The Bleyzer Initiative

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Michael Bleyzer
Dr. Edilberto Segura
John Nellis

THE BLEYZER INITIATIVE

- **Replicate the developed countries' wealth creation capacity in other countries**
- **Refocus** multilateral and bilateral assistance to non-market economy countries on building market economy and private sector development
- Use TBI framework to create capital-friendly environment and attract private equity capital
- Focus most financial assistance on creating private businesses – SMEs and conditions for large multinationals' operations
- Leverage private capital with donor's money
- Implement comprehensive coordinated assistance program for countries in transition: **use donor capital to create the environment, which attracts private capital**
- **Consider privatizing foreign assistance programs beginning with private capital-funded pilot offering a hybrid investment approach to countries in transition**

New World Order

- Today, conflicts rarely stay within national boundaries
- Today, a tremor in one financial market is repeated in the markets of the world
- Today, confidence is global; it's presence or its absence
- Today, the threat is chaos, because for people with work to do and family life to balance and mortgages to pay and careers to further and pensions to provide, the yearning is for order and stability. And if it doesn't exist elsewhere, it's unlikely to exist here

I have long believed that this interdependence defines the new world we live in

Tony Blair, October 2, 2001

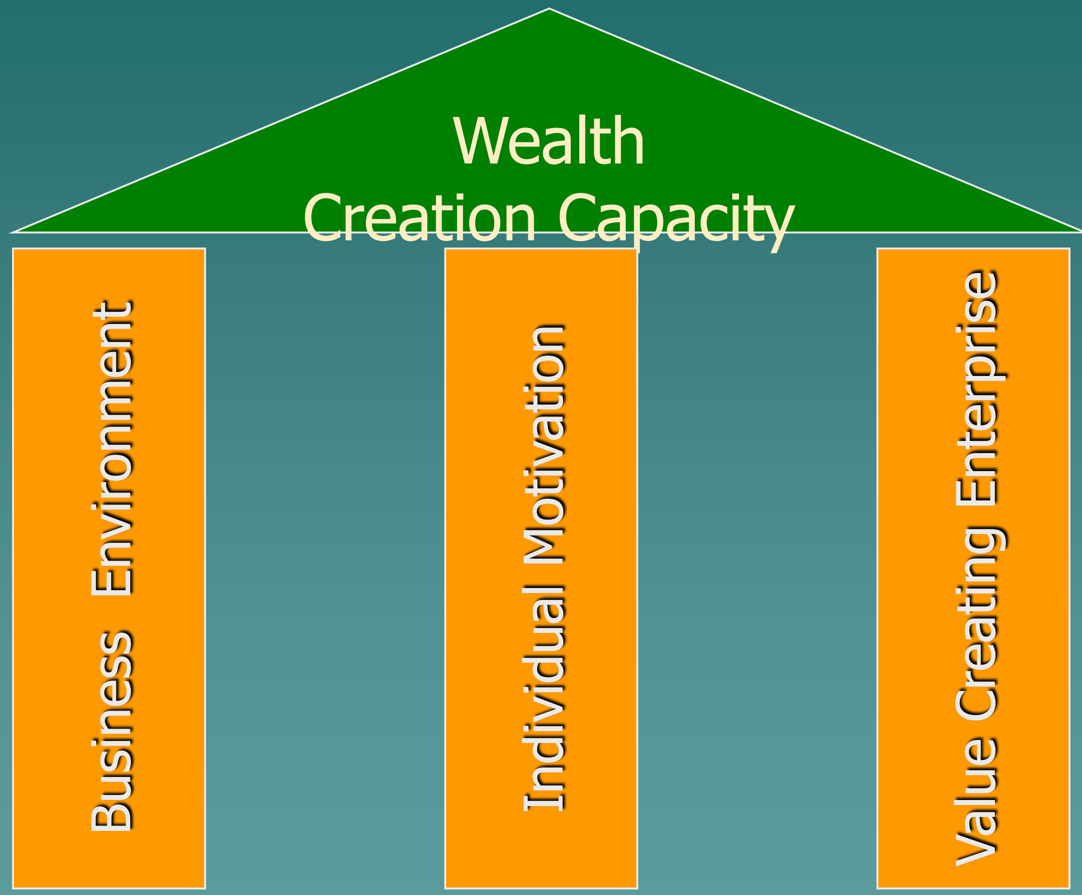
Major Challenge of the 21st Century: Developed and Developing Nations - Assured Interdependence

