirect taxes in the EU (52 %) is from VAT

VAT

Tax policy in the European Union (EU) has two components:

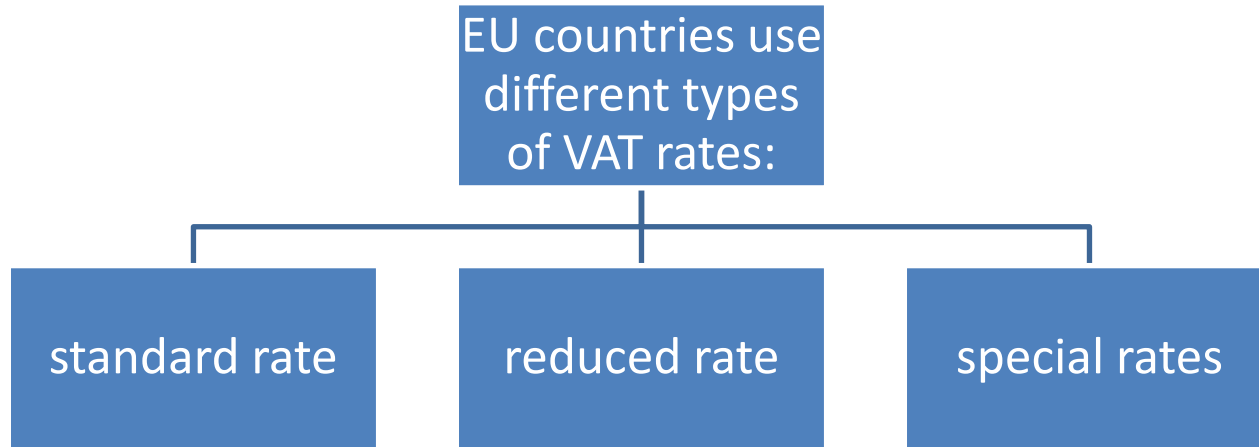
- direct taxation, which remains the sole responsibility of Member States,
- indirect taxation, which affects free movement of goods and the freedom to provide services in the single market

With regard to direct taxation, the EU has however established some harmonised standards for company and personal taxation, and member countries have taken joint measures to prevent tax avoidance and double taxation

On indirect taxation, the EU coordinates and harmonises law on value-added tax (VAT) and excise duties. It ensures that competition on the internal market is not distorted by variations in indirect taxation rates and systems giving businesses in one country an unfair advantage over others

VAT

Value Added Tax (VAT) is a consumption tax that is applied to nearly all goods and services that are bought and sold for use or consumption in the EU



For EU-based companies, VAT is chargeable on most sales and purchases of goods within the EU.

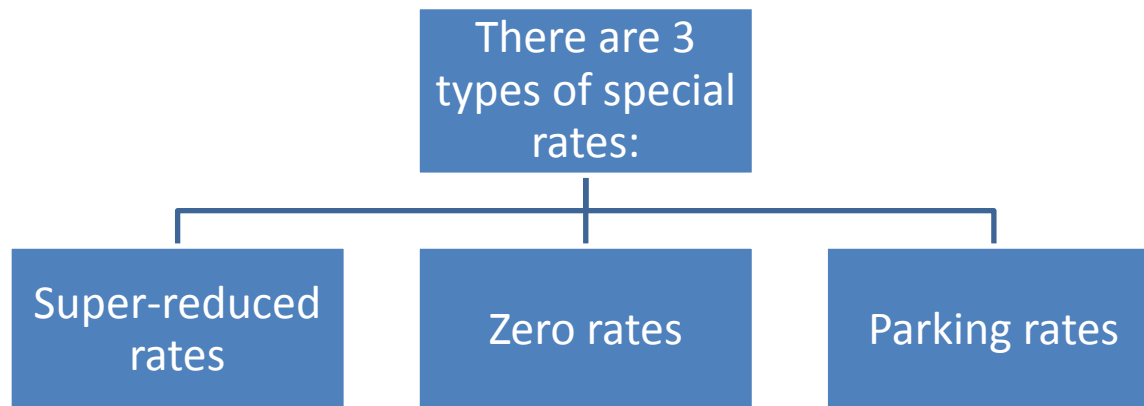
VAT isn't charged on exports of goods to countries outside the EU

VAT rules can be applied differently in each EU country

VAT

Each EU country has a standard rate which applies to the supply of most goods and services. **This cannot be less than 15%.**

Some EU countries are allowed to apply special VAT rates on certain supplies. These special rates apply to EU countries that were applying them on 1 January 1991. They were originally meant to be transitional arrangements for a smoother shift to the EU VAT rules when the Single Market came into force on 1 January 1993, and were intended to be gradually phased out.



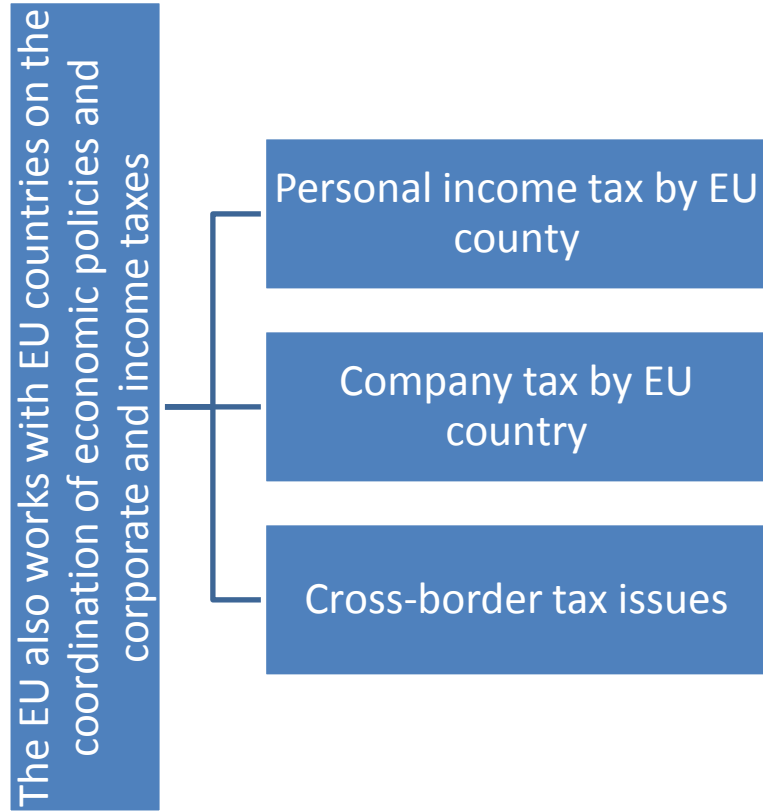
Excise duties

Excise duties are indirect taxes applied to the sale or use of goods such as alcohol, alcoholic drinks, energy products, electricity, and tobacco products

Most excise goods become **subject to excise duty** as soon as they are produced, or imported into the EU. This duty can be suspended, meaning it **doesn't have to be paid** until the product is released for consumption.

Excise duties may be paid by:

- the person or business who is the **authorised warehouse-keeper** of the place where excise products are produced, processed, stored, dispatched or received
- the sender, recipient, transporter or 3rd party providing a movement guarantee - who **caused the goods to leave the duty-suspension arrangement**
- the person importing the goods, if they are imported **without** being put under the **duty-suspension arrangement**



Income taxes abroad

There are no EU-wide rules that say how EU nationals who live, work or spend time outside their home countries are to be taxed on their income. However, the country where you are **resident for tax purposes** can usually tax your total worldwide income, earned or unearned. This includes wages, pensions, benefits, income from property or from any other sources, or capital gains from sales of property, from all countries worldwide

Each country has its own definition of tax residence, yet:

- you will usually be considered **tax-resident in the country where you spend more than 6 months a year**
- you will normally remain **tax-resident in your home country if you spend less than 6 months** a year in another EU country.

Income taxes abroad

Dual residence

- In some cases, two countries could consider you a tax-resident at the same time, and both could require you to pay taxes on your total worldwide income. Fortunately, many countries have double tax agreements , which usually provide rules to determine which of the two countries can treat you as a resident.

Posted workers/jobseekers

- In some cases, such as for workers post abroad for a limited time or **jobseekers abroad**, you may be considered tax–resident, and therefore taxable, in your home country even if you stay abroad for more than 6 months - if you keep your permanent home in your home country and your personal and economic ties with that country are stronger.

Fictitious tax residence

- Under some double tax treaties , the country where you earn all or almost all of your income will treat you as tax-resident, even if you don't live there. This status of fictitious tax-resident is granted by some countries to cross-border commuters.

Income taxes abroad. Equal treatment

Under EU rules, no matter in which EU country you are considered a tax-resident, you should be taxed in the same way as nationals of that country under the same conditions. For example, in the country where you are tax-resident or where you earn all or most of your income, you should be entitled to:

- any available family allowances and tax deductions for childcare costs, even if the costs are incurred in another EU country
- any available tax deductions for interest on mortgages, even for a house you own in another EU country
- joint tax assessment with your spouse, if this is possible in that country

Company tax by EU country

Company tax — also referred to as corporation tax — should be paid by various types of companies, clubs, co-operatives and unincorporated associations on profits from doing business. The rules are set by national authorities and can be different for each member state.

Cross border tax issues

There are no EU-wide rules that say how EU nationals who live, work or spend time outside their home countries are to be taxed on their **income** - coming from wages, pensions, benefits, property, successions and donations, or any other sources.

There are only national laws and **bilateral tax treaties** between countries - and these don't cover all eventualities and vary considerably.

Risk of double taxation

There is a risk that your income may be taxed twice if two countries have the right to tax your income because, for instance:

You live in one country but work in another (cross-border commuter)

You are posted abroad for a short assignment

You are living and looking for work abroad and have transferred unemployment benefits from your home country

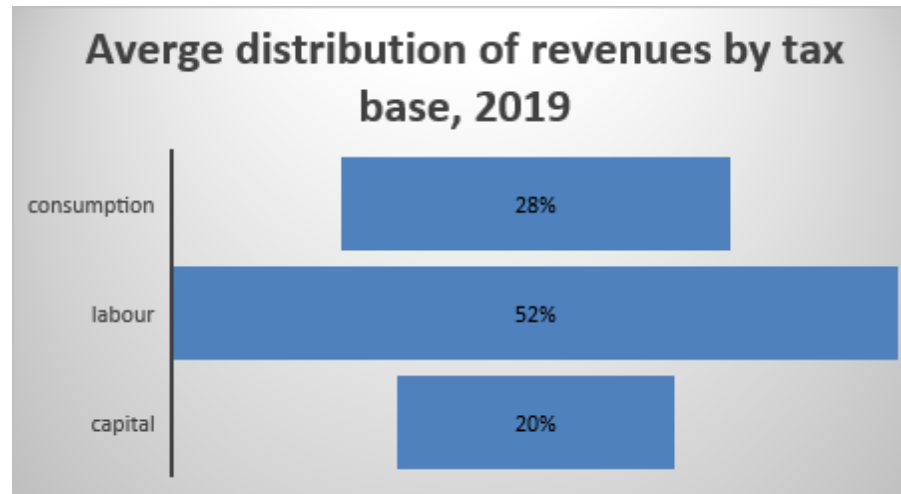
You have retired to one country and receive a pension from another

