Accelerating Economic Growth In America

Dr. Edilberto Segura
Partner & Chief Economist, SigmaBleyzer
Chairman of the Board, The Bleyzer Foundation

Texas Economic Development Council
2012 Spring Conference
April 18-20, 2012

v2

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

THE BLEYZER FOUNDATION

Private Equity Investments in Texas

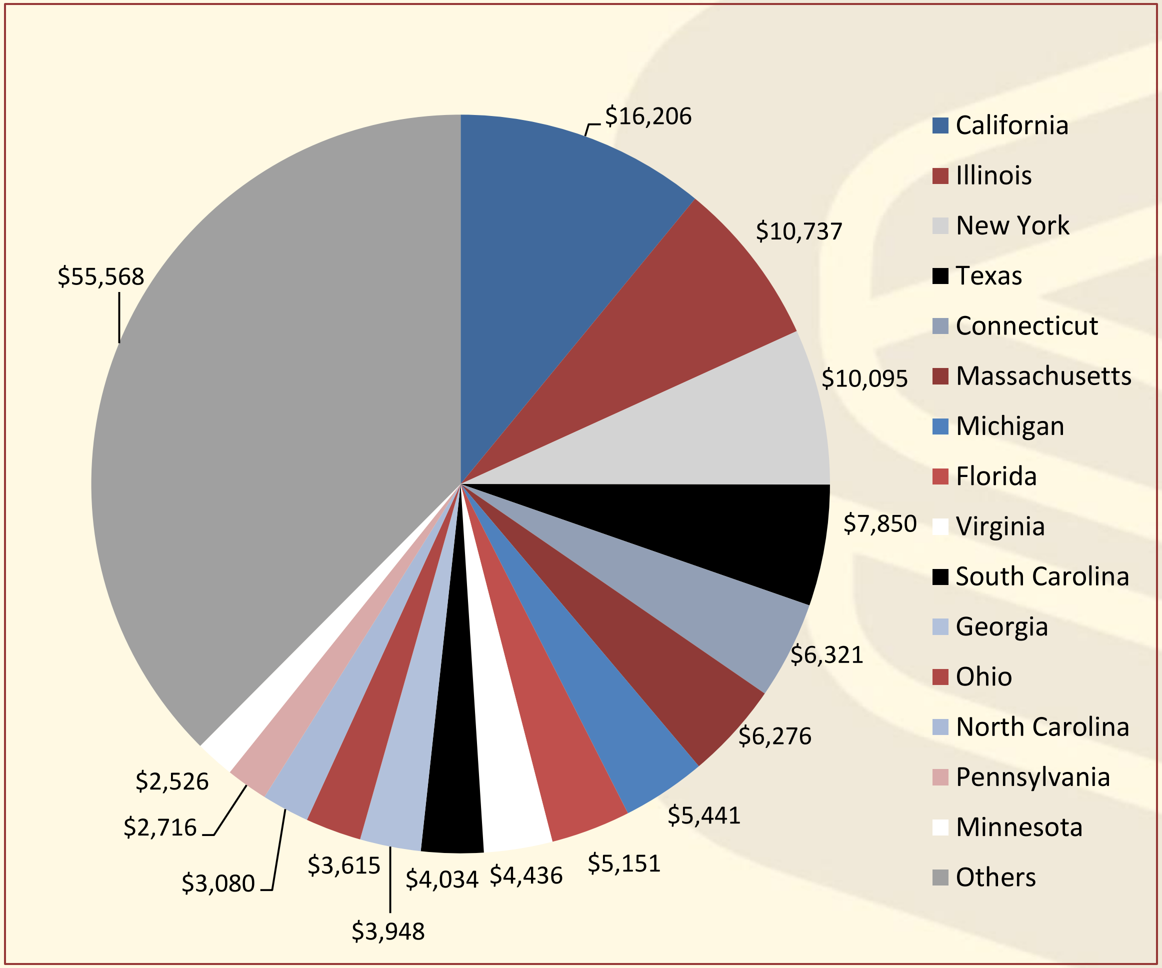
- **SigmaBleyzer** is a Houston-based private equity firm, with over 15 years of operating history, managing assets valued at over $1 billion.
- We have extensive experience working in a large number of countries and sectors, including: cable TV, food and beverage, financial services, energy, pharmaceuticals, consumer goods, agriculture, chemicals, metallurgy, etc.
- We have invested in over 100 companies, and now employ over 11,000 people in the portfolio companies we control, principally in Ukraine, Romania, Kazakhstan, and Texas.
- We have a strong record of creating value. We take an active, hands-on management role with each portfolio company and create value at the operations level, not just through financial engineering or leverage.
- I am addressing you today because at SigmaBleyzer we see a great opportunity here in Texas.

We know that Texas is a Great Place to Do Business

- Texas has the 13th largest economy in the world.
- Texas has been the number 1 exporting state in the nation for the past 9 years.
- Texas has already regained all private jobs lost during the recession; the nation as a whole is still short of nearly 5 million private sector jobs.
- Site Selection Magazine– Texas has one of the best business climates in the nation.
- Chief Executive Magazine– For 7 years, Texas was rated the best state for business.
- Development Counselors International- Texas takes top spot for best buz climate.
- CNBC– over the past five years Texas consistently scored best or second best state for business.
- Kosmont-Rose Institute– top 3 least expensive cities for doing business are in Texas (from 421 across the U.S.) .
- Forbes Magazine– Texas cities top the lists for best big, mid-size and small cities for jobs.
- Tax Foundation– Texas has the second best state business tax climate in large states.

But Texas is not receiving PE funds consistent with its size.

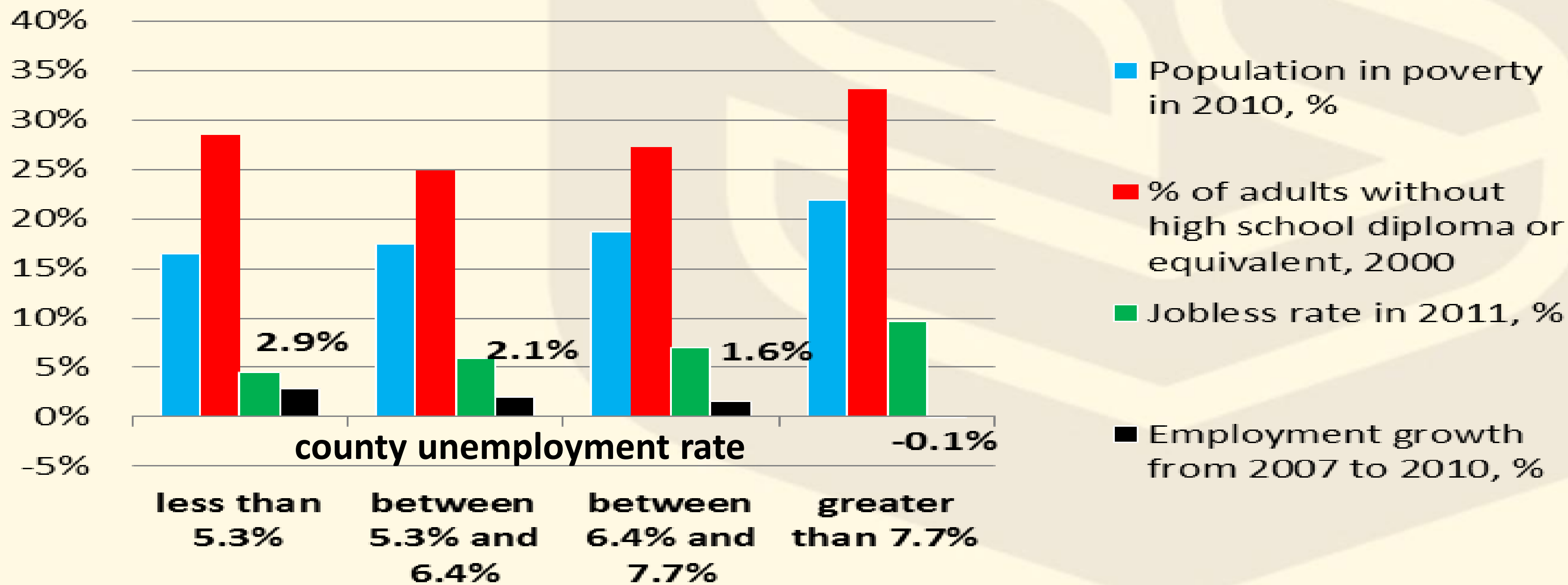
2010 Private Equity Investments, in US $ Millions