- Polarization → envy and instability
- Wealth redistribution → flawed and outdated
- Replication of **wealth creation** capacity is needed
- Accomplished through a combination of precisely **targeted assistance** and active engagement – tight linkage between **macro-level economic development** and **micro-level business development**
- Methodology → develop **implementation plans** and **measure progress**
- Private capital will lead new nations to market economy

Wealth Creation Capacity Replication (WCCR)

- 28 “developed countries” not only accumulated most of the wealth, but more importantly most of the wealth creation capacity
- To fight poverty and move the rest of the world (the other 160+ countries) towards market economy, democracy and stability WCCR is necessary

Three Pillars of Wealth Creation Capacity



Aid Can Actually Be Counterproductive

- Many of the old models of economic development assistance are outdated. Money that is not accompanied by legal and economic reform are often wasted. In many poor nations, corruption runs deep. Private property is unprotected. Markets are closed. Monetary and fiscal policies are unsustainable. Private contracts are unenforceable
- When nations refuse to enact sound policies, progress against poverty is nearly impossible. In these situations, more aid money can actually be counterproductive, because it subsidizes bad policies, delays reform, and crowds out private investment
- In sound policy environments, aid attracts private investment by two to one

President Bush, March 14, 2002

Benchmarking Economic Policies

- Based on **historical results** in a large sample of countries
- **Benchmarking and statistical analysis** of 128 countries indicate strong correlation between flows of FDI and investment environment
- Increased flow of FDI is normally correlated with incremental economic growth, improved investment returns, higher risk / reward ratios

Private Equity (FDI) - the Most Stable Source of International Financing

Net Capital Flows to Emerging Markets[1]
(in US Dollars billions)

	1984-89	1994	1995	1996	1997	1998	1999	2000	2001	2002 [e]	2003 [e]
Total Net Private Capital	12	152	212	229	102	62	85	29	25	62	65
Foreign Direct Investment	**13**	**81**	**98**	**114**	**142**	**154**	**164**	**158**	**172**	**151**	**161**
Portfolio Investment	6	113	43	90	47	0	34	-4	-43	-3	-4
Commercial Bank Loans	-5	-42	71	24	-86	-92	-113	-124	-105	-86	-92
Official Assistance	24	4	27	-2	68	70	12	0	15	21	18
International Reserves[2]	-8	-69	-118	-108	-69	-48	-88	-113	-120	-147	-130

[1] Emerging Markets include developing countries, countries in transition, Korea, Singapore, Taiwan, China, and Israel.
[2] For International Reserves a minus sign indicates an increase in Reserves. For Other categories, a minus means a net outflow
Source: World Economic Outlook (WEO) database, IMF, September 2002

TBI Economic Policy Framework

- The Objective of the TBI Economic Policy Framework is to provide the basis to transform a developing country into a country with:
  - improved quality of life
  - better per-capita income
  - less income inequality
  - fair protection of the disadvantaged poor.
- Countries with these conditions are less susceptible to terrorism and political instability.
- The TBI Economic Policy Framework has two components:
  - Macroeconomic Stabilization Policies
  - Policies for Sustainable Investments or investment drivers

TBI Economic Development Framework

- Macroeconomic Stabilization Policies
  - Fiscal policies
  - Monetary policies
- Investment Drivers (Initially 70 investment drivers were identified through benchmarking and statistical analysis of 128 countries, analyzed and grouped into the following key government policy action groups, which stimulated foreign direct investments in successful transition economies)
  1. Liberalization and deregulation of business activities
  2. Stability and predictability of legal environment
  3. Corporate and Public Governance
  4. Liberalization of Foreign Trade and International Capital movements
  5. Financial Sector Development
  6. Corruption Level
  7. Political Risk
  8. Country Promotion and Image
  9. Targeted Investment Incentives