In these situations, while **you will always be subject to the tax rules of your country of residence**, you may also have to pay taxes in the other country. These agreements usually spare you from double taxation:

- under many bilateral tax agreements, the amount of tax you paid in the country where you work will be **offset against** the tax you owe in your country of residence
- in other cases, the income earned in the country where you work might be taxable only in that country and **exempt from tax** in your country of residence

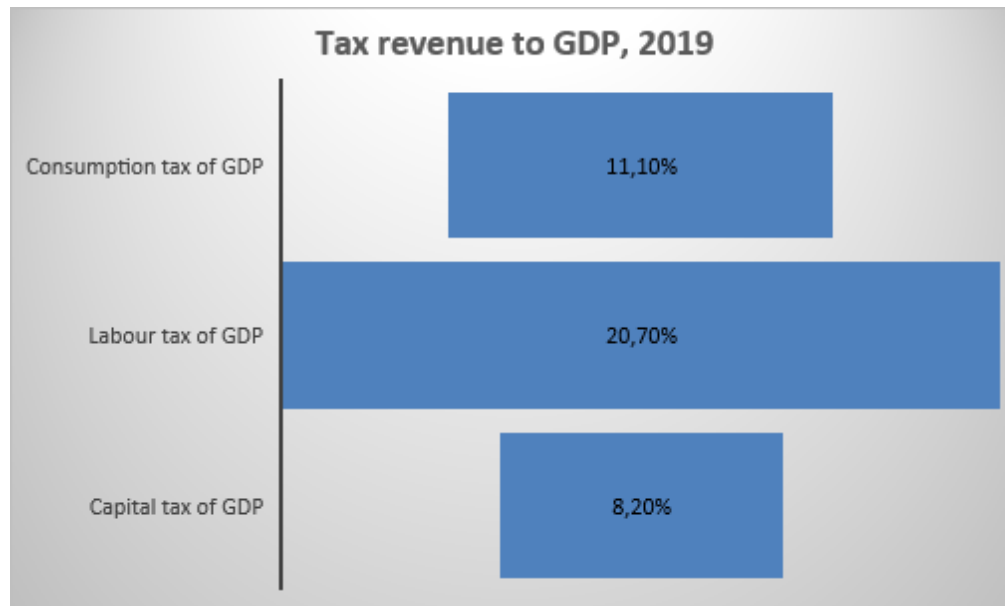
Taxation trends in the European Union

According to the latest forecast (Spring 2021), tax revenue in the EU is expected to have decreased in 2020, but less than GDP. Therefore, the tax-to- GDP ratio would have increased in 2020 but it will fall significantly in 2021, with further decreases in 2022



The EU continues to show a level of tax revenue significantly above than other advanced economies. In 2019, tax revenue in the EU stood at 40.1% of gross domestic product (GDP). The taxation structure remained stable in the EU. Revenue was almost equally distributed among indirect taxes, direct taxes and social contributions. The distribution of revenues by tax base (consumption, labour and capital) was very similar to those of previous years (around 52 % from labour, 28 % from consumption and 20 % from capital)

Taxation trends in the European Union



Revenue derived from consumption in the EU-27 represented 11.1 % of GDP in 2019, just slightly below the value in 2018. The implicit tax rate (ITR) on consumption continued to increase in 2019, continuing the trend started in 2009. The value added tax rates have remained almost unchanged since 2013. Labour taxes, which provide the largest share of revenues, remained unchanged in 2019, at 20.7 % of GDP. Revenues from taxes on capital were also stable at 8.2 % of GDP

Taxation trends in the European Union

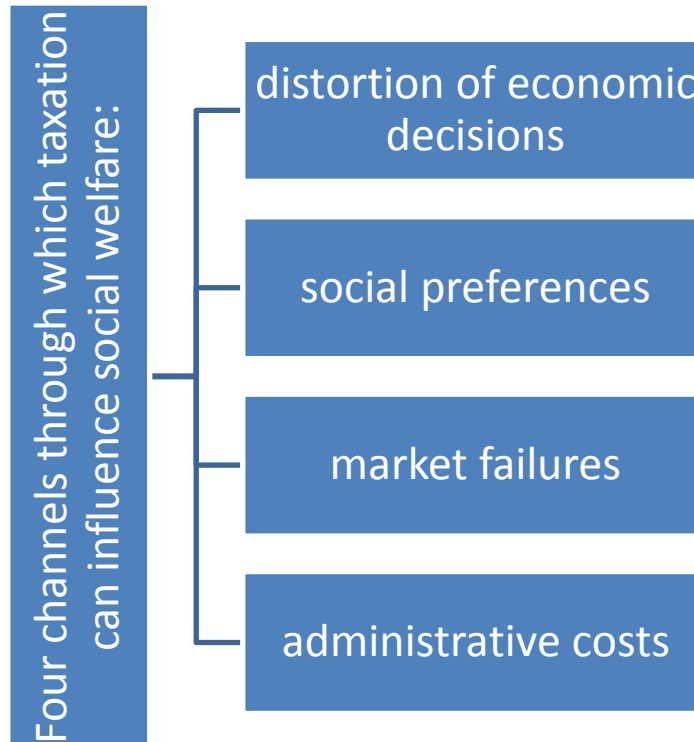
The latest data confirm the development towards lower rates on corporate taxation (nominal and effective), but at a very slow pace, while revenues from corporate income stagnated in 2019 after several years of sustained growth that stopped in 2017. At EU level, environmental taxes displayed a quite stable picture in 2019. However, several countries significantly increased their environmental revenues, in particular thanks to energy-related revenues.



EU's five tax priorities:

- stimulating investment and addressing positive and negative externalities;
- improving tax administration and tax certainty;
- boosting employment;
- reducing inequalities;
- ensuring tax compliance

The primary purpose of taxation is to fund public spending by re-allocating funds from taxpayers (citizens/businesses) to government



Four channels through which taxation can influence social welfare

Distortion of economic decisions – in the absence of market failure, most forms of taxation distort otherwise efficient economic decisions, leading to sub-optimal outcomes. The distortion can affect inter alia:

- (a) the scale, location and sector of investment;
- (b) how to finance investment, e.g. debt vs equity;
- (c) factors affecting the supply and demand of labour;
- (d) the nature and timing of consumption. Tax systems should minimise these distortions and the resultant 'deadweight loss'

Market failures – sometimes, economic decision-making in the absence of taxation is neither efficient nor fair. In such cases, taxation can play a role in correcting for economic inefficiencies to the benefit of the society as a whole, e.g. where there is:

- (a) too much activity that harms others, e.g. environmentally damaging behaviour (smoking, driving a car, production sites that pollute the environment, selling unhealthy products); this might also lead to unfair burden-sharing across generations; and
- (b) too little activity that benefits others, e.g. investment in research, development and innovation or spending on education, which is a key driver of upward social mobility

Source: https://ec.europa.eu/taxation_customs/system/files/2020-01/tax_policies_in_the_eu_survey_2020.pdf

Social preferences – it is not only the level of overall income that matters, but also the extent to which it is shared among members of a society.

- Taxation can be a powerful instrument for redistribution. Depending on social preferences and policy goals, redistributive taxes can be welfare enhancing, despite distorting individually efficient decisions;

Administrative costs

- levying taxes is costly for administrations and taxpayers. Efficient tax administration minimises these costs

The tax mix in the EU — recent trends

Securing sufficient funds to finance public expenditure involves:

(a) the right mix of taxes, taking into account:

- investment and addressing positive and negative externalities;
- tax administration and tax certainty
- employment;
- inequality;

(b) ensuring that all members of society pay their fair share, be it through effective enforcement and/or increasing voluntary compliance

Sustainability of tax systems in a changing world

DIGITAL TRANSFORMATION OF LABOUR MARKETS.

- Technological change in the form of automation/robotisation will continue to transform labour markets, possibly reducing the labour income share and increasing wage polarisation.
- What does this mean for taxation? A relative fall in labour income could lead to a decline in labour tax revenues, but may also reduce scope for redistribution through the personal income tax system. This would raise equity concerns, in particular in a context of increasing wage polarisation. New forms of work may raise tax concerns on two fronts. On the one hand, ensuring social protection coverage for the workers in question will probably require additional financing, including through sources other than social contributions. On the other hand, new tax administration approaches may be needed to adapt to transformed labour markets. The traditional withholding of taxes by the employer might no longer be feasible (multiple employers, self-employment, etc.). Online platforms may be central with regard to withholding tax, but at the same time, tax authorities may not want to outsource their enforcement obligations to platforms

Sustainability of tax systems in a changing world

GLOBALISATION AND DIGITALISATION

- Technological change and globalisation have produced more complex, more cosmopolitan business structures. New digital business models serve customers/users globally, while keeping key functions and taxable activities in a few locations and often relying heavily on intangible assets.
- What does this mean for taxation? The outdated international corporate tax framework does not cater for the new realities of value creation and economic presence (see Section 4.1.2). Together with still existing tax avoidance opportunities, this poses substantial challenges for the sustainability of tax revenues. The fact that avoidance opportunities can be exploited by a limited group of taxpayers (businesses and citizens) reduces tax morale and threatens the popular ‘legitimacy’ of the system.

Sustainability of tax systems in a changing world

POPULATION AGEING

- The EU is an ageing society. Increases in the average life expectancy and a birth rate below replacement levels are expected to lead to significant demographic change in the population, including the labour force, in the coming decades.
- What does this mean for taxation? The ageing of societies and the relative shrinking of the working-age population could generate substantial pressure on revenue from labour taxation and social contributions. The tax burden would fall on a reduced population of taxpayers, while ageing is likely to create additional public spending needs (e.g. care for the elderly). This could be mitigated by the increased use of alternative tax bases, such as consumption or capital taxes, with due consideration of its implications for economic growth and tax burden sharing.

Sustainability of tax systems in a changing world

CLIMATE CHANGE AND ENVIRONMENTAL TAXATION

- Climate change and other environmental issues are expected to affect us in various ways, with consequences in terms of health, biodiversity, infrastructure and economic activity.
- What does this mean for taxation? Additional tax revenues will probably be needed to support mitigation and adaptation policies. Also, taxation may be used to internalise environmental costs and support the transition to a low carbon more resource efficient and circular economy. Climate change and environmental degradation can also affect tax revenue generated through income taxation due to their impact on health, biodiversity, infrastructure, and economic activity.

Effective marginal tax rates on corporate income

The effective marginal tax rate (EMTR) on corporate income can influence decisions as to how much to invest. It is the (forward-looking) expected tax burden on the last euro invested in a project that just breaks even (the 'marginal' investment). It captures a wide range of factors in addition to statutory corporate tax rates, such as:

- the main elements of the tax code that will affect the determination of the corporate income tax (CIT) base;
- the source of financing for the investment (debt, retained earnings or new equity); and
- the type of asset to be invested in (machinery, buildings, intangibles, inventory or financial assets).

Debt bias in corporate taxation

Most corporate tax systems present companies with incentives to take on more debt by making interest payments deductible, but do not treat equity in the same way

The higher cost of equity finance is particularly problematic for young and innovative companies, which often have no access to external debt funding

The corporate debt bias therefore presents an obstacle to the creation of a stronger equity base in European companies and may impede efficient capital market financing

Different types of reform can address the corporate debt bias

The factors driving their potential attractiveness are:

- the applied notional interest rate;
- how the deductible amount of equity is established;
- the absence of comprehensive anti-abuse provisions.