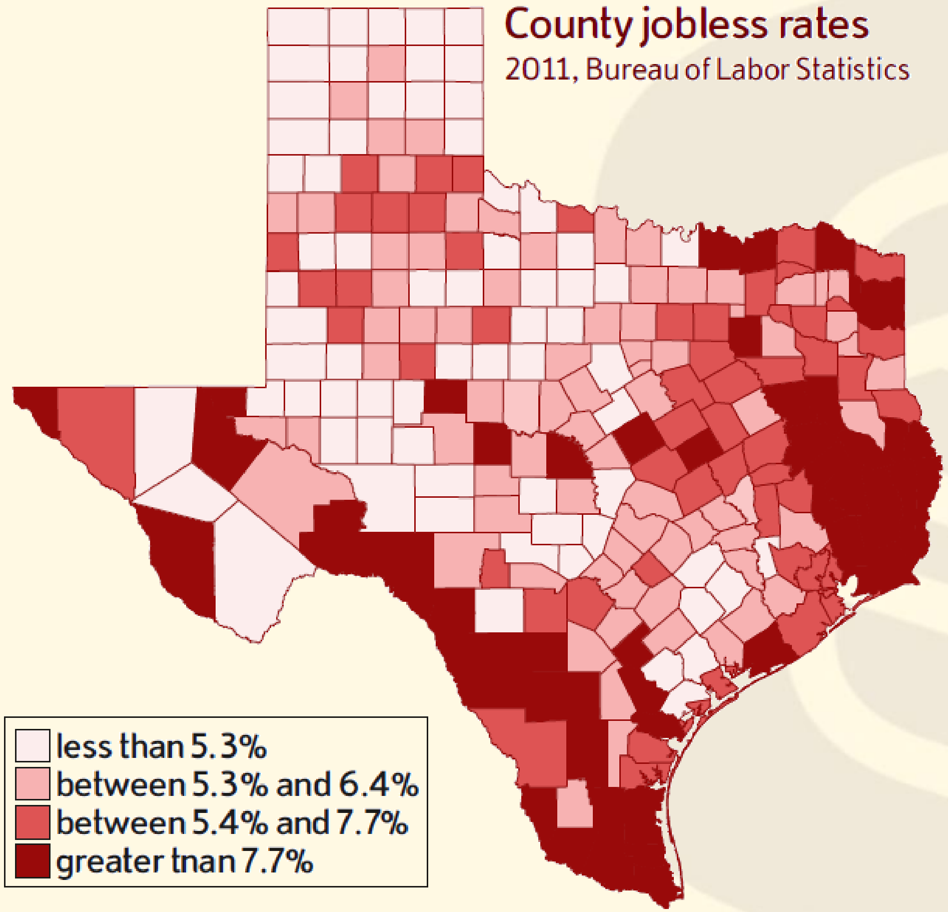
- In 2010, Texas received only 5% of the $150 billion in PE investments made in the US, much less than its 8% share of US GDP.
- It received about half of the PE investments made in California, and significantly less than PE investments in New York or Illinois.
- To take advantage of PE investment opportunities in Texas, SigmaBleyzer is building a dedicated Texas team of PE professionals.

Helping Communities to Improve Business Environments

- In addition to PE investments, we also see opportunities to assist local communities in Texas in formulating programs to **improve their business environments and accelerate the inflows of investments.**
- This support may be desirable because despite its overall attractiveness, economic progress in Texas **is uneven**, with some communities doing well and others lagging behind.



Uneven Economic Progress across the State



- Overall, economic progress in Texas has been strong.
- In 2011, the jobless rate fell in 230 counties.
- Yet, 249 counties out of 254 still have a higher jobless rate than in 2007.
- In 169 counties the jobless rate is 2 percentage points higher than in 2007 and in 65 counties – it is 3 percentage points higher.
- In 28 counties the jobless rate is higher than the national average (8.9% in 2011).
- In 17 counties the jobless rate exceeds 10%.

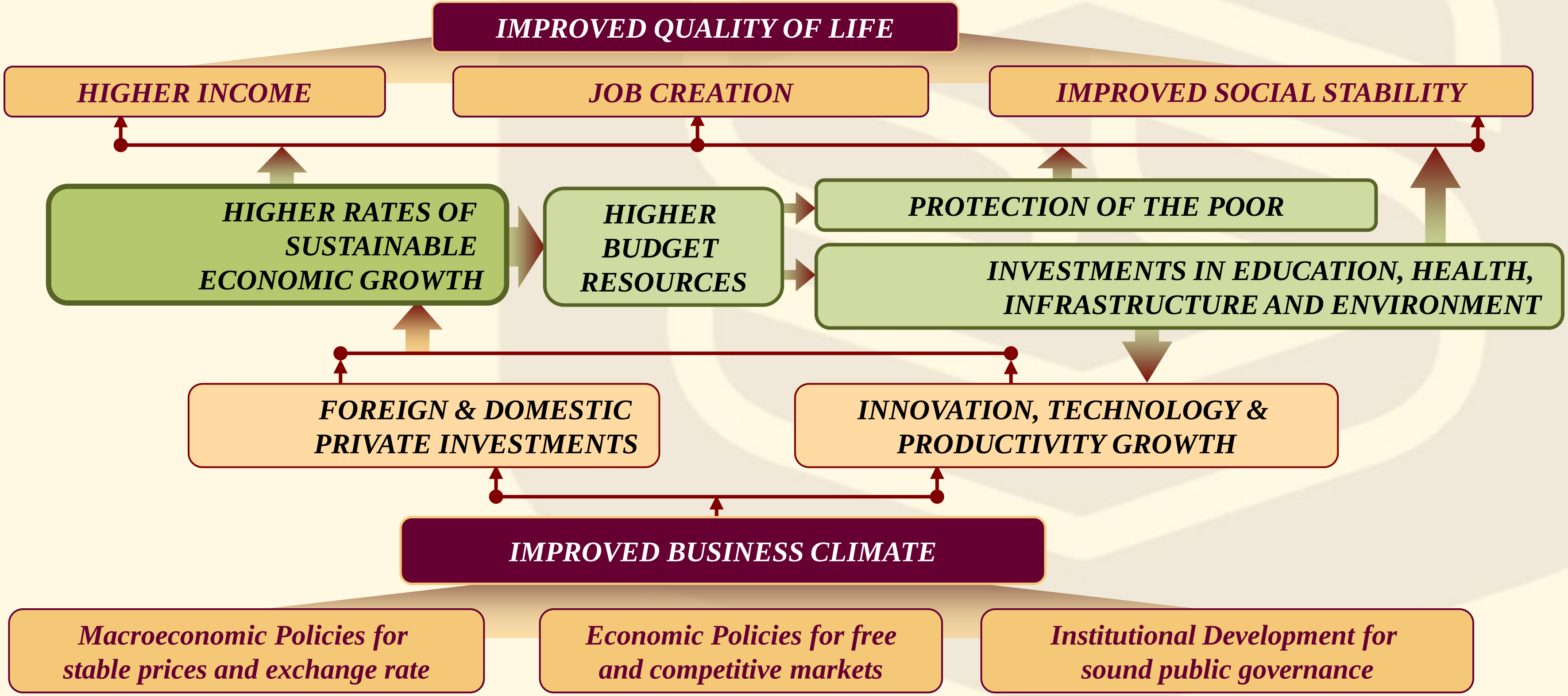
THE BLEYZER FOUNDATION

Business Environment and the Hybrid Investment Style

- In order to assist countries and regions to achieve sustainable growth by improving their business environments, SigmaBleyzer created a sister institution, a non-profit NGO called **The Bleyzer Foundation**, that has been working now for over 10 yrs.
- The staff of The Bleyzer Foundation advise governments on economic matters, produce periodic economic reports, and regularly participate in working groups and at conferences related to business climate improvement.
- *Together The Bleyzer Foundation and SigmaBleyzer developed a unique* ***"Hybrid Investment Style"*** *to provide support in a way that yields benefits to local, regional and State governments, as well as to private investors.*
- The *Hybrid Investment Style* involves simultaneous efforts to create value at the macro and micro levels to provide benefits to all stakeholders:
  - **Macro:** Identify and help remove local investment barriers to spur economic development and create a better business climate for all firms.
  - **Micro**: Private equity investment in the local businesses.
- *Our hybrid investment approach creates value for investors while simultaneously creating value for the community where our businesses are located.*

TBF Philosophy on Jobs and Wealth Creation

- TBF advocates that the key to create jobs and improve quality of life is **sustainable growth by the private sector.**
- We believe that aggregate demand stimuli by government are temporary, palliative and unsustainable, particularly when public debt and fiscal deficits are high.



THE BLEYZER FOUNDATION

TBF's International Investment Drivers

- In 2000 we undertook major studies to identify the economic policies that were necessary to encourage foreign private investments and improve business climates.
  - *Extensive interviews with key stakeholders in the private and public sectors.*
  - *Analysis of existing empirical research on policies to encourage economic development.*
  - *Statistical benchmark analysis using large data set on over 120 countries.*
- The study identified nine key policy actions –the ***TBF Investment Drivers***, that are the pillars of a free and competitive business climate:

1. **Macroeconomic stability:** Low government deficits, public debt and inflation
2. **De-regulation of private business:** Low interference of govts in business
3. **Adequacy of the legal environment:** Ease and fairness in legal case resolution
4. **Efficient government administration :** Low red tape and high govt efficiency
5. **Free foreign trade and capital flows:** Low barriers to trade & cap. movements
6. **Sound financial sector:** Easy availability of credits at low cost
7. **Low crime and corruption levels:** Good security and low corruption
8. **Functioning political system:** Ability to pass and execute required legislation
9. **Good Business Image:** Effective promotion of the local economy

What Investment Drivers are relevant for US Communities?

- With the advent of **Globalization and with easy communications** around the world, US local communities and states are **no longer competing against each other** in their task of attracting major investors.
- They are now competing with local communities around the world.
- **It is no longer Texas versus California, Virginia, or Ohio. But Texas versus Singapore, Brazil or Mexico.**
- A key factor is how the rest of the world perceives you
- In these new environment, the **"investment drivers"** that define where domestic and foreign enterprises will invest are more extensive.
- The traditional approach used by most states of offering a gamut of **tax incentives and cheap financing** to new investors is no longer enough, as many communities have found.
- The approach now has to be more comprehensive to include the investment drivers relevant in an international context.
- In this global environment, narrow factors such as tax incentives or cheap financing are not enough, and are not even among top priorities.