TBI Ratings Sources

Secondary sources:

- Country reports
- Analytical reports
- Statistical reports
- Consultant reports
- Journals
- Magazines
- News articles
- Academic publications
- Other

Primary sources:

- FDI providers
- FDI recipients
- Government organizations
- Government officials
- Non-government organizations
- Development agencies
- Consultants
- Analysts
- Other

Secondary Sources

- World Bank
- Bank of International Settlements
- IMF
- OPIC
- EBRD
- EIU
- Bloomberg
- Country Watch
- Business Central Europe
- Thompson Bank Watch
- S & P
- Moody's
- BISNIS
- Reuter's
- Heritage Foundation
- Transparency International
- International Finance Corporation
- US Reports
- Central Banks Websites
- CIA Handbook
- Fitch-IPCA
- AMCHAM
- Department of Commerce
- Country Websites
- Consulting Companies
- UNDP
- PRS Group
- Impulse Project
- 7 Sisters - Big Oil Firms
- Internet Securities, Inc
- USAID
- MIGA
- OECD
- Others…

Primary Sources

- FDI Providers:
  - Hedge Funds
  - Joint Ventures
  - Private Banks
  - Major Corporations
  - Others
- FDI Recipients:
  - Joint Ventures
  - Local Companies
  - Banks
  - Public / Private Funds
  - Others
- Government Officials / Organizations:
  - Presidential Administrations
  - Embassies
  - Chamber of Commerce
  - Department of Commerce
  - Customs Officials
  - Tax Officials
  - Economic Ministers
  - Trade organizations
  - TACIS
  - Others
- Consultants:
  - Local
  - Foreign
- Analysts
  - Local
  - Foreign
- Other:
  - Educational institutions
  - Thunderbird Faculty
  - Thunderbird Alumni
  - Sister Cities

TBI Framework – A Tool for Action

- A generic prescription for government policies based on benchmarking, best practices definition and statistical analysis of 128 countries
- $FDI = \sum_{n=1-9} a_n d_n + K$

  d=investment driver; a=coefficient; k="natural resources" constant
- "Not Actionable" correlation between FDI flows and "natural characteristics" (e.g., location, size, natural resources, GDP, population, etc.)
- High "Actionable" correlation between government policies and FDI flows
- ***<u>Measuring economic impact of government policies based on the gap between a given country and the best in class in each of the nine government policy areas</u>***
- Econometric model of a transition economy predicting FDI flows based on government policies
- Priorities for 9 points may be different in different countries, but all will need to be addressed to attract stable flows of FDI
- TBI Framework provides a **comprehensive tool** for building consensus and developing an **Action Plan** for **<u>any economy in transition</u>**

Unique Features of the TBI Methodology

- "Quantifies" relative importance of individual economic policies (investment drivers) on FDI and economic growth.
- Supports establishing priorities for Government actions, based on the above quantification of policy impacts.
- Allows forecasting increases in FDI over time, if the country were to narrow its policy gap with the best-in-class countries.
- Other economic reform indexes do not address relative importance of specific policy areas and do not quantify their relative impact on real economic performance.

Unique in the World

- We have not found any other index or a framework anywhere in the world that uses all of the following:
  - Benchmarking Government Policies
  - Identifying best practices in government policies
  - Measuring improvements based on gap analysis
  - Measuring statistical significance of different economic policies
  - Measuring / quantifying impact of economic policy changes on investments and therefore economic growth
  - Forecasting future flows of investments using non-linear mathematical model where the values of regression coefficients are not constant but change depending on the value of the individual indexes. This allows to account for evolving relative importance of each of the nine policy action groups

Macroeconomic Stabilization Policies

- **Macroeconomic Stabilization policies** are those policies and actions that would generate stable prices with low inflation (internal stability), and a stable foreign exchange rate (external stability).
- Internal and external instability increases the risk of doing business: Investors will require significantly higher rates of returns to compensate for the risks of instability.
- As a result of this high risk premium, few projects would qualify for investments, reducing the overall level of investments and economic growth.
- In order to achieve internal and external stability, two sets of policies are key: Fiscal policies and Monetary policies.