Improving tax administration

Tax systems impose compliance costs on taxpayers. The costs a company incurs are determined not only by the rules and obligations per se, but also by how easy it is to deal with the authorities. A simpler and more transparent tax system can reduce tax compliance costs and the time it takes to complete tax returns

Companies also face compliance costs after they have filed their tax returns, e.g. in obtaining tax refunds or when being audited. The 'post-filing index' captures the amount of time a model company takes to comply with tax refunds and corporate income tax (CIT) audits, obtain a refund and complete a CIT audit

A wide range of digital services for taxpayers, especially e-filing opportunities, can reduce compliance costs while making tax administration more efficient and improving compliance

Reform options

Stimulating investment and addressing positive and negative externalities
Options for Member States aiming to do more to boost investment and address positive & negative externalities through tax policy include:
Encouraging alternative sources of financing and risk-taking, focusing on efficiency measures and designing better tax incentives:

- encouraging investment through equity as a complementary source of debt financing; moving from depreciation to immediate expensing of investment; allowing for comprehensive loss offsets; improving the effectiveness of tax incentives for R & D, targeting companies on the basis of a combination of criteria (e.g. age and size); business angel and venture capital investment; concentrating on monitoring and simplifying tax incentives that have the potential to boost real investment;
- shifting towards the taxation of economic rents;
- aligning the design of environmental taxes more closely with the externalities and policy goals they are intended to address, in order to provide consistent price signals; and
- simplifying and clarifying the application of tax rules to the collaborative economy

Reform options

Improving tax administration and tax certainty Taking a proactive approach to digitalisation:

- stepping up tax administrations' digitalisation efforts to facilitate tax compliance and improve customer service; and
- providing tax certainty by keeping tax laws stable and, where changes are needed, consulting taxpayers

Supporting job creation and employment For Member States that face challenges around employment and the tax burden on labour, potential reform options could include: Focusing labour tax cuts on the most reactive groups and those facing the biggest challenges:

- focusing labour tax cuts on groups facing the greatest unemployment challenges and precarious work conditions (e.g. the low-skilled, young people, the elderly and the long-term unemployed), rather than making generic tax reductions;
- removing or amending features of the tax system that create high marginal tax rates for second earners, e.g. by tapering the withdrawal of income-related child tax credits, and moving from joint to individual taxation for couples.

Reform options

Mitigating inequality and promoting social mobility Member States that face particular challenges in social fairness could consider: Mitigating inequalities of income, wealth and opportunity:

- reducing disposable income inequality through redistribution by strengthening progressive PIT;
- mitigating wealth inequality and supporting equality of opportunity by increasing the progressivity of the overall tax mix, including the taxation of wealth transmission, individuals' capital income, and property.

Incentivising behaviour that facilitates social mobility:

- reducing the tax burden on the targeted population in order to create jobs, as employment is one route out of social exclusion and poverty; and
- considering the role of entrepreneurship in supporting social mobility

Reform options

Fighting tax fraud, evasion and avoidance Reform options for Member States looking to combat tax fraud, evasion and avoidance include:

More cooperation and a stronger administrative capacity and legal framework:

- making full use of enhanced transparency, particularly on the ultimate beneficial ownership of legal entities and legal arrangements, and cross-border cooperation tools, e.g. automatic exchange of information, sharing of data analysis between countries, multilateral controls and joint audits;
- modernising and digitalising tax authorities to facilitate tax compliance and prevent tax abuse
- strengthening the legal framework, e.g. by closing loopholes in domestic legislation and reinforcing antiabuse provisions.

Promoting trust, transparency and a culture of tax compliance:

- raising taxpayers' awareness of the value delivered through tax revenues; monitoring and showing results of tax administrations' performance;
- strengthening tax morale through information campaigns;
- cooperating with businesses to improve tax compliance while using behavioural economics insights to nudge taxpayers to 'do the right thing at the right time';
- reinforcing at national level the protection and safeguarding of whistleblowers who, acting in good faith, denounce serious threats or harm to the public interest.

Questions

- What is the role of EU in taxation?
- Please list and characterize direct taxes for EU
- Please describe features and specificity of indirect direct taxes for EU
- How is VAT chargeable and when you can use special rates?
- In which case is Excise duty to be paid?
- Please specify Income tax abroad category
- What is the treatment for Company tax in EU countries?
- How EU countries do mitigate risk of double taxation?
- Which trends of taxation in EU countries can you emphasize?
- What are the main EU tax priorities?
- How can taxation influence the the social welfare?
- What are the main blocks which influence the sustainability of taxation?
- What are the options for reforming taxation?

Sources

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- https://ec.europa.eu/taxation_customs/system/files/2020-01/tax_policies_in_the_eu_survey_2020.pdf

European Union experience in customs

The European Customs Union

- The Treaty establishing the European Economic Community (EEC) provided for the introduction of a Customs Union. It was to create a homogeneous economic area vis-à-vis the outside world. The Customs Union, together with coordination of commercial policies with third countries, was to be achieved progressively through:
- the abolition of customs duties between Member States;
- the abolition of quantitative restrictions between Member States;
- the establishment of a common customs tariff vis-à-vis third countries.

The EU Customs Union, established in 1968, makes it easier for EU companies to trade, harmonises customs duties on goods from outside the EU and helps to protect Europe's citizens, animals and the environment

At external borders, the Common Customs Tariff, along with the Integrated Tariff (TARIC), are applied to goods from non-EU countries. Goods moving freely within the EU must comply with the rules of the internal market and with certain provisions of the Common Commercial Policy. In addition, the Community and Union Customs Codes ensure that Member States' customs authorities apply the rules uniformly

Customs cooperation

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graph LR; A[Customs cooperation] --- B[Information technology for customs purposes]; A --- C[Customs information system (CIS) system]; A --- D[Close cooperation between EU customs administrations (Naples II Convention)]; A --- E[Money laundering: prevention through customs cooperation];
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Information technology for customs purposes

Customs information system (CIS) system

Close cooperation between EU customs administrations (Naples II Convention)

Money laundering: prevention through customs cooperation

Customs cooperation/ Information technology for customs purposes

Information technology for customs purposes. The aim is The CIS aims to assist in preventing, investigating and prosecuting serious contraventions of national laws by making information available more rapidly, increasing the effectiveness of EU countries' customs cooperation and control procedures

The CIS consists of a **central database**, accessible from every EU country. It comprises exclusively data necessary to achieve its aim, including personal data, in the following areas:

commodities (products that can be bought or sold);

means of transport;

businesses;

persons;

fraud trends;

availability of expertise;

items detained, seized or confiscated;

cash detained, seized or confiscated

Customs cooperation/ Customs information system (CIS) system

The aim is

- It seeks to strengthen administrative cooperation (mutual assistance) among national authorities and between the authorities and the European Commission regarding the application of EU customs and agricultural legislation.
- The customs information system (CIS) helps to prevent, investigate and prosecute breaches of EU customs or agricultural legislation.
- It increases the effectiveness of the cooperation and control procedures of the national authorities by disseminating data and information quickly.
- The system also enables data exchange on goods moving between the customs territory of the EU and non-EU countries.

Customs cooperation/ **Close cooperation between EU customs administrations (Naples II Convention)**

The aim is

- It replaces and strengthens the original Naples Convention agreed in 1967.
- It covers mutual assistance and cooperation between national authorities in prevention, investigation and prosecution of certain infringements of European Union (EU) and national customs rules

Customs cooperation/

Close cooperation between EU customs administrations (Naples II Convention)

KEY POINTS

- EU countries' authorities need to cooperate with each other in order to successfully tackle **customs fraud** and **transnational trafficking**, and to **prosecute** and **punish the offenders**.
- EU customs include agricultural levies, harmonised excise duties on alcohol, tobacco and mineral oil and turnover tax on imports from non-EU countries. The convention does not cover **value added tax**.
- The convention applies to national customs rules including those relating to drugs, weapons and child pornography, as well as non-harmonised excise duties.
- The convention considers '**infringements**' in a broad sense, including attempted infringements and all forms of participation, such as instigation and being involved as an accessory, as well as association with a criminal organisation and money laundering.
- **Mutual assistance** between customs authorities is given following a **request** for information, surveillance, enquiries or notification; or spontaneously, without prior request, including covert surveillance and spontaneous provision of information.
- **Requests** are normally exchanged between the central coordinating units appointed within each national customs administration.
- **Requests** are in principle **made in writing**, giving the reason for the request, the relevant facts and the rules and legislation involved. However, in **emergency situations**, oral requests are accepted but must be confirmed in writing as soon as possible.
- Customs administrations must provide each other with the **necessary staff** and **organisational support** when cooperating on cross-border issues such as
 - hot pursuit — cross-border pursuit of suspects;
 - cross-border surveillance;
 - covert investigations;
 - joint special investigation teams; and
 - controlled deliveries — illicit deliveries which are not seized at the border, but are tracked to their final destination.
- Cross-border cooperation focuses on illicit drugs, weapons, munitions, explosives, cultural goods, dangerous and toxic waste, nuclear materials and equipment for biological and chemical weapons.

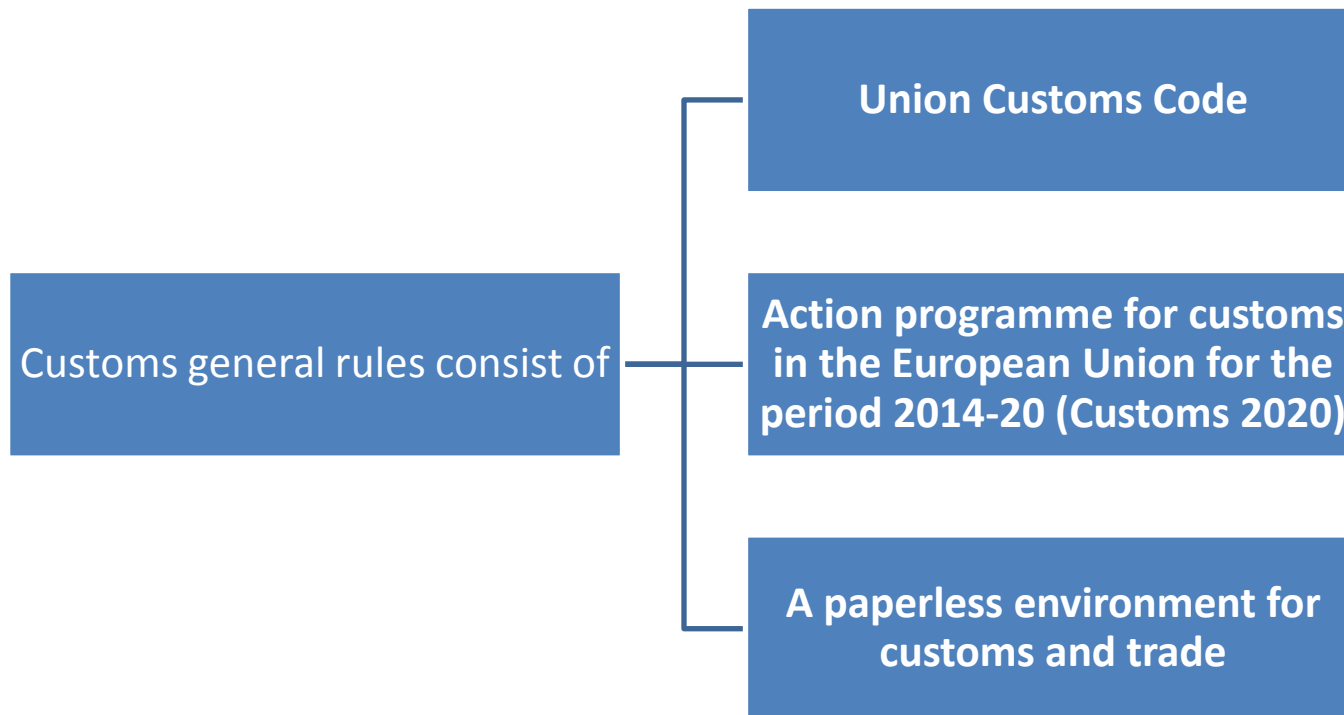
Money laundering: prevention through customs cooperation

Money laundering: prevention through customs cooperation. The aim is: It complements the rules of Directive (EU) 2015/849 on prevention of the use of the financial system for the purpose of money laundering and terrorist financing within the EU.