- This more international approach is important because the **US is no longer the main provider of investment funds** around the world.
- In the past, a focus on US investors was reasonable, since US companies were the main provider of investment capital not only here, but also in the rest of the world.
- **This is no longer the case.** In terms of international foreign exchange reserves, including gold and foreign exchange, four countries now hold **50% of the world's foreign exchange reserves of $13 trillion** (China, Japan, the EU and Saudi Arabia).
- These countries are also the **major foreign investors worldwide**: in 2010, in terms of outward foreign direct investments, they invested $630 billion abroad, compared with $330 billion of outward FDIs by the US.
- And they look for investment opportunities across the world. The US is now competing with many other countries that wish to attract financing.

THE BLEYZER FOUNDATION

The Need to work with the Federal Government

- Globalization and the international character of competition and investments mean that US states and local communities no longer can attract large domestic and foreign investors on their own.
- **Today the policies of the Federal Government play a determinant role.**
- Therefore a key topic is: **How effective is the Federal Government in helping US communities to attract investments??**
- Most surveys of investor sentiments say that the impact of the Federal Government has been deteriorating.
- And one of the main reasons is that the **size of the Government** is now too big,
    - requiring large tax revenues,
    - creating uncertainty with large public debt and large fiscal deficits,
    - imposing heavy regulatory burdens on private businesses, and
    - out-crowding out financing away from the private sector.
- The next slides review these matters.

THE BLEYZER FOUNDATION

US Loss of Competitiveness

US Rank in Global Competitiveness Index

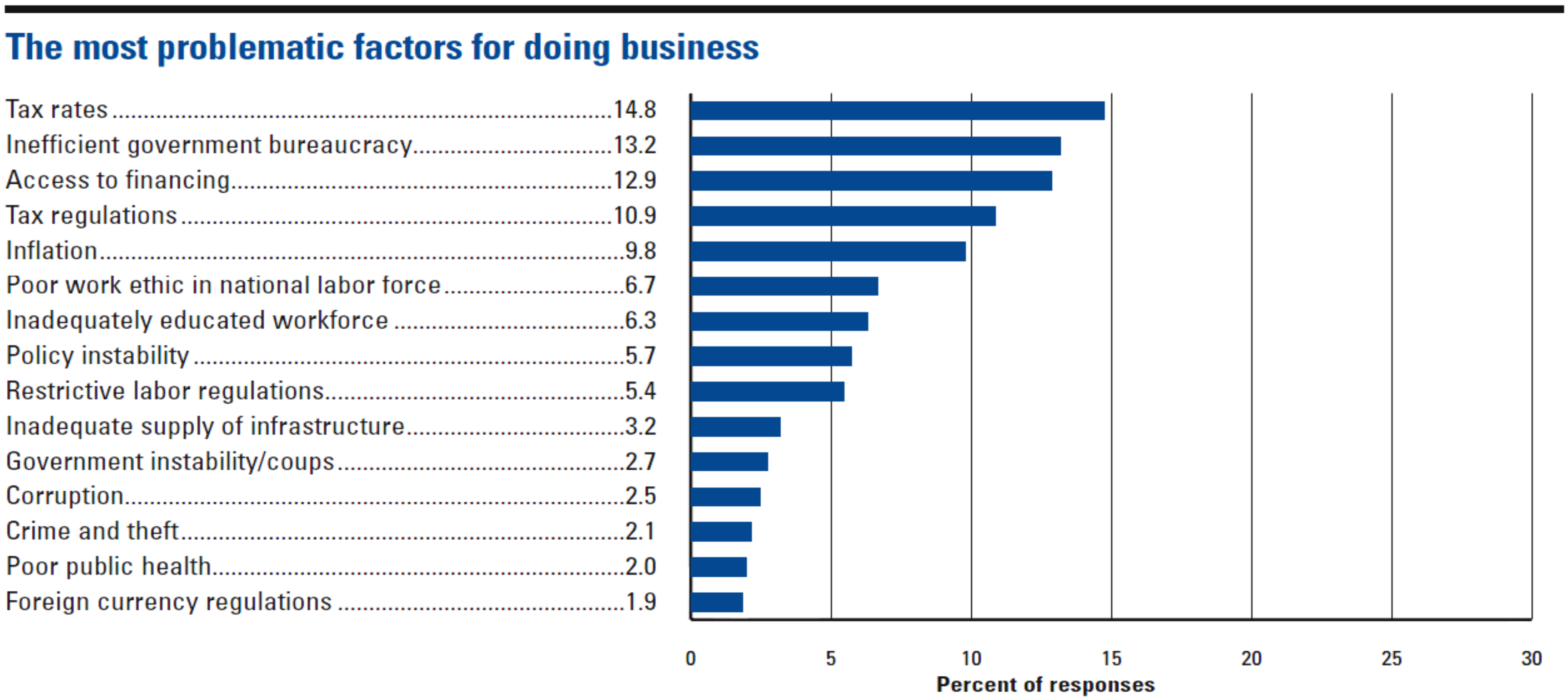
	Rank (out of 142 countries)
Basic requirements (20.0%)	36
Institutions	39
Infrastructure	16
Macroeconomic environment	90
Health and primary education	42
Efficiency enhancers (50.0%)	3
Higher education and training	13
Goods market efficiency	24
Labor market efficiency	4
Financial market development	22
Technological readiness	20
Market size	1
Innovation and sophistication factors (30.0%)	6
Business sophistication	10
Innovation	5

Source: World Economic Forum, The Global Competitiveness Report, 2011-12

- The US loss of competitiveness is shown in the 2011 competitiveness ranking by the World Economic Forum.
- In basic competitiveness requirements – Institutions, Infrastructure, Macroeconomic and Health/Education- the US is now ranked number 36.
- Even on technological readiness – an area where the US used to excel- it is now 20.
- In financial market development, it is ranked 22.
- Its overall competitiveness ranking is good only because of its market size. But even here it has competition from the EU, China and India.

Problematic Factors for Doing Business in the US

Out of the four most problematic factors for doing business in the US, three of them are related to **the large size of the US Government**