Macroeconomic Stabilization Policies

1. **Fiscal Policies** are those that would lead to a Government's fiscal budget in which the fiscal deficit that can be financed by borrowings on a sustainable basis (normally no more than 3% of GDP). This includes actions to:
   - improve the fiscal revenues (tax structure, increase in the tax base, improve tax administration, eliminate tax exemptions, improve cost recovery of public services)
   - Improve Management of Public Expenditures (reduce Current Expenditures of Government, Improve Treasury Operations, reform the Pension System and eliminate Subsidies.
2. **Monetary Policies** are those under which the creation of money (money supply) will not exceed the demand for money (which is affected by the level of income, inflation and interest rates).

Policies for Sustainable Investment (Investment Drivers)

- **Policies for Sustainable Investment** are those policies and actions that would generate a high rate of GDP growth that can be maintained over a long period of time.
- Macroeconomic stabilization policies by themselves are necessary but not sufficient to achieve long-term stability and sustainable growth.
- This is because stabilization policies fail to remove deep-rooted structural economic and social distortions.
- To bring sustainable economic stability and growth, stabilization policies must be complemented by policies for sustainable investment activity.

Government

Government is defined as all governing bodies of all branches and at all levels, including for example executive, legislative, judiciary branches, local and regional governments, and others

Driver 1: Liberalization and Deregulation of Business Activities

- Government policies and actions that reduce government intervention and enable private businesses to operate freely and make profits in a competitive environment. Create an on-going system to remove barriers to entry, operations and exit, that will among others:
  - Facilitate the formation of new businesses
  - Reduce licensing and registration requirements
  - Remove price controls and domestic trade restrictions
  - Reduce the number of government inspections, interventions and interferences in business activities
  - Simplify reporting requirements
  - Reduce the cost of doing business, including taxation levels
  - Simplify closure of failing enterprises
  - Liberalize labor markets, improving labor mobility and reducing excessive labor costs imposed by Government (such as excessive minimum wages, payroll taxes, high un-employment compensation).

Driver 2: Stability and Predictability of the Legal Environment (The Rule of Law)

Set of policies and actions to enact and implement stable and predictable laws and regulations that would support and encourage private sector businesses in a free market. They require, among others, the following actions by the Executive, Legislative and Judiciary branches of Government:

- Enact appropriate legislation that would define the "rules of the game" for all business, without discrimination or preferential treatments, including modern civil, labor, tax and commercial codes and legislation to protect intellectual property rights, patents, technology transfer policies, and direct foreign investments.
- Improve the processes for drafting, presenting, and carrying out public review of proposed business-related legislation.
- Create an independent Judiciary, with its independent budget.
- Make the Courts more efficient and capable of settling commercial disputes.
- Empower the Executive to enforce judgments made by the Courts, including those on commercial contracts.
- Review existing legislation from the point of view of inconsistencies among different legal documents.

Driver 3: Corporate and Public Governance

- Set of policies and actions aimed at improving the governance of private companies and public administration to support private sector activities in a free market economy. They include policies in Corporate Governance, Public Administration and Privatization of state properties.
- **On Corporate Governance,** the objective is to establish appropriate rules that would guide the activities of businesses in the best interest of their shareholders, protecting ownership rights. Key policies and actions include:
  - Enact appropriate corporate governance legislation.
  - Require all companies listed in stock exchanges to switch over to international accounting standards and to submit annual reports.
  - Encourage the creation of non-government organizations to support corporate governance and issue corporate governance codes and model charters and by-laws.
  - Implement a comprehensive corporate governance training program for board members, shareholders, managers, etc.