Obligation to declare

- The regulation places an obligation on any individual entering or leaving the EU and carrying cash* of a value of €10,000 or more to declare that sum to the competent authorities*. The information provided must be correct and complete, otherwise the declaration is invalid.
- The declaration is provided in writing, orally or electronically, to be determined by the EU country, and must contain information on:
 - the declarant, including full name, date and place of birth and nationality;
 - the owner and the amount and nature of the cash;
 - the intended recipient of the cash;
 - the provenance and intended use of the cash.
- The information obtained, either from the declaration or as a result of controls, must be recorded and processed. It is made available to the authorities responsible for combating money laundering or terrorist financing in the EU country of entry or of exit. The information provided may be communicated to non-EU countries by the EU countries or by the [European Commission](#), subject to the consent of the competent authorities. The national and EU rules on the transfer of personal data must be complied with.
- Professional secrecy covers all information which is by nature confidential or which is provided on a confidential basis. It must not be disclosed without the express permission of the person or authority providing it. However, the competent authorities may be obliged by law to disclose this information, for instance in connection with legal proceedings. In such a case, any disclosure or communication of information must fully comply with prevailing data protection legislation.

Customs-General Rules



Customs-General Rules/ **Union Customs Code**

Union Customs Code

The regulation establishes the Union Customs Code (UCC), setting out the general rules and procedures applicable to goods brought into or taken out of the customs territory of the European Union, adapted to modern trade models and communication tools.

The UCC and the related delegated and implementing acts (adopted by the European Commission under the regulation) aim to:

- offer greater legal certainty and uniformity to businesses;
- increase clarity for customs officials throughout the EU;
- complete the shift by customs to a paperless and fully electronic environment;
- simplify customs rules and procedures and facilitate more-efficient customs transactions in line with modern-day needs;
- reinforce swifter customs procedures for compliant and trustworthy businesses (authorised economic operators);
- safeguard the financial and economic interests of the EU and of the EU Member States as well as the safety and security of EU citizens.

UCC aims to:

Streamline and simplify customs legislation and procedures, building on existing concepts

- It clarifies rules, such as those on release of goods for free circulation and on special procedures.
- It contains most of the EU customs legislation in one package and provides precise rules of application.
- It defines data requirements for customs, pre-arrival and pre-departure declarations, notifications, applications and decisions in an integrated way. The EU Customs Data Model has been designed, in line with international standards like the World Customs Organisation (WCO) data model, to assist national customs authorities in adapting the data requirements to their systems.
- All of this is designed to contribute to a harmonised implementation of customs rules and procedures across the EU.

UCC aims to

Simplicity

Service

- The design of the UCC has taken into account to a large extent the daily needs and existing practices of trade. For instance, it allows the use of electronic transport manifests for customs purposes and the moving of goods under temporary storage without lodging a transit declaration and it envisages new forms to extinguish a customs debt.
- It introduces modern concepts, such as centralised clearance, and offers more uniformity to business, by providing uniform and harmonised rules on guarantees, for example.
- It also reduces the administrative burden on compliant and trustworthy economic operators (AEOs) by allowing a number of simplifications of customs procedures, and of the use of guarantees, and by allowing self-assessment of customs debts under certain conditions.

Speed

- The UCC strives for further automation of all exchange and storage of information through additional IT systems that integrate the new processes and legal requirements, such as common and shared services to customs and harmonised interfaces and EU portals for trade.

UCC aims to:

Transition to fully electronic customs

- While the substantive provisions of the UCC entered into force on 1 May 2016 a transition period is necessary before full implementation can be achieved. This is primarily due to the fact that there is a need to develop new IT systems or upgrade existing ones in order to fully implement the legal requirements. This transition period currently lasts until 31 December 2020 at the latest, but the Commission has recently proposed that the transitional period to be extended to 2025 for a small number of customs formalities managed by electronic systems that may not be fully completed until 2025

Customs-General Rules /Action programme for customs in the European Union for the period 2014-20 (Customs 2020)

This is a regulation setting out a programme to support and modernise the EU's customs union by stepping up cooperation between customs authorities. It aims to support customs authorities to **protect the financial and economic interests** of the EU and EU countries, including combating fraud and protecting intellectual property rights

The programme's operational objectives include:

- developing, improving, operating and supporting European information system for customs;
- identifying, developing, sharing and applying best working practices and administrative procedures;
- reinforcing customs officials' skills and competences;
- improving cooperation between customs authorities and international organisations, non-EU countries, other governmental authorities, including EU and national market surveillance authorities, as well as businesses and their representative organisations.

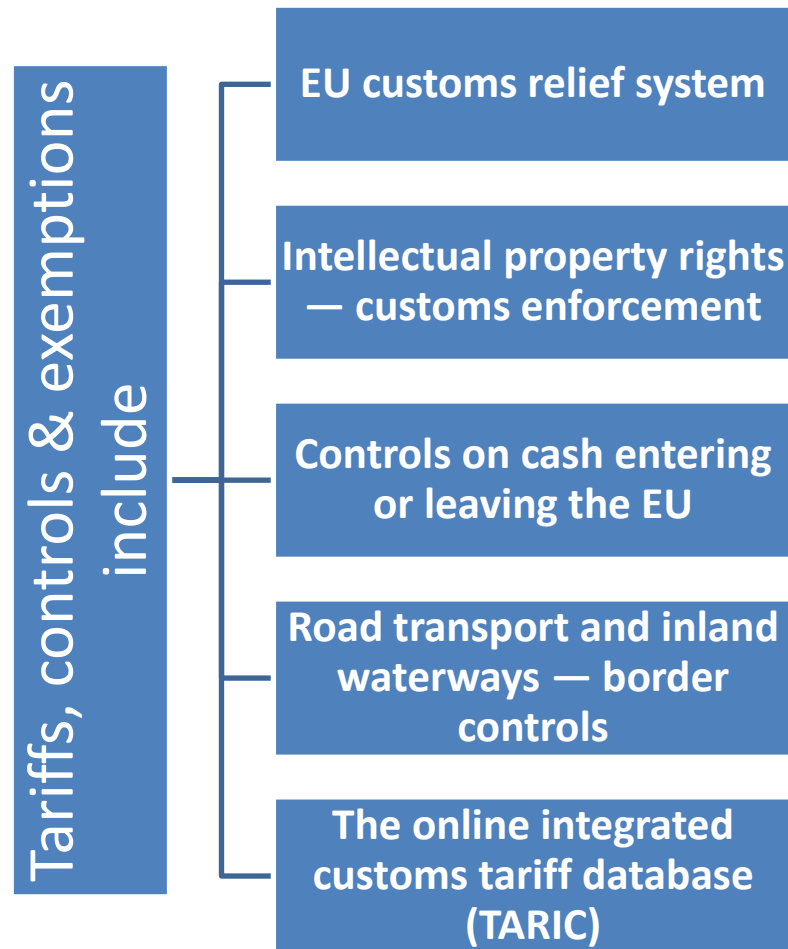
Customs-General Rules/A paperless environment for customs and trade

It aims to promote electronic customs (e-customs) in the European Commission. Such systems facilitate trade by reducing costs and coordinating procedures. They also permit the exchange of data between the customs administrations of EU countries, traders and the Commission. In this way, they improve and facilitate supply chain logistics and customs processes.

Following on from the 2003 communication on creating a simple and paperless environment for customs and trade, it was agreed under this decision that the Commission and the EU countries would set up:

- secure;
- integrated;
- interoperable; and
- accessible e-customs systems for the exchange of
 - data contained in customs declarations
 - documents accompanying customs declarations and certificates and
 - other relevant information

Tariffs, controls & exemptions



Tariffs, controls & exemptions/ EU customs relief system

The aim:

It allows for the granting of relief from the duties that would normally be payable on goods both imported into and exported out of the EU

It sets out the cases in which relief from import and export duties

Relief from import duties

There are various categories of goods which are eligible for relief from import duties. Subject to certain conditions, goods are free from import duties when they concern:

- Personal property
- Goods of negligible value, non-commercial goods, capital goods and goods contained in travellers' personal luggage
- Agricultural, biological, chemical, pharmaceutical and medical products
- Other categories

Relief from export duties

There are various categories of goods which are eligible for relief from export duties. Subject to certain conditions, goods are free from export duties when they concern:

- goods of **negligible value**;
- **domesticated animals** exported when an agricultural undertaking transfers its activities from an EU to a non-EU country;
- **agricultural** or stock-farming products obtained by non-EU farmers in adjoining countries;
- seeds exported by agricultural producers for use on properties in non-EU countries;
- fodder and feedingstuffs accompanying animals during their exportation.

Tariffs, controls & exemptions/ Intellectual property rights — customs enforcement

The regulation provides revised procedural rules for customs authorities to enforce intellectual property rights (IPR) on goods liable to customs supervision or customs control.

This regulation particularly covers goods in the following situations:

- when declared for release for free circulation, export or re-export;
- when entering or leaving the customs territory of the EU;
- when the goods are suspended from customs clearance or are in a free zone or free warehouse

The regulation:

- sets out the conditions for customs action where goods are merely suspected of infringing IPRs;
- sets out measures to be taken against goods that have been found to infringe IPRs;
- **expands the range of IPR infringements** covered and reinforces the competence of customs authorities to control all goods under customs supervision — this does not apply to non-commercial goods in travellers' personal luggage;
- ensures that **high-quality information** is provided to customs to enable a comprehensive assessment of the risk of IPR infringement;
- sets out the legal basis for a **central database** for recording the applications for customs action and detentions of IPR-infringing goods as well as the exchange of information between customs authorities.

Tariffs, controls & exemptions/ **Controls on cash entering or leaving the EU**

The regulation introduces controls on cash entering or leaving the EU.

Anyone entering or leaving the EU with €10.000 or more must declare the cash to that country's authorities and provide the following information, either in writing or electronically:

- full personal details, such as name, nationality and date of birth, of the carrier, the owner and the intended recipient of the cash;
- value and nature of the cash, its origin, its intended use and the method of transport.