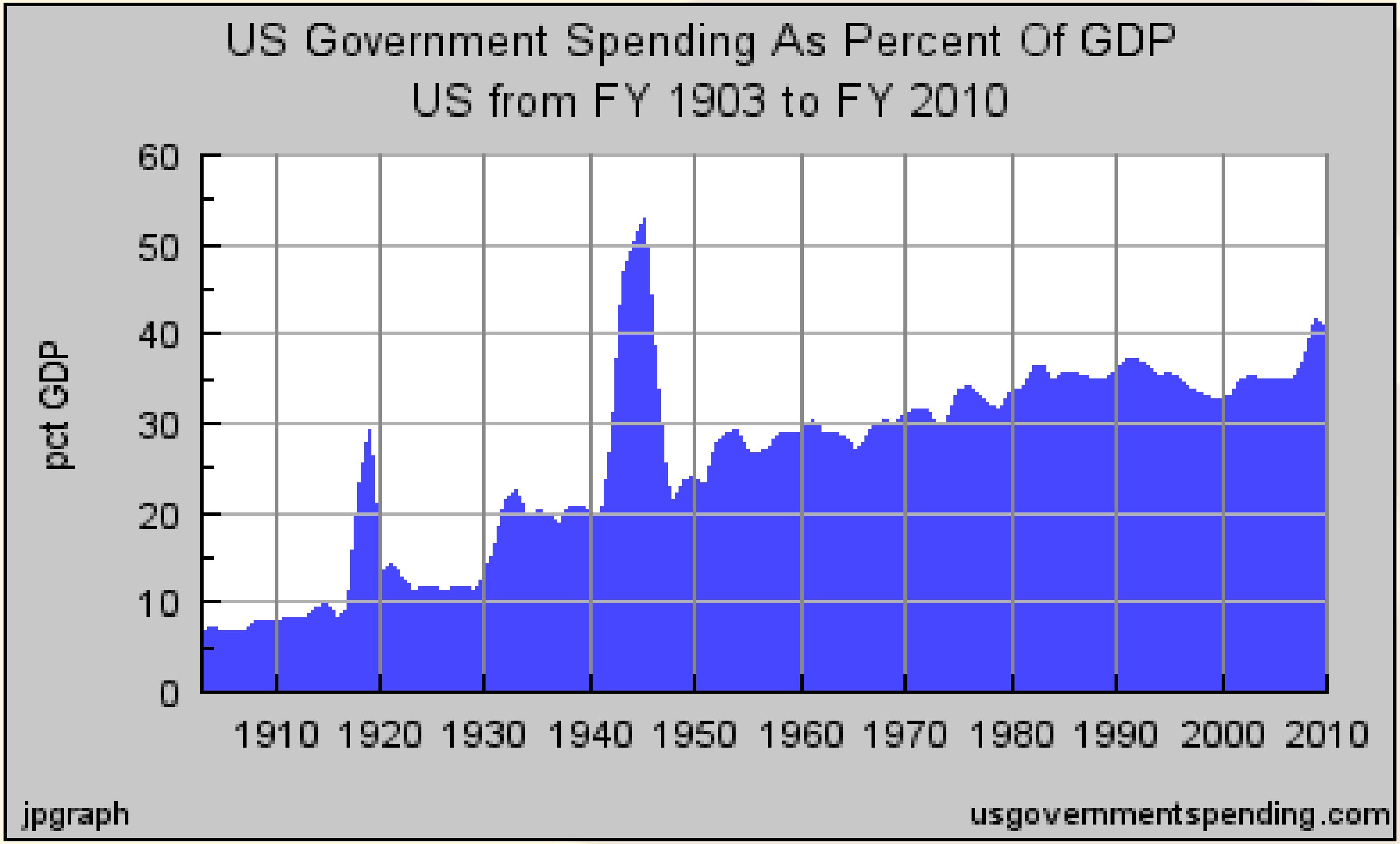


Note: From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

The Global Competitiveness Report 2011-2012 © 2011 World Economic Forum

THE BLEYZER FOUNDATION

In fact, the Size of the US Total Government is out of Control

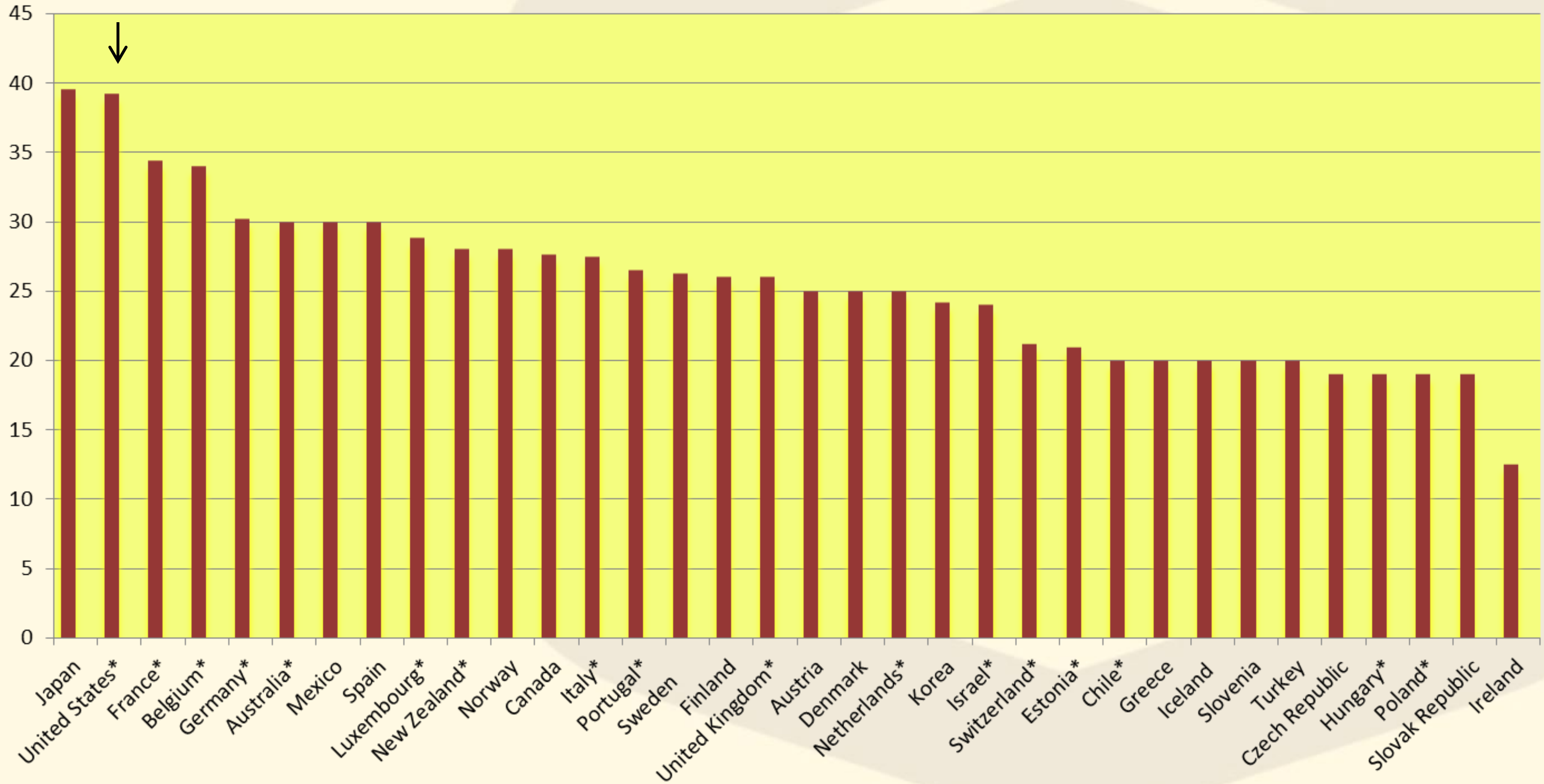


Note: US Total Government spending includes Federal, State and Local governments

THE BLEYZER FOUNDATION

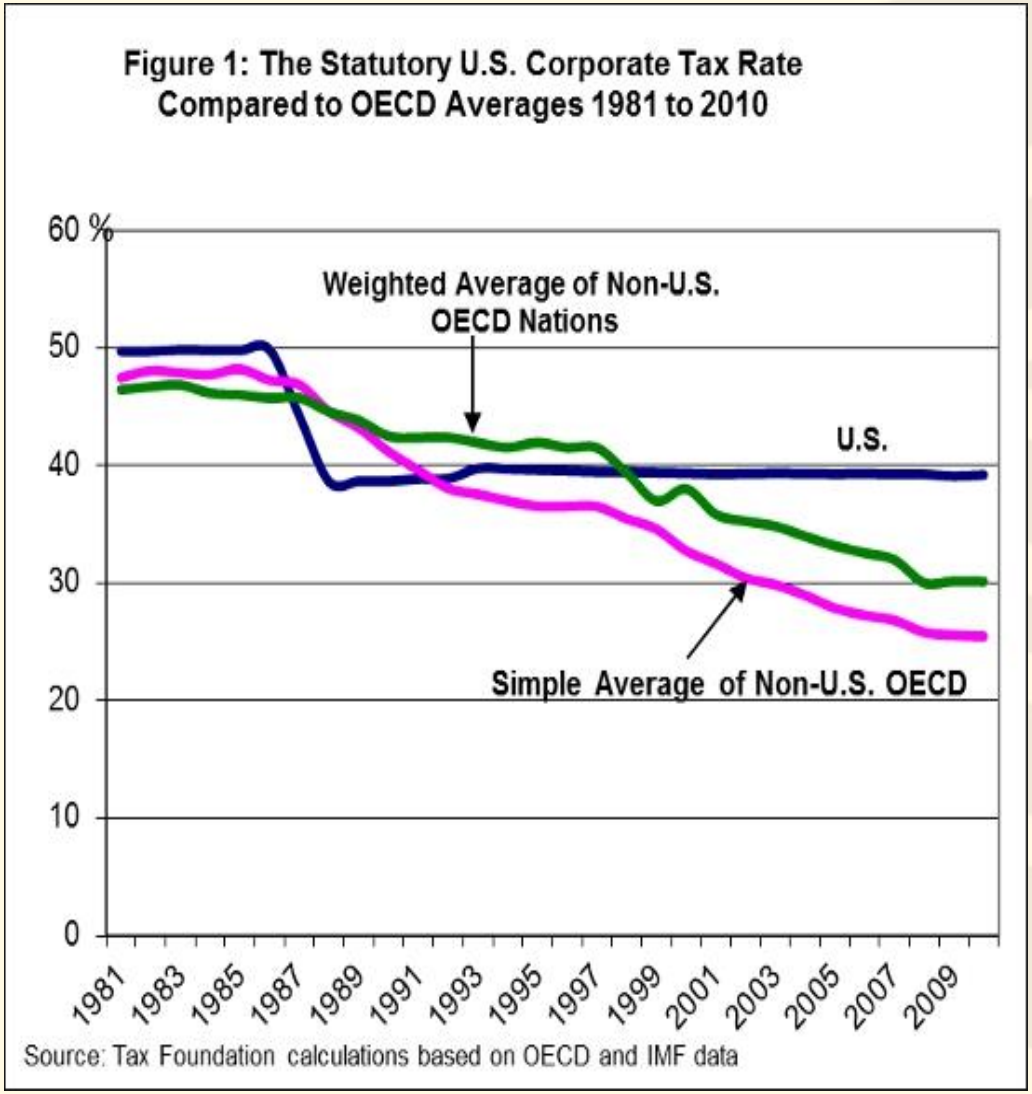
Corporate Tax Rates in OECD Countries

With a large government, in order to finance its large government expenditures, the US has one of the highest Corporate Tax Rate among OECD countries.