Driver 3: Corporate and Public Governance

- **On Public Administration**, the objective is to redefine the role of the Government to support the private sector and secure the provision of sound and efficient Government services without corruption . The implementation and sustainability of economic policy reforms over time also require strong -- though smaller -- Government with strong management and administrative capacity. A Public Administration reform program should include:
  - Establish a clear strategy and vision for the role of the Government as complementary to and supportive of the private sector.
  - Introduce adequate regulations to avoid monopolistic behaviors.
  - Consolidating ministries and agencies to avoid responsibility over-lapping.
  - Undertaking "Functional" and "Operational" reviews for individual ministries and agencies.
  - Reforming and modernizing the Civil Service by providing adequate incentives for performance and "market" controls.
  - Reforming Government Procurement Practices.
  - Reforming central-local government fiscal relationships.
  - Reduce shadow economy activities by drastically lowering cost of compliance with legislation in effect.

Driver 3: Corporate and Public Governance

- **On Privatization,** the objective is to improve the efficiency of resource use through private ownership, minimize the possibilities of undue market power by the Government, and concentrate Government resources on public goods. Key measures include:
  - Pass appropriate legislation to permit the privatization of land and state enterprises.
  - Develop appropriate mechanisms to register ownership rights, including land titling and land registration.
  - Create and encourage the independence of an agency to carry out the privatization of state properties.
  - Approve fair and transparent procedures for the privatization of state properties
  - Complete rapidly the privatization of all state enterprises under clear and transparent procedures.
  - Take early actions to prepare state companies for privatization, including actions to protect minority shareholder rights, and transfer social assets to local authorities.

Driver 4: Liberalization of Foreign Trade and International Capital Movements

Set of policies and actions to facilitate the exports and imports of goods and transfer capital internationally. This will require the following actions:

- Remove restrictions to exports, including export quotas, duties, indicative prices, advance deposits, and foreign exchange surrender requirements.
- Remove restrictions to imports, including high import duties, critical import list, and indicative prices.
- Simplify and expedite custom services, including procedures for custom clearances.
- Develop more modern and consistent procedures for certification requirements and standards of products
- Liberalize foreign exchange transactions and eliminate restrictions on foreign direct investments.
- Cancel all restrictions on purchase of securities in foreign currency.

Driver 5: Financial Sector Development

Set of policies and actions to develop a healthy financial sector capable of meeting the financing needs of growing businesses. Key measures are the following:

- Liberalize interest rates on bank deposits and lending.
- Eliminate preferential credit programs imposed by the Government on banks
- Increase the independence and autonomy of the Central Bank to operate by efficiency not political considerations, with its main goal being the maintenance of internal and external stability.
- Ensure that health of the banking sector by improving bank supervision and enforcing prudential regulations.
- Develop appropriate mechanisms to deal expeditiously with troubled banks.
- Strengthen the Securities and Stock Market Commission.
- Introduce International Accounting Standards and external auditing requirements for all banks.
- Encourage competition and efficiency in the financial sector by facilitating the expansion of foreign banks and non-bank financial institutions.

Driver 6: Corruption Level

Set of policies and actions to minimize corruption and protect businesses from abuse of power by government officials. Key measures include:

– Undertake measures to "prevent" corruption, reducing the opportunities for corruption and making corruption more difficult to undertake.

– Develop the legal framework to ensure better enforcement of anticorruption measures and impose visible, harsh, swift and certain penalties for official corruption.

– Get public support for anti-corruption programs by making people aware of their rights and the rules of the game.

Driver 7: Political Risks

Set of policies and actions to minimize the effects of political uncertainties on business activities. Key measures include:

- Pass appropriate legislation to reassure investors that arbitrary expropriation of private property, including "creeping expropriation", will not be permitted in the country.
- Introduce strong measures to eliminate power abuses by the Government authorities, bring tax collectors and local officials under the control the central administration.
- Give the Government the total authority to do their jobs unimpeded by vested interests.
- Provide Governmental stability, including the longevity of key Officials.
- Ensure law and order.
- Minimize the risks of civil and external disturbances that may affect businesses.