Tariffs, controls & exemptions/ **Road transport and inland waterways — border controls**

The regulations abolish controls performed by EU countries of compliance with rules in the fields of road and inland waterway transport at the internal borders of the EU. To ensure the free movement within the EU of the vehicles and vessels concerned, these controls are no longer to be performed as border controls but solely as part of the normal control procedures applied in a non-discriminatory fashion throughout the territory of the EU countries

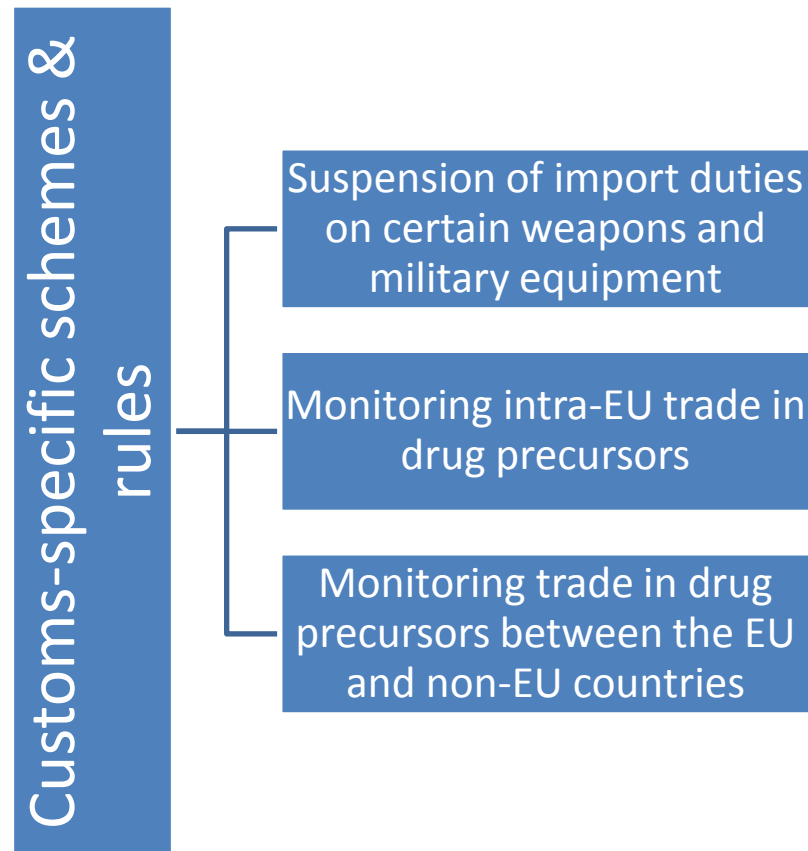
Tariffs, controls & exemptions/ **The online integrated customs tariff database (TARIC)**

It sets up the legal basis for TARIC, the integrated tariff of the EU, and introduces a common system for coding and classifying goods known as the Combined Nomenclature (CN), essential for processing and publishing EU trade statistics.

TARIC, the integrated tariff of the EU, is a database which brings together commercial and agricultural legislation and customs tariffs. This ensures there is uniform application by EU countries and gives a clear view of all measures to be undertaken by those involved in importing into the EU or exporting goods from the EU.

TARIC contains all customs duty rates and certain EU rules applicable to external trade. It does not contain information relating to national taxes such as VAT

Customs-specific schemes & rules



Customs-specific schemes & rules/**Suspension of import duties on certain weapons and military equipment**

Its purpose is to suspend import duties on certain weapons and military equipment to allow the EU countries' authorities in charge of defence to procure the best military material available in the world. It is only applicable to goods imported by or on behalf of the defence authorities in EU countries

The regulation suspends the common customs tariff duties applicable to weapons and military materials on condition the goods are used by (or on behalf of) the EU country's armed forces, for example:

- in the territorial defence of EU countries,
- participation in international peace keeping,
- other missions such as the protection of EU citizens

The goods on which the duties are suspended are arms and ammunition, including parts and accessories, certain rare gases, explosives, detonators, certain photographic materials and certain chemical products

Private companies established in the EU will only be able to import the goods duty-free provided that they manufacture the relevant military equipment, and that they supply final products to the authorities in charge of defence in the EU countries. All other uses are liable for customs duties.

Customs-specific schemes & rules/ **Monitoring intra-EU trade in drug precursors**

It implements the EU's obligations under the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) which requires measures to be taken to monitor the placing on the market of drug precursors.

It lays down measures to control and monitor the trade of drug precursors within the EU

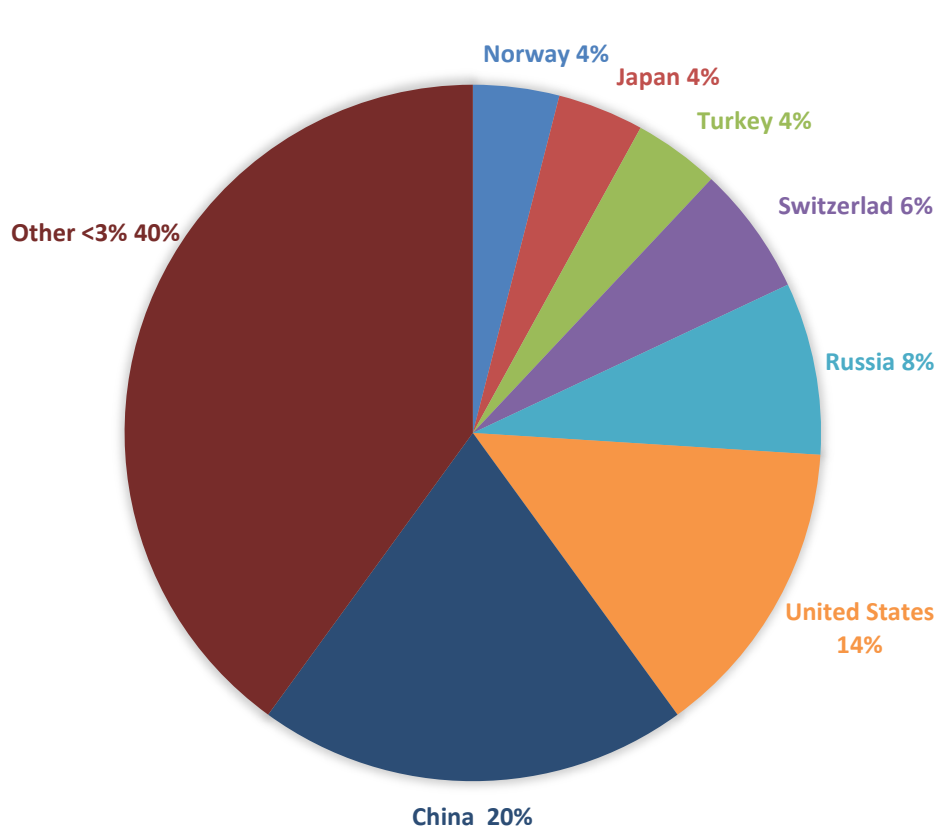
Customs-specific schemes & rules/ **Monitoring trade in drug precursors between the EU and non-EU countries**

It implements the EU's obligations under the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) which requires measures to be taken to monitor the placing on the market of drug precursors.

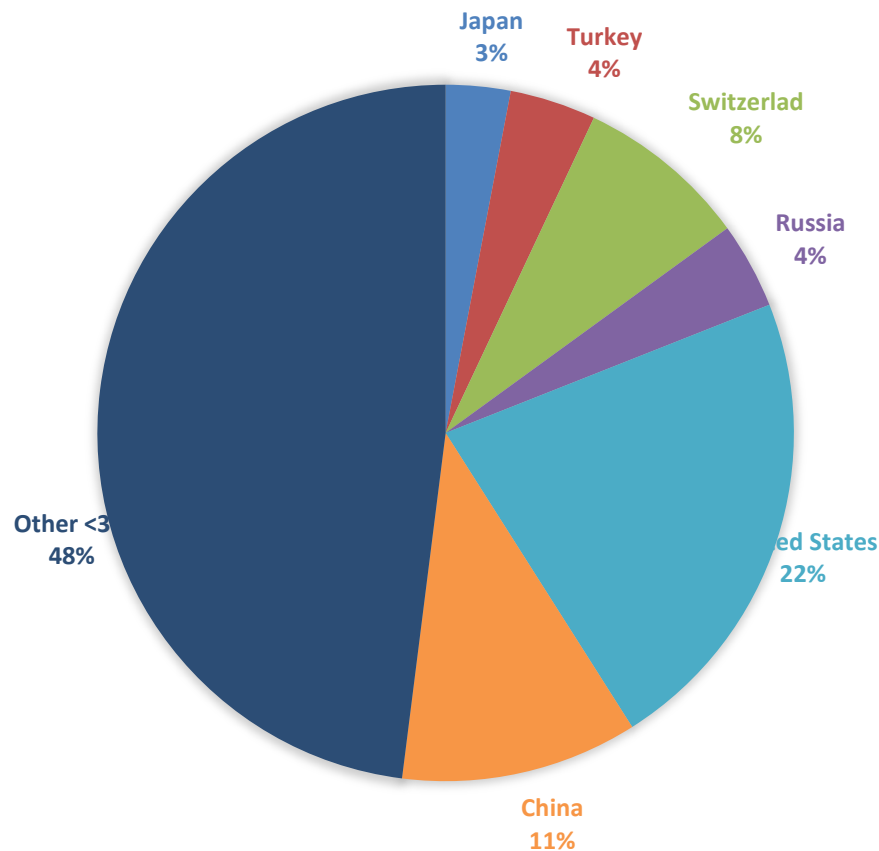
It lays down measures to control and monitor trade between EU and non-EU countries

The EU is the largest trading block in the world, accounting for over 15% of the world trade, alongside the United States and China. In 2019, the value of the EU trade with other countries amounted to EUR 4.09 trillion. Half of EU external trade was mainly with five main partners: the United States, China, Switzerland, Russia and Turkey.

IMPORT 2019 EUR 2,05 TRILLION



EXPORT 2019 EUR 2,04 TRILLION



Questions

- Please give a brief history of origination of European Customs Union
- What are the main elements of Customs Cooperation? Disclose its characteristics
- Please describe the blocks of Customs general rules
- What is the mechanism of acting the Union Customs Code (UCC) and its aims
- Disclose divisions and their specificity in Tariffs, controls & exemptions
- Which blocks of trade does Customs-specific schemes & rules cover?
- Describe the state of trade turnover among EU members and non-EU countries

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Role of European Union in trade facilitating. Trade Facilitation Agreement

WTO members concluded negotiations at the 2013 Bali Ministerial Conference on the landmark Trade Facilitation Agreement (TFA), which entered into force on 22 February 2017 following its ratification by two-thirds (112 WTO members) of the WTO membership.

The Trade Facilitation Agreement has three sections:

- Section I contains provisions for expediting the movement, release and clearance of goods, including goods in transit. It clarifies and improves the relevant articles of the General Agreement on Tariffs and Trade (GATT) 1994. It also sets out provisions for customs cooperation.
- Section II contains special and differential treatment (SDT) provisions that allow developing and least-developed countries (LDCs) to determine when they will implement individual provisions of the Agreement and to identify provisions that they will only be able to implement upon the receipt of technical assistance and support for capacity building.
- Section III contains provisions that establish a permanent committee on trade facilitation at the WTO, require members to have a national committee to facilitate domestic coordination and implementation of the provisions of the Agreement. It also sets out a few final provisions.