Source: OECD, 2011, Combined Tax Rates, Federal and State

The US is losing competitiveness in tax costs

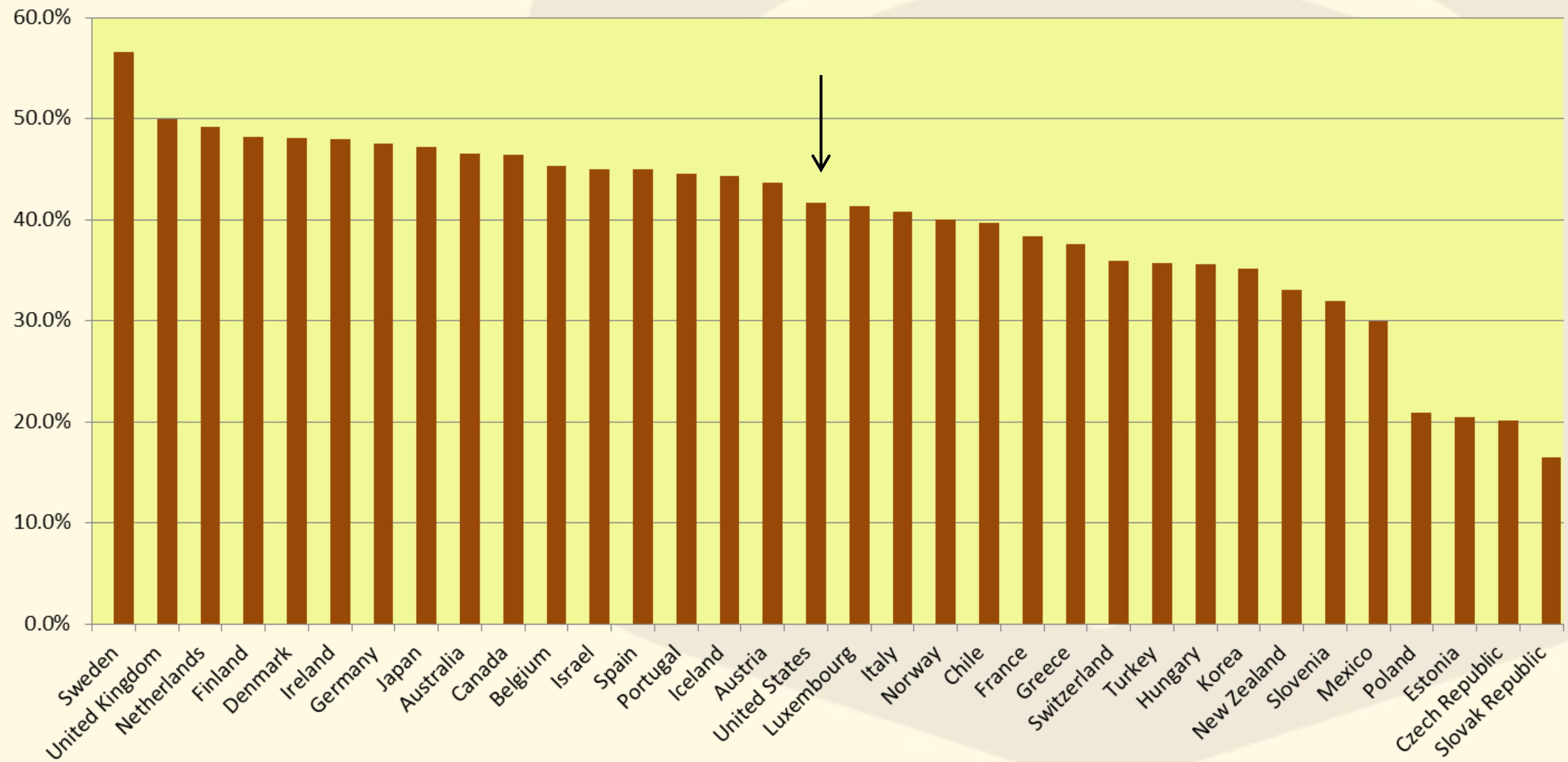


- The US is losing competitiveness in the cost of doing business because during the last two decades, most OECD countries have reduced their corporate tax rates, whereas the US has not.
- OECD countries reduced their taxes to make them more competitive vis-à-vis emerging countries that were taking large foreign investment flows.

THE BLEYZER FOUNDATION

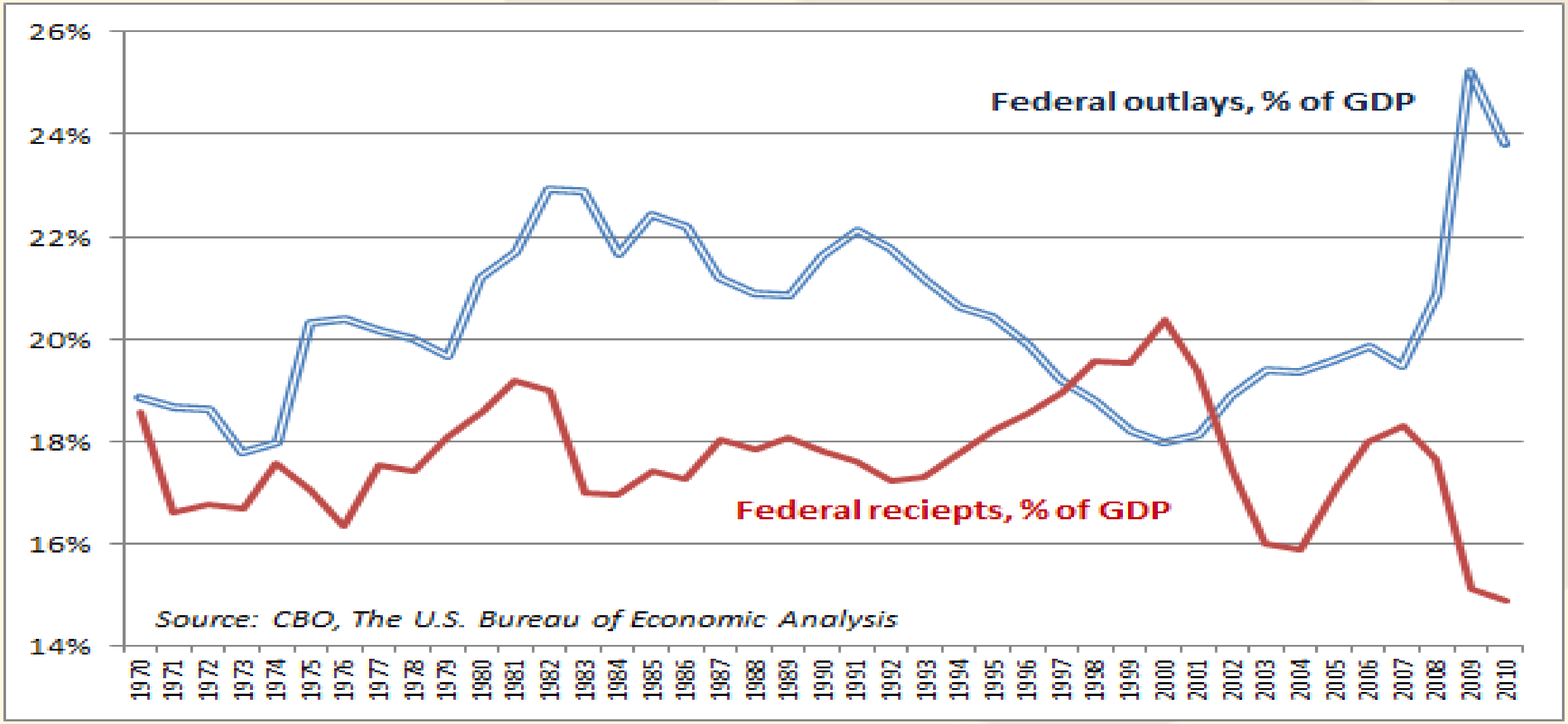
Personal Income Tax rates are also high

The top marginal personal income tax rate is also higher in the US than in many Western European countries, such as Italy, Norway, France, Switzerland, and much higher than the rates in East Asia or Latin America.



Federal Government Spending Accelerated in the Last Two Years.

- Although fiscal revenues have declined, the major cause of the current large fiscal deficit (the increased gap between outlays and receipts) was an increase of spending above trend.
- With high and uncompetitive tax rates, increasing them is not going to help.



THE BLEYZER FOUNDATION

Government Expenditures and Public Debt

Country	Government Spending %GDP	Public Debt % GDP
Zimbabwe	97.8	241
Cuba	78.1	96
France	52.8	84.2
Belgium	50.0	100.2
Ukraine	47.3	39.5
Greece	46.8	130.2
Germany	43.7	74.3
United States	**38.9**	**92.7**
Japan	37.1	225.8
Australia	34.3	21.9
Russia	34.1	11.1
Mexico	23.7	45.2
China	20.8	19.1

- Except for Europe, the US has one of the world's highest ratios of Government Spending to GDP.
- It also has one of the highest ratios of public debt to GDP.
- At 93% of GDP, public debt is not sustainable and may increase exponentially, unless the economy growths at a faster pace.

Effects of Fiscal Deficits and Debt on Economic Growth

Real GDP growth, %		
	2010	*2011*
US	**3.0%**	**1.7%**
Japan	4.4%	-0.7%
Germany	3.7%	3.0%
Italy	1.8%	0.4%
Spain	-0.1%	0.7%
Portugal	1.4%	-1.6%
Ireland	-0.4%	0.7%
Greece	-3.5%	-6.9%
Russia	4.3%	4.3%
Poland	3.9%	4.3%
Romania	-1.6%	2.5%
Kazakhstan	7.3%	7.5%
India	10.6%	7.2%
China	10.4%	9.2%
Brazil	7.5%	2.7%
Argentina	9.2%	8.9%
Mexico	5.5%	3.9%

f - forecast; source: IMF, The World Economic Outlook, April 2012

- The combination of high fiscal deficits and public debt in **Europe** have led to low rates of GDP growth averaging 2% in 2010,1.5% in 2011 and a projection of zero growth in 2012 for the European Union.
- **The USA** is approaching European countries in government size and debt and is **also growing at a slow pace.**
- Asia and most Latin American emerging countries have managed to maintain smaller governments, lower levels of public debt, and have been able to maintain higher rates of economic growth averaging 7.4% in 2010 and 5.8% in 2011.