Driver 8: Country Promotion and Image

Set of policies and actions to promote the country and improve its image as perceived by foreign and domestic investors. Key measures include:

– Announce and disseminate widely the Government's policy and commitment to implement strong market oriented policies and show implementation progress.
– Vocally support foreign investment by changing the attitude of officialdom at central and local levels.
– Require all embassies abroad to have their commercial section strengthened, and to go on a sales drives to better disseminate business opportunities.
– Assist in the establishment of a private investment promotion agency.

Driver 9: Targeted Investment Incentives

Set of policies and actions to bring investment incentives to levels similar to those of its trading partners, while avoiding targeted incentives that may lead to distortions and inefficient allocation of resources. Key measures include:

- Eliminate special investment incentives targeted to specific sectors, enterprises or regions.

(Note: this driver has a negative correlation)

IFIs Role, Results and Problems

- Official multilateral institutions (particularly IMF and World Bank) were created to provide economic advice and financing to developing countries to sustain economic growth.
- The IMF has been relatively successful in securing macroeconomic stability in many developing countries.
- But the World Bank and the Regional Banks have been less successful in creating the conditions for sustainable economic growth.
- Their poor record is not because they lack good people to diagnose and prescribe.
- The main reason is that they are at heart political, "official" institutions, owned by Governments and operating under political rather that economic incentives.
- They suffer from many of the same problems faced in developing countries by state-owned enterprises.

IFIs Role, Results and Problems

- Their goals and objectives are unclear and diffused and sometimes even in internal conflict.
- They are dominated by a laudable but fuzzy concept of ending poverty and assisting the poor
- The Governing Boards and Presidents of these institutions are political appointees and are there first to defend the interests of their countries and only secondarily to support the spread of economic reforms.
- They also have a great pressure to lend and to make sure that each country will receive a "fair" share of lending.
- This may mean that they also have a pressure to maintain "friendly" relations with all countries, regardless of their commitment to reform.
- As a result, they tend to be over optimistic about the prospects of reform to enable continuation of lending.

IFIs Role, Results and Problems

- Internal budget limitations also lead to insufficient due diligence before loans are made.
- The need to maintain their creditworthiness and avoid defaults also leads these institutions to pressures to continue lending to enable the countries to re-pay their debts.
- Similarly, the lack of accountability for public funds has led to inadequate supervision and control in the use of loan proceeds, with numerous cases where funds were misused.
- Non-performing countries understand these pressures and play a lip-service game by repeating reform promises they had made earlier and had failed to live up the first time around.

IFIs Role, Results and Problems

- Other borrowing countries have lost confidence in these institutions as they are seen as instruments of the G-7 to advance their political interests.
- These difficulties have also led these institutions to concentrate on "easy" sectors that are non-controversial and would be easily approved by everybody.
- This normally means more loans and investments in the social sectors (education, health, environment) which are unlikely to raise questions.
- Therefore, much less emphasis is placed on lending for private sector development, which would require policy reforms that may clash with vested interests (such as liberalization of business that may bring foreign competition) and may require a tougher stance.

Where is Private Sector?

- It is clear that a favorable business environment is an important determinant of business profitability.
- Then, why such an important matter has been ignored by large private foreign investors? Why in the past, the private sector has not been more involved in inducing policy reforms if these reforms are so important to the health of their businesses?
- Improving business environment is a kind of "public good". Its advocacy has the cost incurred by the “champion”, but the benefits will accrue to all investors. Once it is achieved, everybody will reap the benefits.
- An individual investor will rarely engage in this activity as the cost is high and the improvements will also benefit its competitors, which would just be “free-riders”, without bearing any of the costs.
- Therefore, Economic Development has been so far "delegated" to the international financial institutions, particularly the IMF (for economic stabilization) and the World Bank and Regional Banks (for economic growth).

Private Sector Initiative

- This kind of "public good" demands collective action among a group of investors.
- Collective Action through a Private Aid Initiative would minimize the risks that led Public Government-owned institutions to fail.
- A private sector initiative would be
  - more focused on the private sector
  - more demanding on measuring results
  - not operating in hopeless environment
  - more capable of walking away when promises are not fulfilled
  - more clear on its business goals and therefore more understandable for the recipient governments