Special and Differential Treatment Provisions for Least Developed Countries (LDC)

To take advantage of these SDT flexibilities a Member must place each provision of the Agreement into one of three categories (A, B or C) as defined below:

- **Category A:** provisions that an LDC Member designates for implementation within one year of the Agreement entering into force
- **Category B:** provisions that an LDC Member designates for implementation after a transitional period of time after entry into force of the Agreement
- **Category C:** provisions that an LDC Member designates for implementation after a transitional period of time and the provision of assistance and support for capacity building

The Agreement also provides additional protections for LDC Members such as:

- **Early Warning Mechanism:** whereby a Member can request an extension from the WTO Trade Facilitation Committee if it experiences difficulties in implementing a provision in Category B or C by the date it had notified. The extension will be automatic if the additional time requested does not exceed 3 years.
- **Expert Group:** where a requested extension has not been granted and a Member lacks capacity to implement, The TF committee will establish an Expert Group to examine the issue and to make a recommendation.
- **Shifting between Categories:** Members may shift provisions between Categories B and C.
- **Grace Period:** following entry into force of the Agreement, LDCs will not be subject to the Dispute Settlement Understanding for a period of 6 years for Category A provisions and for 8 years for Categories B and C.

Special and Differential Treatment for Developing Countries

To take advantage of these SDT flexibilities a Member must place each provision of the Agreement into one of three categories (A, B or C) as defined below:

- **Category A:** provisions that a developing country Member designates for implementation by the time the Agreement enters into force
- **Category B:** provisions that a developing country Member designates for implementation after a transitional period of time after entry into force of the Agreement
- **Category C:** provisions that a developing country Member designates for implementation after a transitional period of time following the entry into force of the Agreement and the provision of assistance and support for capacity building

The Agreement also provides additional protections for Developing country Members such as:

- **Early Warning Mechanism:** whereby a Member can request an extension from the WTO Trade Facilitation Committee if it experiences difficulties in implementing a provision in Category B or C by the date it had notified. The extension will be automatic if the additional time requested does not exceed 18 months
- **Expert Group:** where a requested extension has not been granted and a Member lacks capacity to implement, the TF committee will establish an Expert Group to examine the issue and to make a recommendation
- **Shifting between Categories:** Members may shift provisions between Categories B and C
- **Grace Period:** Following entry into force of the Agreement developing countries will not be subject to the Dispute Settlement Understanding for a period of 2 years for Category A provisions.

Benefits of the TFA

Estimates show that the full implementation of the TFA could reduce trade costs by an average of 14.3% and boost global trade by up to \$1 trillion per year, with the biggest gains in the poorest countries. For the first time in WTO history, the requirement to implement the Agreement is directly linked to the capacity of the country to do so. A Trade Facilitation Agreement Facility (TFAF) has been created to help ensure developing and least-developed countries obtain the assistance needed to reap the full benefits of the TFA.

Technical assistance and capacity building

Technical assistance for trade facilitation is provided by the WTO, WTO members and other intergovernmental organizations, including the World Bank, the World Customs Organization and the United Nations Conference on Trade and Development (UNCTAD)

In July 2014, the WTO announced the launch of the Trade Facilitation Agreement Facility , which assists developing and least-developed countries in implementing the Trade Facilitation Agreement. The Facility became operational with the adoption of the Trade Facilitation Protocol on 27 November 2014

Trade Facilitation Agreement Facility

The aim of this new initiative, entitled the WTO Trade Facilitation Agreement Facility (TFAF)

to help ensure that this assistance is provided to all those that require it

The functions of the Facility will include:

- supporting LDCs and developing countries to assess their specific needs and identify possible development partners to help them meet those needs
- ensuring the best possible conditions for the flow of information between donors and recipients through the creation of an information sharing platform for demand and supply of Trade Facilitation-related technical assistance
- disseminating best practice in implementation of Trade Facilitation measures
- providing support to find sources of implementation assistance, including formally requesting the Director-General to act as a facilitator in securing funds for specific project implementation
- providing grants for the preparation of projects in circumstances where a Member has identified a potential donor but has been unable to develop a project for that donor's consideration, and is unable to find funding from other sources to support the preparation of a project proposal
- providing project implementation grants related to the implementation of Trade Facilitation Agreement provisions in circumstances where attempts to attract funding from other sources have failed. These grants will be limited to "soft infrastructure" projects, such as modernization of customs laws through consulting services, in-country workshops, or training of officials.

Trade Facilitation Agreement Facility

TFA Facility offers:

- the Facility will support LDCs and developing countries to assess their specific needs and identify possible development partners to help them meet those needs
- ensures the best possible conditions for the flow of information between donors and recipients by creating an information-sharing platform for the demand and supply of TFA-related technical assistance
- helps Members to access help in matching Members with donor funds to implement their projects
- the Facility will provide funds for the exceptional cases where countries have made thorough attempts to find assistance but have failed to receive the support they need

The facility provides for two types of funds:

- The first is a grant to help in the preparation of projects. These funds may be given when a Member has identified a potential donor but has been unable to develop a project for that donor's consideration. In this case, funding of up to 30,000 US dollars can be provided to fund expert support to help prepare the project proposal.
- The second type of fund is for project implementation — specifically for “soft infrastructure” projects, such as modernization of customs laws through consulting services, in-country workshops, or training of officials. If a country finds itself in the situation where it simply cannot find a donor — even with our help — then they can apply to the Facility for a grant of up to 200,000 US dollars to implement their project.

How does TFA facilitates the trade?

Release and clearance of goods

- Time is a valuable commodity. Several TFA provisions will facilitate more rapid movement of goods across borders such as through the release of products even before the final determination of customs duties, expediting shipments from certain air cargo, and prioritizing perishable goods.

Availability of information on rules and procedures

- Information is key, more so for traders that have to navigate foreign markets and regulations. The TFA states, that WTO members shall publish information online on import and export procedures while within available resources, establishing contact points to respond to enquiries

Automation and e-services

- Going digital can help make trade easier. Under the TFA, there are provisions requiring WTO members to accept e-payments and electronic versions of certain documents where appropriate and possible.

How does TFA facilitates the trade?

Disciplines for fees and penalties

- Several TFA provisions address how fees and penalties are imposed on traders. For example, fees and charges for customs processing of imports and exports shall be limited to the approximate cost of the services rendered.

Harmonized processes and standards

- Traders find it helpful when rules and procedures are predictable and familiar across borders. They like it too when authorities coordinate with one another. The TFA contains articles on Border Agency Cooperation and Customs Cooperation and it states that WTO members establish a single window or entry point to participating authorities or agencies

Consultations and appeals

- The TFA provides opportunities for traders and other interested parties to comment on proposed rules related to the movement of goods. It also states, that WTO members shall provide a right to appeal customs administrative decisions

Assistance for implementation

- The TFA recognizes particular needs of developing countries and especially LDCs. It provides for special and differential treatment for these members as they seek to implement the agreement. A Trade Facilitation Agreement Facility (TFAF) was also created to help ensure they receive the assistance needed to reap the full benefits of the TFA and to support the ultimate goal of full implementation.

Trade Facilitation Agreement Facility

The WTO Trade Facilitation Agreement Facility (TFAF) will support developing and LDC members to assess their specific needs for implementing the agreement and to identify possible development partners by providing:

- Help in preparing A, B, C, notifications
- Training and information materials to ensure that WTO members fully understand the Agreement
- Support to access the available implementation assistance from various donors and organizations
- And two types of grants (project preparation and project implementation) related to Category C notifications when no other funding source is available

The European Union promotes and plays a leading role in trade facilitation by:

- ensuring forward looking implementation of the TFA;
- acting both as an example to follow and an engine for further progress;
- continuing to provide technical assistance and capacity building to help others meet their obligations.

The Europe Region offers a unique combination of challenges and opportunities to conduct and achieve a full implementation of the TFA:

- a combination of developed and developing Members BUT allowing thus having in the same region both donors and beneficiaries of assistance and support to capacity building;
- a high number of countries (WTO and non WTO members) - and, as a consequence of borders, in most cases engaged in sub-regional economic integration through FTAs or Customs Unions and/or in regional or bilateral agreements or initiatives aiming at enhancing customs cooperation, security, cross-border facilitation for goods, means of transport and persons and transit;

Implementation of the TFA deserves clear political will and commitment and a strong coordination of efforts in each Member, in particular through the setting up of **National Committees for Trade Facilitation (NCTF)**, allowing the public authorities and private parties to find appropriate balance between facilitation and controls and to overcome traditional resistance to change

A key enabling role

to customs in the
implementation of the TFA
and the NCTF

Workshop on the implementation of the WTO Trade Facilitation Agreement in the European Union in Clermont-Ferrand in 2016 offered the opportunity to identify challenges, share experiences and express innovative ideas on trade facilitation, international development and the modernisation of customs by:

- recalling the context and presenting the state of play and the future of the implementation of the TFA in the European Union and its Member States;
- benefitting from the perspectives of the World Customs Organisation, of FERDI-Université d'Auvergne and four partner countries (Burkina Faso, Cameroon, Côte d'Ivoire and Senegal), and of companies actively involved in international trade and customs activities (Michelin, Valrhona, Limagrain);
- elaborating on progress regarding AEO programmes and Single Window within the context of TFA implementation

EU continues playing a leading role in Trade Facilitation by:

ensuring forward looking implementation;

acting both as an example to follow and an engine for further progress;

continuing to provide technical assistance and capacity building to help others meet their obligations

Facilitation and customs increasingly feature in European agreements with 3rd countries, covering such matters as:

- simplification of requirements and formalities in respect of the release and clearance of goods, including, collaboration on the development of procedures enabling the submission of import or export data to a single agency,
- improved working methods and ensuring transparency and efficiency of customs operations,
- reduction, simplification and standardisation of data in the documentation required by customs,
- application of modern customs techniques, including risk assessment, simplified procedures for entry and release of goods, post release controls, and company audit methods

The European Commission actively participates in, and works with international organisations such as the World Customs Organisation (WCO) on customs and trade issues

WCO accepted the request of the European Union to join the WCO as of 1st July 2007



EU involvement in the WCO focus on the full spectrum of customs issues, in particular the following broad areas:

- Nomenclature and classification in the framework of the Harmonised system;
- Origin of goods;
- Customs value;
- Simplification and harmonisation of customs procedures and trade facilitation;
- Development of supply chain security standards;
- Development of IPR enforcement standards;
- Capacity building for customs modernisation and reforms, including in the context of development cooperation;
- Mutual Administrative Assistance for the prevention, investigation and repression of customs offences.

At the 2019 WCO Council Sessions, Members endorsed a new Strategic Plan for the 2019-2022 period, comprising ten priorities that the WCO Secretariat should focus on:

- COVID-19 Action Plan,
- Coordinated Border Management,
- Safety and Security,
- the Revised Kyoto Convention,
- E-Commerce,
- the Harmonized System,
- the Capacity Building Strategy,
- Performance Measurement,
- Integrity,
- Digital Customs and Data Analytics

The European Commission provides advice on technical assistance and capacity building projects and programmes.

This includes assistance and advice on the design and management of customs and tax administrations (blueprints), and also includes resources for consultation, planning, and co-ordination of actions in this field.

Customs blueprints

The customs blueprints aim to help improve the operational capacity of customs services by setting standards of achievement in key areas, including measurable indicators.

They can be used as benchmark against which to measure shortfalls and plan subsequent improvements.