Confronting the Nation's Fiscal Policy Challenges
Conclusion

"Given the aging of the population and rising costs for health care, attaining a sustainable federal budget will require the United States to deviate from the policies of the past 40 years in at least one of the following ways:

- Raise federal revenues significantly above their average share of GDP;
- Make major changes to the sorts of benefits provided for Americans when they become older; or
- **Substantially reduce the role of the rest of the federal government relative to the size of the economy."**

September 13, 2011

Public Policy Prescription for the US Government

- The US priority should be to **reduce the size of the federal government.**
- The government should undertake a broad review of all programs and functions currently performed by the federal government **to ascertain if a program should be retained, transferred to the states, privatized, or just eliminated**.
- This approach was pioneered and successfully tested in many countries, including Canada, New Zealand, Australia and Poland. These countries found that through this approach, the fiscal budget deficit could be reduced permanently to sustainable levels.
- They found that the role of the federal government should be limited to the elaboration and monitoring of national policies, with implementation transferred to the states. For the US this would mean that a good portion of Medicare and Medicaid could be more effectively managed and financed at the state level.
- This approach is also consistent with international experience on how to reduce fiscal deficits effectively. Only expenditure reductions resulting from elimination of ineffective programs are sustainable. Tax increases are not, particularly if they are already high, since they discourage investments and retard growth.

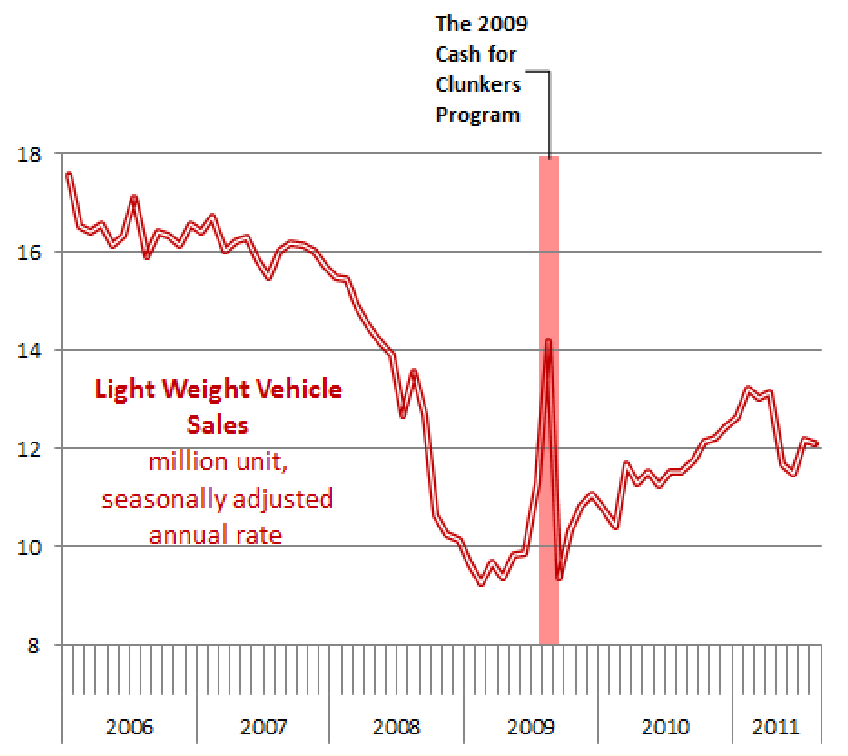
THE BLEYZER FOUNDATION

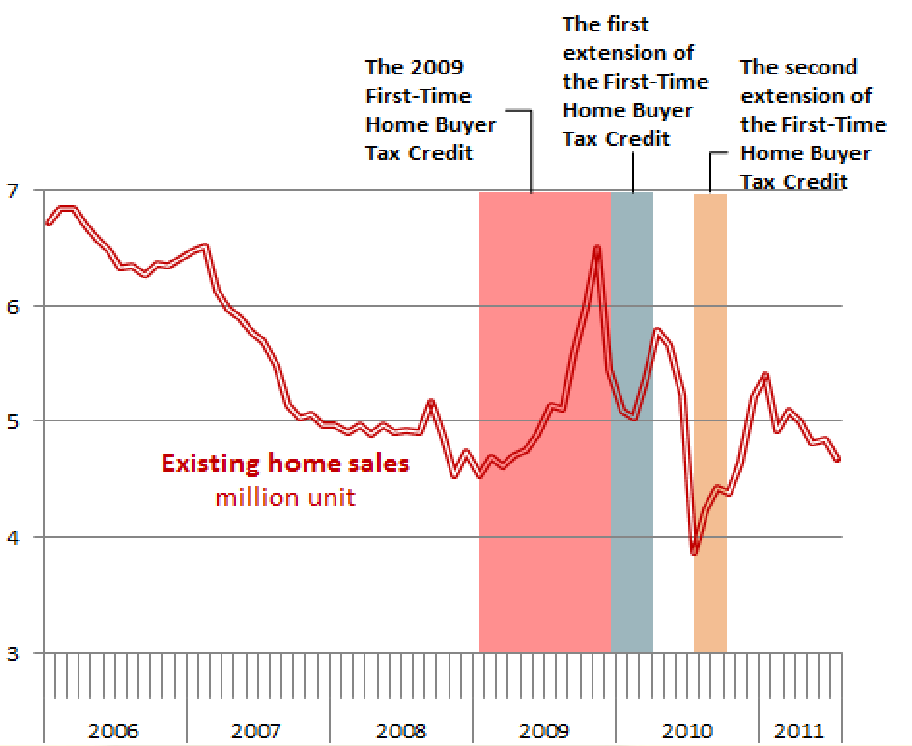
Role of the Federal and State Governments in Creating Jobs

- **Given the large size of the US Government, is it effective in creating jobs??**
- The government is not effective in creating jobs: Additional public sector jobs cost more money to taxpayers, reducing private sector jobs.
- Federal policies on job creation ignore the historical failure of these policies.
- Sustainable private sector jobs can only be created by private sector; but the government can play a useful role in facilitating this by, first, improving business environment and second, supporting innovation and new technologies
- These supply side measures are the only ones that create permanent jobs as many demand side measures have failed.
- Several past government programs tried to create jobs by boosting private demand, but many of them represented temporarily shifts in fiscal policy, such as temporary tax cuts, or the provision of temporary jobs in infrastructure
- These temporarily increases in government spending usually failed to trigger a sustainable shift in consumer behavior because of the expectation of policy reversal in the future. As a result few new jobs were created.
- Furthermore, given supply rigidities, if there were any increase in consumption, they would come from imports, not local production.

Evidence of Failure of Demand Side Policies

- There is ample evidence that demand side programs have not worked.
- For example, both the cash-for-clunkers and the first-time home buyer tax credits programs failed to reverse the downtrend in car and home sales (see charts below).





Why we need to Focus on supply, rather than demand measures.

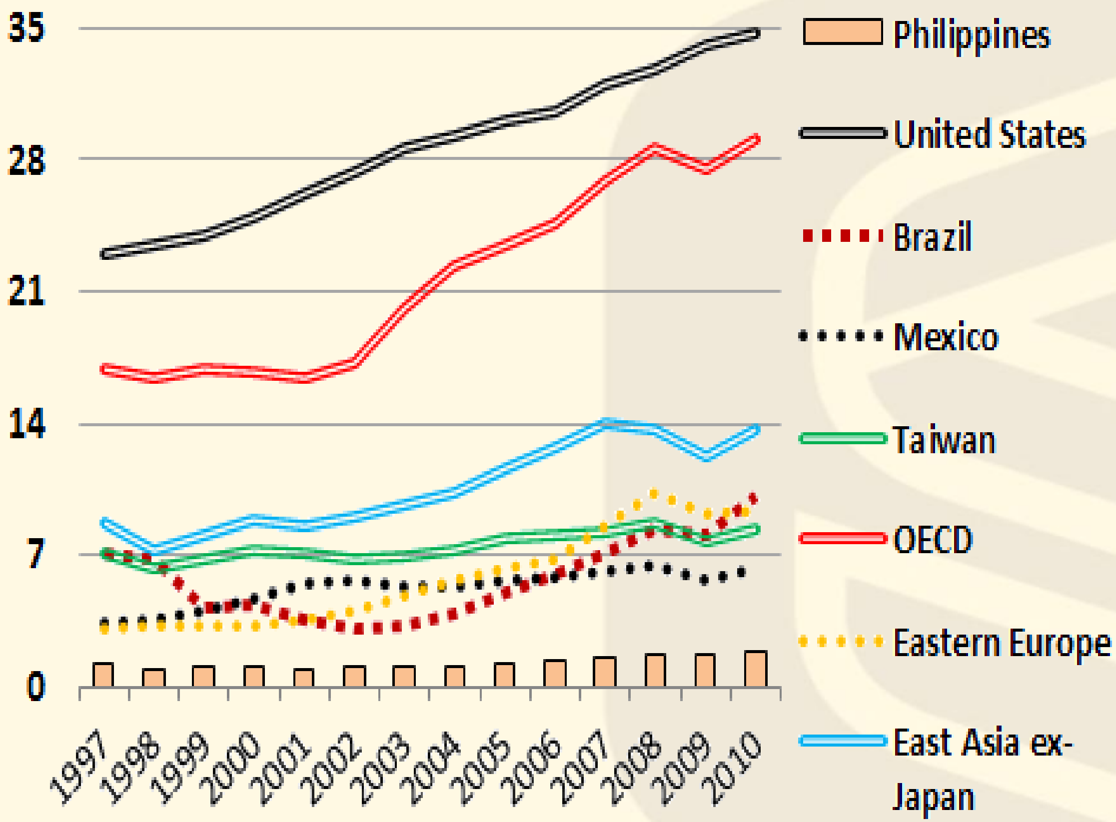
- The main reasons why we need supply side measures are **globalization and outsourcing**, which were less important in the past.
- Due to globalization, during the last decades, the US has lost many manufacturing jobs and, more recently, construction-related jobs. **These jobs will not return.**
- With reduced international competitiveness, of the roughly 27 million jobs created during 1990 and 2008, 98 percent were in the non-tradable sector of the economy, the sector that produces goods and services such as housing that cannot be exported and must be consumed domestically.
- On the other hand, employment barely grew in the tradable sector of the U.S. economy, the sector that produces goods and services that can be consumed anywhere, such as manufactured products, engineering, and consulting services.
- With the collapse of non-tradable jobs – which are unlikely to return - the US will need to come with new sources of growth (new areas in which we could be internationally competitive).
- This can only come with much greater focus on (1) measures to reduce the cost of doing business, and (2) innovation and new technologies.