The Customs blueprints assist the EU Commission and EU countries in coordinating and targeting of the assistance provided to customs administrations in non-EU countries, in particular enlargement countries and other neighbouring countries.

The Blueprints are particularly useful for:

- enlargement countries that need to adopt the EU acquis and ensure adequate operational capacity while preparing to implement EU legislation and procedures in time for accession.
- countries seeking to facilitate trade or joining a free trade area or a customs union.

Questions

- Please disclose brief history of TFA appearance
- What is the structure of TFA and significance of each element?
- What is the sense of Special and Differential Treatment Provisions for Least Developed Countries?
- Please list categories of provisions of the Agreement
- What is the sense of Special and Differential Treatment for Developing Countries?
- Please specify additional protections for LDC Members and for Developing Countries Members
- What does TFA Facility offer?
- Which types of funds does TFAF provide?
- What is the main aim and functions of TFAF?
- What is the role of Europe Region to conduct and achieve a full implementation of the TFA?
- What is the focus of EU involvement in the WCO?

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Corporate governance in European Union

The purpose of EU rules in corporate governance is to

- enable businesses to be set up and to carry out operations anywhere in the EU
- provide protection for shareholders and other parties with a particular interest in companies, such as employees and creditors
- make business more efficient, competitive and sustainable in the long term
- encourage businesses based in different EU countries to cooperate with each other.

What is European Union is doing in corporate governance area?

- EU company law rules cover issues such as the **formation, capital and disclosure requirements, and operations (mergers, divisions) of companies**
- EU company law rules also address **corporate governance issues**, focusing on relationships between a **company's management, board, shareholders and other stakeholders**, and therefore, on the ways the company is managed and controlled
- The corporate governance issues were also identified as an important area to focus on in the context of implementation of the **Commission Action plan on financing sustainable growth**
- Specific rules on **corporate governance and remuneration apply to banks and investment firms. The aim of these rules is** to curb excessive risk taking, and thereby help ensure financial stability

EU company law is now codified in a single Directive - Directive 2017/1132 **relating to certain aspects of company law**

The Directive 2019/1151 of 20 June 2019 covers provisions on the use of digital tools and processes in company law. Member States need to transpose this Directive by August 2021 (with longer deadline for some specific provisions). 16 Member States (Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Finland, France, Hungary, Luxembourg, Netherlands, Poland, Romania, Slovenia, Slovakia, Sweden) have availed of the possibility provided by the Directive to have an extension of the transposition period by one year, i.e. by August 2022

The Directive EU 2019/2121 of 27 November 2019 lays down new rules on cross-border conversions and divisions and amends the rules on cross-border mergers. Member States need to transpose this Directive by January 2023. This new set of rules will enable companies to use digital tools in company law procedures and to restructure and move cross-border, while providing strong safeguards against fraud and to protect stakeholders. These new Directives revise and complement Directive 2017/1132.

Directive 2012/17/EU and Commission Implementing Regulation (EU) 2020/2244 set out rules on the **system of interconnection of business registers ('BRIS')**. BRIS is operational since 8 June 2017. It allows EU-wide electronic access to company information and documents stored in Member States' business registers via the European e-Justice Portal. BRIS also enables business registers to exchange between themselves notifications on cross-border operations and on branches.

Directive 2009/102/EC provides a framework for setting up **single-member companies**

Two Regulations provide rules on EU legal entities:

- **Regulation 2157/2001** sets out a statute for a **European Company (Societas Europea or 'SE')**, i.e. a EU legal form for public limited liability companies, and allows companies coming from different Member States to run their business in the EU under a single European brand name
- **Regulation 2137/85** sets out a statute for a **European Economic Interest Grouping (EEIG)**, i.e. a EU legal form for a grouping formed by companies or legal bodies and/or natural persons carrying out economic activity coming from different Member States; the purpose of such a grouping is to facilitate or develop the cross-border economic activities of its members.

Corporate governance issues, focusing on relationships between a company's management, board, shareholders and other stakeholders

Shareholders rights Directive 2007/36/EC sets out certain rights for shareholders in listed companies. This Directive was amended by Directive (EU) 2017/828, which aims to encourage more long-term engagement of shareholders.

Furthermore, the 2018 Commission Implementing Regulation (EU) 2018/1212 lays down minimum requirements as regards shareholder identification, the transmission of information and the facilitation of the exercise of shareholders rights.

Takeover bids Directive 2004/25/EC sets out minimum standards for **takeover bids** (or changes of control) involving securities of EU companies.

Commission Action plan on financing sustainable growth

Corporate governance defines relationships between a company's management, its board, its shareholders and its other stakeholders. It determines the way companies are managed and controlled.

This Action Plan outlines the initiatives that the Commission intends to take in order to modernise the company law and corporate governance framework. It identifies three main lines of action:

- **Enhancing transparency** – companies need to provide better information about their corporate governance to their investors and society at large. At the same time companies should be allowed to know who their shareholders are and institutional investors should be more transparent about their voting policies so that a more fruitful dialogue on corporate governance matters can take place.
- **Engaging shareholders** – shareholders should be encouraged to engage more in corporate governance. They should be offered more possibilities to oversee remuneration policy and related party transactions, and shareholder cooperation to this end should be made easier. In addition, a limited number of obligations will need to be imposed on institutional investors, asset managers and proxy advisors to bring about effective engagement.
- **Supporting companies' growth and their competitiveness** – there is a need to simplify cross-border operations of European businesses, particularly in the case of small and medium-sized companies.

Enhancing transparency

- Disclosure of board diversity policy and management of non-financial risks.
- Improving corporate governance reporting.
- Shareholder identification
- Strengthening transparency rules for institutional investors.

Engaging shareholders

- Better shareholder oversight of remuneration policy.
- Better shareholder oversight of related party transactions.
- Regulating proxy advisors.
- Clarification of the relationship between investor cooperation on corporate governance issues and the 'acting in concert' concept.
- If such clarification is not provided, shareholders may avoid cooperation, which in turn could undermine the potential for long-term engaged share ownership under which shareholders effectively hold the board accountable for its actions.
- Employee share ownership.

Improving the framework for cross-border operations of EU Companies

- Transfer of seat.
- Improving the mechanism for cross-border mergers
- Enabling cross-border divisions
- Smart legal forms for European SMEs
- Promoting and improving awareness of the European Company (SE) and the European Cooperative (SCE) Statutes
- Groups of companies

OECD Principles of Corporate Governance

- Ensuring the Basis for an Effective Corporate Governance Framework
- The Rights of Shareholders and Key Ownership Functions
- The Equitable Treatment of Shareholders
- The Role of Stakeholders in Corporate Governance
- Disclosure and Transparency
- The Responsibilities of the Board

Ensuring the Basis for an Effective Corporate Governance Framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

- The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.
- The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.
- The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.
- Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

The Rights of Shareholders and Key Ownership Functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights

- Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.
- Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company
- Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings
- Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed
- Markets for corporate control should be allowed to function in an efficient and transparent manner
- The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated
- Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

The Equitable Treatment of Shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

- All shareholders of the same series of a class should be treated equally
- Insider trading and abusive self-dealing should be prohibited
- Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation

The Role of Stakeholders in Corporate Governance

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

- The rights of stakeholders that are established by law or through mutual agreements are to be respected.
- Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.
- Performance-enhancing mechanisms for employee participation should be permitted to develop.
- Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.
- Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.
- The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights

Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company

- Disclosure should include, but not be limited to, material information on: 1. The financial and operating results of the company. 2. Company objectives. 3. Major share ownership and voting rights. 4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board. 5. Related party transactions. 6. Foreseeable risk factors. 7. Issues regarding employees and other stakeholders. 8. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.
- Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.
- An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.
- External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.
- Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.
- The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice

European Commission Directive 2006/46/EC required all listed companies to produce a corporate governance statement in their annual report to shareholders

The European Commission is described as “the only body paid to think European.” The Treaty on European Union identifies the responsibilities of the Commission to include the following:

- Developing strategies;
- Drafting legislation and arbitrating in the legislative process;
- Representing the EU in trade negotiations;
- Making rules and regulations;
- Drawing up the budget of the European Union;
- Scrutinizing the implementation of the treaties and legislation.

Action plans, published by the European Commission in 2003 and 2012

EU Action Plan (2003). This plan (European Commission 2003a) was based on a report by the High Level Group of company law experts chaired by Jaap Winter (Winter Report 2002). The plan established four main pillars for corporate governance reforms:

- **Modernizing the board of directors**—The Commission’s recommendations (all adopted in 2005) concerned the following: Executive versus non-executive directors; Independent directors; Directors’ remuneration; Collective responsibility
- **Enhancing corporate governance disclosure**—The Commission required all listed companies in the EU to include in their annual report a comprehensive corporate governance statement covering the key elements of their governance structures and practices based on a “comply or explain” principle.
- **Strengthening shareholders’ rights**—The Commission requires that shareholders should have similar rights throughout the EU
- **Coordinating corporate governance initiatives in member states**—These recommendations focused on the development of national corporate governance codes and the monitoring and enforcement of compliance and disclosure.

Europe 2020 was launched in 2010 and is the European Union's 10-year growth and jobs strategy. It sets five headline targets for the EU to achieve by the end of 2020. These cover the following areas:

- Employment;
- Research and development;
- Climate/energy;
- Education;
- Poverty reduction and social inclusion.

The objectives of the Europe 2020 strategy are supported by seven flagship initiatives:

- Innovation;
- The digital economy;
- Employment;
- Youth;
- Industrial policy;
- Poverty;
- Resource efficiency

EU Action Plan (2012) was adopted in 2012 to increase long-term growth-orientated investment that will lead to more competitive and sustainable companies in the long term. The following are some of the plan's key measures to enhance transparency:

- **Board structure**—The Commission acknowledged the coexistence of different board models deeply rooted in national legal systems, stating that it would not pursue board-structure harmonization.
- **Shareholder identification and engagement**—The Commission recommended better mechanisms for companies to identify shareholders and to enhance shareholder engagement. The plan strengthens transparency rules for institutional investors, including disclosure of institutional investors' voting and better shareholder control over related-party transactions. The Commission intends to investigate whether employee share ownership should be encouraged
- **Disclosure**—The Commission recommended that corporate governance reporting be improved, especially concerning explanations for not applying code provisions. This particularly includes the disclosure of board diversity policy, risk-management policies, remuneration policies and individual remuneration of directors, and shareholder voting on the remuneration policy and the remuneration report

European countries and some international bodies support corporate governance in diverse ways. The following points describe the focus on corporate governance of different entities:

- **EU member states.** Parliaments in all member states have introduced or revised their national corporate governance codes in the last years.
- **EU candidate and potential candidate countries.** Many of the EU candidate and potential candidate countries have been introducing corporate governance laws and regulations to satisfy EU membership conditions.
- **International bodies:** International bodies, such as IFC, International Corporate Governance Network (ICGN) and the Organisation for Economic Co-operation and Development (OECD), have been developing international standards that affect European corporate governance practices.

Four key corporate governance challenges for Europe

- **Finding the right blend of regulation and soft law.** The Commission needs to decide on the mix of formal regulation and comply-or-explain provisions that will deliver the most effective outcomes for companies in their ability to generate wealth and employment over the long term
- **Boilerplating.** Many European listed companies' annual reports provide information that does not differ from other companies' annual reports and is identical from year to year.
- **Weak explanations.** Weak explanations occur when companies deviate from the national code of corporate governance, and the explanation for the deviation under the comply-or-explain regime is often lacking in detail. Several jurisdictions (for example, Belgium, the Netherlands, and the United Kingdom) have guidelines on the appropriate character of an explanation.
- **Finding the right blend of national and regional regulation.** Some national governments wish to retain law-making authority, and there is therefore some tension between the centralized law making generated by the European Parliament and the Commission.

Principles of good governance in European companies. According to ecoDa, good governance is based on a number of widely accepted principles of good governance (ecoDa 2010):

- Delegation of authority. European companies should produce a schedule of matters reserved for the board (this sets out the parameters of delegated authority) and a schedule of authorities for executive management (this identifies the financial thresholds regarding decision-making powers).
- Checks and balances. Appropriate checks and balances ensure that no one person has unfettered power over decision making.
- Professional decision making by an effective team. European boards are considered key decision making bodies and so should focus on improving board effectiveness and efficiency.
- Accountability and transparency. European companies frequently voluntarily disclose more information than required by law as a means of gaining the confidence and commitment of investors and other external stakeholders.
- Conflicts of interest. Directors in European companies are aware that directors are prohibited from directing the activities of the company in favor of themselves or particular shareholders.
- Aligning incentives. ecoDa recommends that European companies align incentives in a way that is consistent with the long-term interests of the company

Benefits associated with good corporate governance

- **Improved access to external financing.** Companies with good corporate governance have better access to external financing (particularly from foreign investors) because of higher levels of trust between the providers of capital and executive managers.
- **A lower cost of capital.** Investors who receive high levels of disclosure from well-governed companies are likely to provide capital to those companies at a lower cost
- **Improved operational performance.** Sustainable wealth creation within the private sector can be achieved only through good management, entrepreneurship, innovation, and better allocation of resources. Effective corporate governance adds value by improving companies' performance through more efficient management and better asset allocation.
- **Increased company valuation and improved share performance.** Many researchers have identified the existence of a “corporate governance premium”—an additional price that investors will pay for shares in well-governed companies
- **Improved company reputation.** Many European companies indicate that improvements in corporate governance can lead to increased job satisfaction among employees, higher staff retention, and higher quality recruitment
- **Reduced risk of corporate crises and scandals.** A company with good corporate governance practices will, by definition, have an effective risk-management system that is more likely to cope with corporate crises and scandals.

The Company

A country's economy can be divided into three sectors:

- **The private sector** is that part of a country's economy that is not state controlled and is run by individuals and companies for profit
- **The public sector** is the part of a country's economy that is typically a public service, controlled by government authority, and funded by government.
- The third sector is the part of a country's economy that is involved in **nongovernmental and not-for-profit activities**. It is also known as the nonprofit sector, the voluntary sector, the civic sector, or the community sector

Differentiation of the companies:

- **A joint-stock company** is a business entity owned by shareholders. Each shareholder owns a portion of the company proportionate to his or her ownership of the company's shares.
- **Listed companies** are limited liability companies that are listed or quoted on public equity markets. The shares of these types of companies are readily bought or sold on a stock exchange
- **Unlisted companies** are limited liability companies that are not listed or quoted on public equity markets. The scope of unlisted companies is very wide and encompasses start-ups, single owner-manager companies, family businesses, private equity-owned companies, joint ventures, and subsidiary companies.

Challenges in corporate governing of Listed companies

- They are subject to high levels of regulation and compliance requirements.
- Comply or explain can lead to a focus on specific processes and box-ticking by investors.
- Ownership of shares can quickly change, which can lead to a threat of aggressive and unwanted takeovers.
- It often seems easier to comply through a copy-paste response or to give boilerplate “excuses,” than to think through a tailored approach that would involve more detailed explanations.
- Various organizations (European Commission 2009; ecoDa 2012) have considered what constitutes an adequate and reasonable explanation.
- The comply-or-explain obligation holds for only part of the codes on corporate governance.

In many respects, **unlisted companies face greater corporate governance challenges** than listed companies face. Much of the governance framework of listed companies is externally imposed by various types of regulation and formal listing requirements. By contrast, unlisted companies have greater scope to define (or not define!) their own governance strategy. This means that owners of unlisted companies must themselves reflect on the potential costs and benefits of various governance approaches. Furthermore, in contrast to larger listed enterprises, smaller unlisted entities may not have access to in-house support, such as legal advisors or company secretarial resources, to assist them with important decisions about governance.

Public sector governance challenges

- **Complex relationship management:** Public sector governance is often defined as being concerned with three principal relationships: between citizens and the state; between policymakers and the bureaucracy (those responsible for providing public goods and services); and between the bureaucracy as delivery agents and citizens as clients.
- **Strategic goals and objectives:** In the public sector, the profit motive is often reduced (or even absent), and therefore public sector bodies may have a greater tendency to be overstaffed and inefficient.
- **Crowding out:** An increase in public sector spending can reduce resources for the private sector. For example, if taxes rise to increase government spending, then as a consequence the private sector may have fewer resources for private sector investment. There have been bitter arguments in Europe, with the supporters of austerity saying that if government spending can be reduced it will free up resources for more efficient private sector growth and job creation.
- **Bribery and corruption**

The not-for-profit sector governance challenges:

- Funding cuts;
- Public attitude;
- Not meeting objectives;
- Security of assets or staff;
- Delivery of service;
- Retention of quality of staff;
- Information technology/information management;
- Health and safety;
- Performance of investments;
- Loss of key contracts/finance

Transparency and disclosure

Companies in Europe are obliged to have high levels of transparency and disclosure. Disclosure should include, but not be limited to, material information on the following:

- The financial and operating results of the company;
- Company objectives;
- Major share ownership and voting rights;
- Remuneration policy for members of the board and key executives and information about board members, including their qualifications, the selection process, other company directorships, and whether they are regarded as independent by the board;
- Related-party transactions;
- Foreseeable risk factors;
- Issues regarding employees and other stakeholders;
- Governance structures and policies, in particular the content of any corporate governance code or policy and the process by which it is implemented

The following matters must now be disclosed in the nonfinancial statement:

- Diversity policy in the board of directors;
- Environmental aspects;
- Social and employee-related aspects;
- Respect for human rights.

The Owners

Stock exchanges in Europe

The role of stock exchanges is to provide access to long-term capital. In Europe the role typically includes:

- **Listing.** Although the prime responsibility for company listing lies with the stock exchange, in many European countries responsibility is shared between the stock exchange and the securities regulators.
- **Standards and codes.** The standard-setting role of European stock exchanges was exercised through the issuance of listing, ongoing disclosure, maintenance, and delisting requirements.
- **Monitoring compliance.** In addition to overseeing their own rules, in many cases stock exchanges in Europe have been assigned the role of monitoring compliance with legislation and subsidiary securities regulation.

The European Model of Share Ownership

The insider model involves shareholders having a very strong engagement and monitoring role with the board. Difficulties with the insider model include private benefits, related-parties transactions, and (potential for) abuse of power. The insider model underscores the need for independent directors and for respecting minority rights.

The outsider model is a dispersed-shareholder model that is typically associated with limited impact of shareholders as well as with institutional capital, a complex investment chain with numerous parties involved, block holdings by institutional investors, and a monitoring focus. A

The main policy objectives at the European Commission level are to cause shareholders to be more engaged and thus make companies more sustainable. The following are the main operational objectives:

- Raise awareness of investors' corporate governance drives—to achieve improved disclosure of voting policies by institutional investors, thus enabling ultimate investors to optimize investment decisions, facilitating dialogue between investors and companies, and encouraging shareholder engagement.
- Provide better oversight on remuneration policies and remuneration of managers—to achieve the harmonization of disclosure requirements and mandatory shareholder voting on the remuneration policy and the remuneration report.
- Improve shareholder control over management—to achieve enhancement of shareholder oversight on related-party transactions and to grant shareholders a right of approval for significant transactions.
- Require better transparency by proxy advisors—to achieve a focus on the preparation of advice and possible conflicts of interests.

The Board

Diversity of board structures in Europe:

- **Unitary (one-tier) boards** consist of both executive and nonexecutive directors. The unitary board is responsible for all aspects of the company's activities, and all the directors have a duty to ensure the prosperity and success of the company.
- **Two-tier boards** separate executives and non-executives into two separate boards: a management board and a supervisory board. The supervisory board is composed entirely of outside directors, and the management board entirely of executive directors. Members of one board cannot be members of the other, so there is a clear distinction between management and control
- **Nordic boards** have the following key features: They are relatively small; The role of the board is to look after and safeguard the shareholders' assets (the stewardship function); The board is entirely or predominantly composed of non-executive directors; The roles of chair and CEO are always separated, and there is a strict separation of duties and responsibilities between the board and the CEO; Board members are normally reelected annually, but they can be dismissed at any time without stated cause;

The Management

A key aspect of the governance framework

to establish an appropriate level of executive power to delegate to management

The board should fulfill certain key functions, including:

- Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans;
- setting performance objectives; monitoring implementation and corporate performance; overseeing major capital expenditures, acquisitions and divestitures;
- ensuring the integrity of the company's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards

Corporate social responsibility

The European Commission tend to focus upon corporate social responsibility (CSR) and has defined CSR as “the responsibility of enterprises for their impact on society.”—(European Commission 2011)

Corporate Responsibility is a term that is used by some member states and can be defined as “the voluntary action businesses take over and above legal requirements to manage and enhance economic, environmental and societal impacts.” —(UK Department for Business, Innovation and Skills 2014)

An ethical culture in a company is typically associated with the following:

- Enhanced corporate reputation and image;
- Improved risk management;
- Improved disaster recovery and business continuity;
- Stronger stakeholder relationships;
- Possible improvement in avoiding or mitigating litigation

Corporate responsibility trends

- **Corporate responsibility equities indexes.** Stock exchanges developed equity indexes to measure companies' performance relative to CR areas, especially to economic, environmental, social, and other criteria and standards
- **Socially responsible investment** (sometimes also referred to as “green” or ethical investing) involves investment strategies that seek to combine both financial return and social good.
- **Ethical Investment Research Service corporate responsibility studies** concluded that, corporate responsibility “has evolved from a mainly philanthropic activity to a more mainstream approach that integrates responsible business principles into core business activities.” The EIRIS study found that European companies have well-developed responsible business practices across a broad range of issues

Questions

- What are the purposes of EU rules in corporate governance?
- Please characterize Regulations which provide rules on EU legal entities
- Disclose main lines of EU Commission in modernising the company law and corporate governance framework
- Please list and narrate OECD Principles of Corporate Governance
- What is the Basis for an Effective Corporate Governance Framework?
- The role of stakeholders in corporate governance?
- Main pillars in EU reforming of corporate governance
- What are the main objectives of Europe 2020 Strategy
- Please describe differentiation of companies and their challenges in corporate governing
- Please narrate the details of corporate governance related to Owners, Board and Management
- What are the main trends of EU in corporate social responsibility (CSR)?

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Conclusion

- In our Guide we tried to light the main aspects of European Regulation in finance, learn the core directions of financial market, European experience in customs and taxation and role of EU in global trade. Some questions are described in more detailed form, others are given as a general information. Anyway we believe that our students and other stakeholders can use this guide as a handy tool in the process of their studying and work.