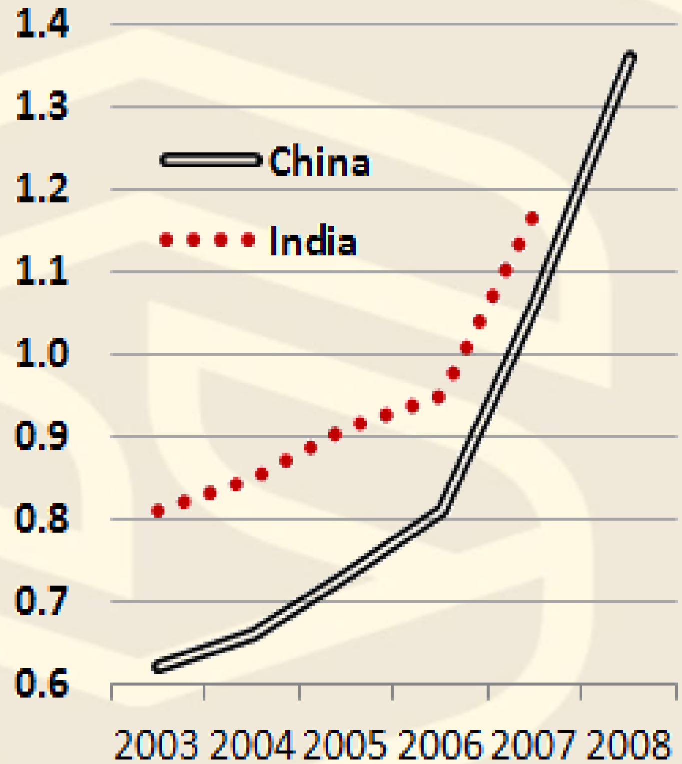
Manufacturing Jobs Trends

- In 1960, manufacturing accounted for 25 percent of the economy
- By 1990 its share of GDP had declined to 17 percent
- By 2000, it accounted for just 14 percent of GDP
- Today, for the first time since the Industrial Revolution, fewer than 10 percent of American workers are employed in manufacturing
- The U.S. has lost over 7 million manufacturing jobs since 1980 (a loss of about 6% of today's labor force)
- All of these statistics are clear evidence that the US has lost competitiveness.

International Comparisons of Labor Costs in Manufacturing

Hourly compensation costs in manufacturing, U.S. dollars



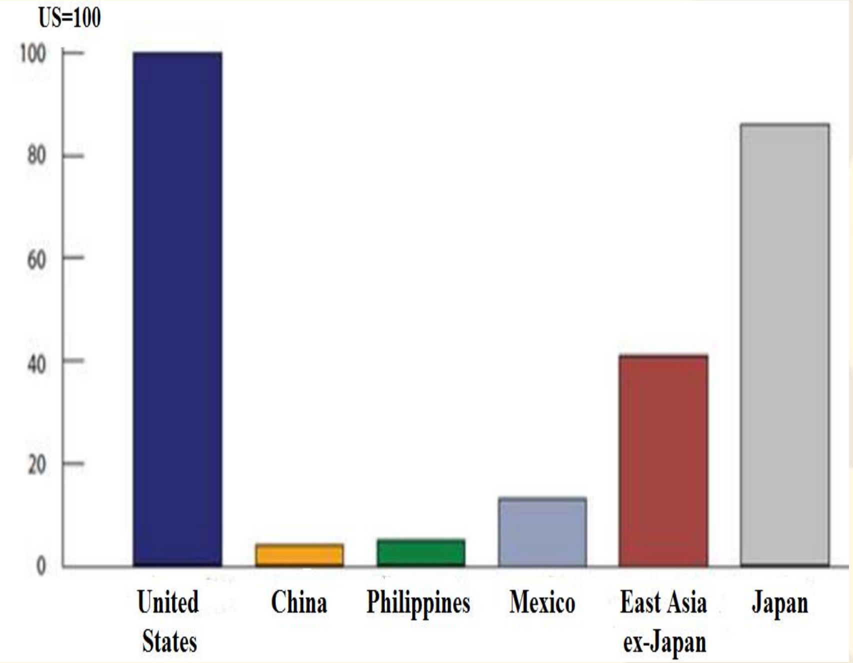


Source: The U.S. Bureau of Labor Statistics

THE BLEYZER FOUNDATION

Why has the US lost Competitiveness?

Index of Hourly Compensation Costs in Manufacturing, 2008, US = 100



- The lack of US competitiveness in manufacturing can not be simply attributed to labor costs.
- In fact, in terms of absolute labor costs in manufacturing, the US can not compete with most other countries in the world.
- It is a fact that US labor costs are 5 times higher than in Mexico; and 20 times higher than in China.
- But for the same manufacturing output, the US uses 100 times less labor than China.

- The US could maintain its labor cost competitiveness in the basis of new technologies and innovations that could generate greater labor productivity than in other countries.
- The lack of competitiveness in the US cannot be attributed just to high labor costs.

Why has the US lost Competitiveness?

- The US used to be one of the most competitive countries in the world.
- This was due to ample availability of one of its most valuable resources: a "**favorable business environment**" that included: a free and competitive market, relatively low cost of doing business thanks to a small government with few interferences in business, plentiful human capital, entrepreneurship, and lots of innovation.
- These resources enabled the US to compete in tradable and non-tradable goods.
- But these "unique" resources have now been partly "depleted" by two recent developments that have affected our competitive edge:
  - First, a large government has led to **encroachment** on private sector activities, through increased taxes and tax regulations, over regulation of market activities by inefficient public institutions, inadequate education, etc. Excessive public debt has also crowded out financing to the private sector.
  - Second, other countries principally in Asia and LAC have moved in opposite direction: they introduced the features that used to characterize the US: fiscal discipline, smaller government size, lower taxation, business deregulation, etc.
- To regain competitiveness, the US must replenish our unique resource of a favorable business environment by reducing the size of government and putting increased emphasis on promoting innovation and new technologies.

The Role of the States and Local Communities

- State governments can no longer remain passive to the negative influence of the large size of the Federal Government on investment attractiveness in local communities.
- A more pro-active approach by the states is now needed.
- In addition local communities should undertake a careful review of their strengths and weakness in an internationally competitive environment to better target their promotion and policy measures to their strengths.
- In fact, even in the area of new technologies, not all communities can become silicon valleys or bio-parks.
- Some may be better equipped to undertake certain activities in other areas such as in a new generation of manufacturing of innovations developed elsewhere.
- Only a careful review of a community’s strengths and weaknesses can identify the measures required to reduce the cost of doing business, retain and expand existing businesses, and attract new companies.

What can be done at the local community level?

Nevertheless, some of the "investment drivers" that could be relevant to local communities include:

- Promote innovation and technology to create unique "niches" that can not be replicated elsewhere, based on local core strengths.
- Reduce the cost of doing business, including local taxes, rentals, etc.
- Reduce local red tape and administrative regulations
- Facilitate communication of business problems with local governments
- Develop a competitive workforce by facilitating training and education opportunities at all levels as well as health services
- Improve local transportation and logistic facilities
- Improve zoning regulations to make more land available, facilitate new business facilities and reduce construction costs
- Facilitate the provision of utilities
- Strengthen local security to minimize crime and corruption
- Enhance the image of the local community as business-friendly

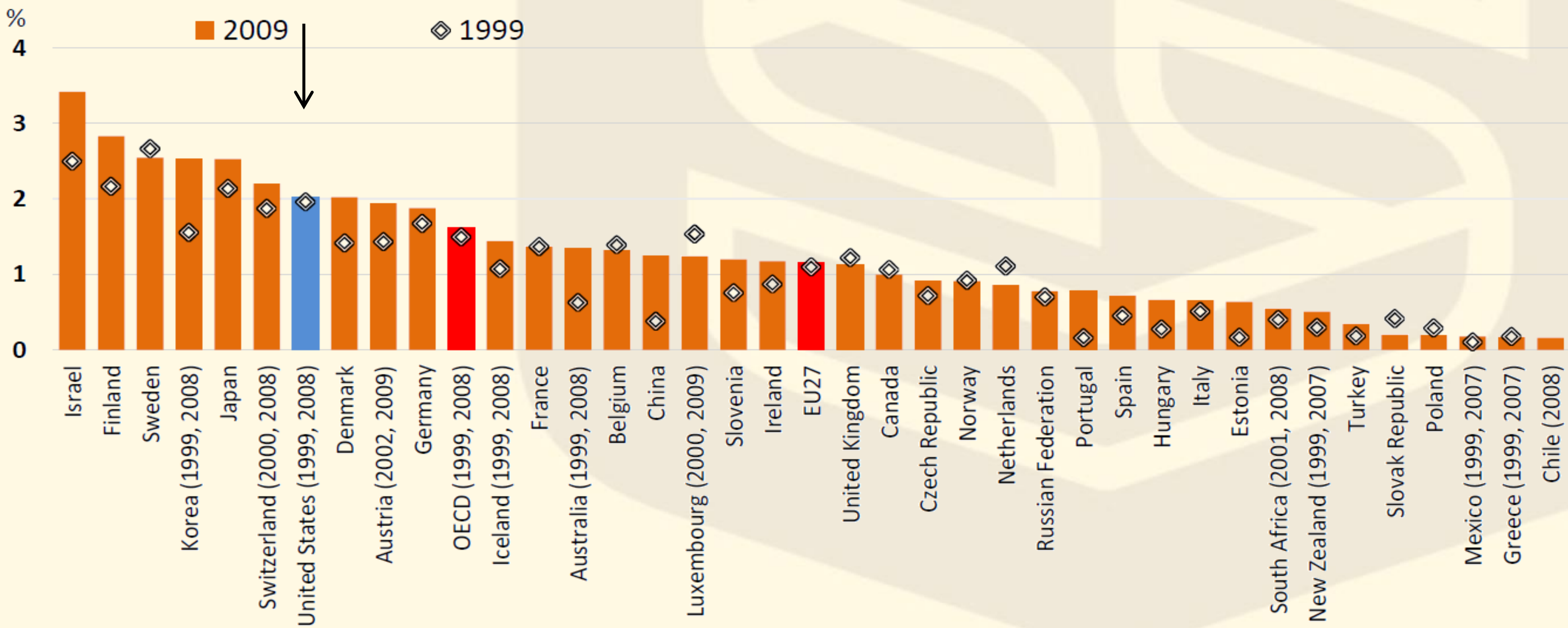
In the next slides, I want to elaborate in one on Promoting Innovation.

Creating Jobs through Innovation and New Technologies

State Governments should focus on promoting innovation as the key to improve competitiveness and create permanent jobs.

Unfortunately, the US has lost its leadership in the level of R&D investment. It has been surpassed by many countries. This trend must be reversed.

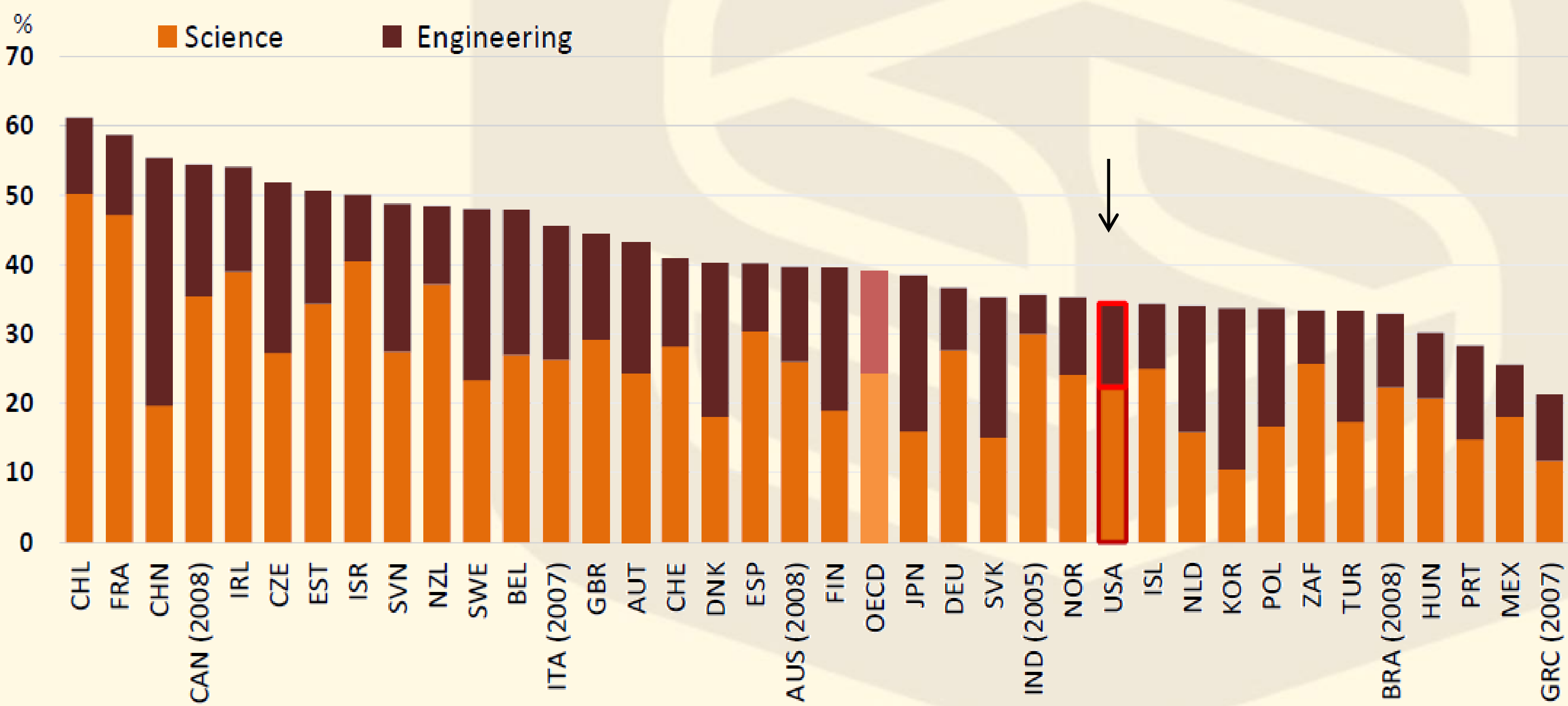
Business expenditure on R&D (*As a percentage of GDP)*



Education Role on Innovation and Technology

University Education in the US is also less focused on science and technology subjects:

Science and engineering graduates at doctorate level, 2009
As a percentage of all new degrees awarded at doctorate level



THE BLEYZER FOUNDATION

Drivers of Innovation and Technology

Several think tanks, including The Bleyzer Foundation, have identified 5 primary drivers that could initiate a boom in innovation and technology:

Reduce the Cost of Doing Business.

- Innovation will not create jobs if its manufacturing takes place abroad.
- Some of the conditions that need to be addressed at both the state and federal level are high taxes, border constraints, inefficient bureaucracy, and access to financing.

Invest in Information Technology Infrastructure.

At the state level, encouraging and promoting growth in technology not only benefits those directly accessing government resources, but the spill over effects can positively impact the economy as a whole.

Establish Better Links Between Government, Business and Universities.

Communication and collaboration is required between these entities so businesses can tap into the growing wealth of global knowledge, adapt it to consumer needs and transform it into products valued by the market.

Invest in Education

- Universities play a significant role in research and development.
- State governments should find creative ways to encourage greater private sector financing of educational facilities at all levels of education.

Establish Technology Parks with Government Infrastructure Support, Managed by the Private Sector

- Well-designed technology parks have a proven track record of reducing the cost of business for technology firms.
- State governments can facilitate and support these developments through strong infrastructure, while allowing the private sector to manage them efficiently.

Where The Bleyzer Foundation Can Help

- The Bleyzer Foundation has extensive and successful experience advising governments on how to attract private investment and improve business climates.
- We can help identify local constraints to economic development and provide effective solutions to these problems.
- Our strength is in bringing together key stakeholders to design and implement policies that enhance business climate.
- And, with over 20 years of fundraising experience we have a unique knowledge of how to organize a successful marketing campaign to attract private investors.

TBF Study of a Typical Local Community

Objective

- Analyze the current state of the business climate of a local community
- Identify strengths and weaknesses, the key obstacles to economic development and key policy actions (investment drivers) within the reach of the local governments that can address those problems
- Based on cost–benefit analysis, advise on policies to enhance investment drivers in the preselected local community to attract new investments
- Based on the analysis of local communities, develop/test policy measures that could be taken by Texas State authorities to improve the business climate state-wide.

Execution

- This work could be carried out in two stages: (1) a comprehensive background analysis of the state of business development and investment climate, and (2) surveys of opinions about the investment climate in the community with key representatives of the business community, key enterprises, and key govt officials.
- The duration of this type of project is about 6 month if the total size of the sample will not exceed 100 companies and 30 non-business stakeholders.

Thank you!

Dr. Edilberto Segura
Partner & Chief Economist, SigmaBleyzer
Chairman of the Board, The Bleyzer Foundation

Texas Economic Development Council
2012 Spring Conference
April 18-20, 2012

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity