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Outsourcing is becoming the standard term for activities that include offshoring and near shoring and has been portrayed as a major threat to jobs of US workers. Legislators at both the state and federal level have proposed laws to discourage and even penalize outsourcing. However, according to figures from the Department of Labor, outsourced jobs are not large in numbers when compared to the size of the US work force.

We invited experts from Colorado technology companies to discuss the role of outsourcing in their strategy. We heard from Prof. Manuel Serapio about his research findings about outsourcing in the IT sector. In that much of the technology and service sector outsourcing has been widely identified with India, we invited two experienced speakers to address the rise of India and the nature of outsourcing in the IT sector in India.

What seems clear is that outsourcing is not new; it has been going on since before the Industrial Revolution. Outsourcing is a strategic competitive option for most companies operating in global markets and needing to improve productivity and reduce costs. Barbara Bauer of StorageTek reports that in addition to cost savings the company found important skill sets in India that were not available in the current US job market. A guest pointed out that business process outsourcing was the growth area for outsourcing. Functions such as HR and payroll, common to most companies, could when outsourced turn cost centers at one company into profit centers at another company.

The sessions on India, with Arup Gupta of Tata Consultancy Services and Radhika Rajan of The Chatterjee Group, identified the evolution of a country from its independence in 1947 to the revolutionary changes there in the last decade. Economic reforms have led to higher growth rates, lower inflation, higher FDI and trade. The country is becoming the world's IT destination and also the fourth largest pharmaceutical market in the world and the second largest small car market in the world. India looks to be heading for a place near the top of the world economies over the next two generations.

A different view of outsourcing was apparent in the discussion of European Union expansion. Our Vienna Global Forum in spring 2004 examined the ten new countries which were set to enter the EU on May 1, 2004. At that time we raised questions about how the new entrants, with younger work forces earning a fraction of the wages of workers in the Western European member states, would integrate with the older, wealthier EU. In our EU sessions we examined several of these competitiveness issues, comparing wages, social benefits and productivity within the expanded EU. We also took a look at Turkey and the prospect of further EU expansion.

We hope you find this edition of the Global Forum Report informative and timely.

Donald L. Stevens, Ph.D., Managing Director
Institute for International Business

Global Executive Forums are held twice annually, with each agenda focused on a global business theme as well as a geopolitical theme. Following each meeting, the sessions are summarized in a Global Executive Forum Report and disseminated to colleges of business across the nation. Information: Phone 303-556-4738; Fax 303-556-6276; Web http://www.cudenver.edu/inst_intl_bus/main.html
Indian IT companies are writing the software that runs the inner systems of foreign companies.

The rise of India in the global economy

It has taken nearly half a century for India to become the overnight star it is today. From 1947 when the British departed, through the beginning of the 90s, the economy stagnated under strict government controls and excessively high tariffs.

“If you wanted to buy a computer, there would be a 160 percent duty,” said Arup Gupta in his address to the Global Executive Forum. He recalled when India’s foreign exchange reserves were enough to pay just one day of imports. “Today our foreign exchange reserves are way above $100 billion,” and a Goldman Sachs Study predicts that India will become the third largest economy in the world by 2050 after the United States and China.

The reason India has been able to get from here to here is due to the economic reforms instituted by Prime Minister Narasimha Rao in 1991 following the assassination of his predecessor Rajiv Gandhi. The current Prime Minister Manmohan Singh, who was finance minister under Rao, is accelerating the pace of economic liberalization.

“The economic reforms have led to higher growth rates, lower inflation, significant increases in foreign direct investment (FDI) and imports and exports,” said Gupta.

What this means in hard figures is a GDP growth of 8.2 percent for the year 2003-04 or $610 billion in US dollars; $8 billion to $10 billion of this comes from IT outsourcing. In the fiscal year ending 2004, India was the recipient of FDI totaling $16 billion. “Roughly half of that comes from the US, with the rest coming mostly from the UK, Germany and Japan,” said Gupta.

India’s economy still lags behind China’s and Gupta readily admits that “in the 70s we missed the manufacturing wave and China took the lead.” Not so with IT services, a sector in which India has been able to claim a dominant global position. “Companies like Tata Consultancy Services (TCS) and other premiere IT companies from India are taking steps to make sure that they retain the lead,” he said.

Gupta linked the boom in India’s software industry to TCS, which in 1968 was instrumental in elevating the professional standards for software developers. “In those days the IT industry in India was really nonexistent,” said Gupta. “Our founder, Mr. Tata, truly believed that software was an engineering science and that only engineers should be involved in its development.”

Consequently, programmers today have a master’s degree or a bachelor’s degree in computer science. “All the Indian software companies are now at CMN Level 5, which is the highest level of certification for software development.” The value of this education shows up in the country’s software exports which “have been growing at an annual rate of 50 percent,” said Gupta. The value is also apparent in India’s hard-won position as an IT destination for the rest of the world.

Without doubt India’s slice of the IT pie is significant and its reach worldwide. Indian IT companies are writing the software that runs the inner systems of foreign companies and they dominate in all aspects of IT-enabled services (electronically based services from call centers to business processing outsourcing).

But will India be able to retain its competitive edge if the rising demand for engineers reduces the supply of talent and causes salaries to swing upward? There are foreign companies already asking Gupta this question.

“As the demand for IT goes up, the salaries are going up,” he said. “But we feel that India is still going to be competitive, at least in terms of salary, for the next 15 to 20 years.” As for supply, “All the educational institutions are geared up to produce the numbers that we think can meet global demand.”

Also, there is a reversal in the trend of engineers immigrating to the US for jobs as many of those jobs are being outsourced to India. “So they are finding a much better opportunity back home,” said Gupta.

And India wants to become a destination for more than just IT services. “India has a dynamic economy not limited to IT or IT enabled services.” According to Gupta, a number of global companies in pharmaceuticals, agriculture and finance are outsourcing their R&D and production functions to India.

■ “India is the fourth largest pharmaceutical

India’s human capital edge

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<thead>
<tr>
<th>Category</th>
<th>Value</th>
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<tr>
<td>Population</td>
<td>1.068 billion</td>
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<tr>
<td>Population under 25 years of age</td>
<td>547 million</td>
</tr>
<tr>
<td>Over 3 million scientific &amp; technical manpower</td>
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<tr>
<td>Over 0.8 million post graduates in science</td>
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<tr>
<td>Over 1 million graduate engineers</td>
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<tr>
<td>0.4 million doctors</td>
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<tr>
<td>0.3 million graduates in agriculture and veterinary sciences</td>
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<tr>
<td>India turns out more than 50,000 computer professional and 360,000 engineering graduates each year</td>
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Source: Tata Consultancy Services
“India has the potential to show the fastest growth over the next 30 and 50 years.” – Goldman Sachs study

producer with 8 percent of the global production by volume.

- “We are the second largest small car market in the world and the largest motorcycle manufacturer in the world because most of the population in India gets around by motorcycle.
- “The Tata Group, a leading conglomerate of 91 companies with revenues over US$14.26 billion, accounts for 2.4 percent of India’s GDP and 5 percent of its exports.
- “Tata Steel is India’s largest private sector steel producer.”

But India is still playing catch-up in areas such as infrastructure. “Where China has invested very significantly in roads and transportation, we are lagging behind,” said Gupta, adding that the government is now investing aggressively to correct this deficiency.

While India has a highly educated population, the literacy rate nationwide is low. That, too, the government is working on, with educational initiatives aimed at getting more people into the system. In 1981 the literacy rate was 43.5 percent; in 2001 it was 65.3 percent. But despite a thriving economy, deep pockets of poverty persist in the rural regions.

“Nobody is saying that today we can compete with the US or China in terms of military or economic power. But in the global perspective, we are definitely making progress. Indian companies have now raised themselves to the level of multinational companies and we are competing in that context,” said Gupta.

“We are poised to be a global economic power, possibly the third largest, by 2050.”

Progress depends on India staying the course.

“Our GDP needs to continue to grow, our political system needs to continue to be stable, and we need to remain competitive not only in IT but in pharmaceuticals and manufacturing,” said Gupta.

No longer a country without prospects, “India is rising and it cannot be safely ignored in the future as it has been in the past.”

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Making the case for India

Color India young, a demographic picture that will help the country’s long-term economic outlook, said Radhika Rajan in her address to the Global Executive Forum.

“One of the most important drivers of a country’s growth is the number of people in the working age group 15-64. And in this India has an advantage because the majority of the population is in this group,” said Rajan. “We’re not going to hit the high dependency ratios (of working age to retired) until way beyond 2040.”

The 15-64 age group is important for another reason, “because people in the working years tend to save more.”

In order for India to become the third largest economy by 2050 as predicted by Goldman Sachs, “it must maintain a 5 percent growth rate per annum. India is the only country among the major countries expected to do this,” said Rajan.

What will poverty look like in 2050 as a result of this growth? “India will still be a relatively poor country with a per capita income of $20,000 a year, the lowest of all the major economies. Goldman Sachs predicts the US in 2050 will have a per capita income of $80,000; Russia and Brazil also will be higher than India. But as an aggregate, the clout and the wealth that India represents will be quite high.”

The per capita income, while comparatively low, has steadily increased over the last two decades to 3.9 percent today from 1.9 percent 20 years ago.

“Since 1993, about 100 million people have been raised above the poverty line.”

As India looks to secure its future as an economic power, it is focused on maintaining its stability while making all the right moves to generate growth and opportunity. Internal price flexibility, infrastructure development, privatization and the forces of globalization have pushed the country along in this direction.

Domestic sector growth

In addition to positive demographic trends, the services sector will continue to drive the economy, Rajan said. This sector, together with industry, accounts for 78 percent of India’s GDP. Other factors important to the economy:

- Export sector. “From 1998 to 2003, exports of services grew 228 percent. Despite the recent noise in the US against outsourcing, we believe strong software exports, including business process activities, are likely to continue based on the economic benefits of the model.” Exports of agriculture products decreased by 3.03 percent during this period.
- Agriculture. 22 percent of the GDP comes from agriculture. This is a challenge because 57 percent of employment is in agriculture. “India is the largest milk producer in the world and the largest producer of fruits and vegetables in the world. There are huge opportunities in food processing and similar industries which have been held back because of

Radhika Rajan is a principal with The Chatterjee Group in New York, where she is responsible for structuring and building investment vehicles and platforms into India. Currently she is focusing on structuring a hedge fund to invest in Indian equities. She is a results-oriented financial markets professional with over 20 years of profit-responsible experience including 17 years as a proprietary trader, strategist and market maker at premier institutions in foreign exchange and financial futures. She is the coauthor of a book on the global Internet economy published by MIT Press Feb. 2003.
The major risk to India’s economic growth is the large size of the fiscal deficit . . . attributed to cuts in tax rates.

India is -

- The 2nd most populated country in the world with one sixth of the world’s population; projected to overtake China in 2033;
- the 7th largest country in the world in terms of total area of the country; it is one-third the size of Europe with a 7,000 km coastline, 13 major ports handling 287 mt cargo;
- the largest consumer of tea;
- the largest in the number of cinema attendance at 2.9 billion a year;
- the largest consumer of gold accounting for one-fifth of the world’s annual gold consumption.

—EIU; UNESCO Institute for Statistics; CLSA

government policy which protects the agriculture sector from outside investors.

- Financial sector. Market forces have caused a steady drop in interest rates over the last decade and a sharper decline over the last three years. Rajan attributed this to more favorable government policies. “The Chatterjee Group has been investing in India since 1994 and views the financial sector as holding great potential.”

- Stock exchange. “India has the third largest investor base in the world after the US and Japan with over 30 million shareholders. There are about 9,000 stocks listed on the country’s two major exchanges: The National Stock Exchange (NSE) and the Mumbai Stock Exchange (BSE).” Both are located in Mumbai (formerly Bombay).

According to a report by The Chatterjee Group, “Market valuations do not appear excessive and recent economic projections of a 6 percent to 8 percent growth rate appear sustainable. The present government feels strongly that 8 percent per annum growth is necessary to meet its poverty eradication and employment objectives.”

- Currency (rupee). “For the first time in my lifetime the currency has actually appreciated and is likely to continue a stable to upward growth path.” The threat of competitive Asian devaluations is gone, with the Chinese yuan also expected to strengthen. The only threat to the rupee’s strength is rising oil prices. India imports nearly 70 percent of its oil.

But it’s the size of India’s fiscal deficit — 60 percent of the GDP — that poses the major risk to economic growth. “This figure has remained static over the last number of years in spite of getting more people and more corporations into the tax net,” said Rajan. This is because tax rates have been lowered across the board. “I think India has lower personal tax rates than the US. Dividends are not taxed. Long-term capital gains have been abolished and short-term capital gains is just 10 percent.”

The government hopes that efficiencies in tax collection and widening the tax net will alleviate the problem. But “it’s a serious issue.”

Another question was about jobs: “There’s an incredible amount of people coming into the workforce every year. Where are they going to find jobs?”

Said Rajan, “This is an important question because the maximum number of jobs that are created each year in the IT sector is maybe 10 million, clearly not enough for a nation with about a half billion people under the age of 25 plus a significant number under the age of 16.” She said there were signs that the services industry was expanding beyond IT and into health services and education services.

“A large number of private medical and engineering colleges have sprung up, especially in the southern states, and they totally cater to the job market.”

China vs. India

Two of the largest countries in the world have taken different paths to growth.

Said Rajan: “China’s development has followed the traditional model of agriculture to industry, with a strong and growing manufacturing sector and a slow-growing services sector. India’s development is the mirror image.”

China has a number of things going for it that India has yet to equal, said Rajan: “A dynamic economy with an annual GDP growth rate of about 9 percent for the past 15 years, a 40 percent savings rate — almost twice that of India’s; much better infrastructure; and a huge manufacturing sector with a large pool of hard-working low-cost labor.

“India has the advantage of a huge services sector and a small but skillful group of better educated people who are entrepreneurial and speak English. Underpinning these advantages is India’s democratic system of government.

“India is often compared unfavorably to China in terms of development. But India is a participatory democracy — the largest in the world — and when innovations and policies are achieved by consensus they have a far more lasting and stable effect than when they’re achieved by authoritarian fiat.”

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**India: Domestic growth drivers**

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<tr>
<td>Services</td>
<td>7.60%</td>
<td>8.50%</td>
<td>Rising consumer disposable income Boom in the ITES / BPO industry*</td>
</tr>
<tr>
<td>Mfg./Infrastructure</td>
<td>5.10%</td>
<td>6.80%</td>
<td>Heavy government spending in highways and transportation. Increased private investment in telecom</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1.40%</td>
<td>9.10%</td>
<td>Bumper monsoons</td>
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*IT Enabled Services / Business Procession Outsourcing
Source: The Chatterjee Group
The cost per engineer in the US, Japan and Europe can range from four-five times higher than in India.

India’s software development curve

There are many challenges connected to the outsourcing of complex software development projects but “the hardest part is finding the combination of people who are experienced and who understand the business of the company and the technologies that can serve that business,” said Barbara Bauer, in her address to the Global Executive Forum. Bauer drew on her experience at StorageTek to define the issues and provide insights into India’s strengths and weaknesses.

Traditionally a company that builds tape drives and disk drives, StorageTek is now building a suite of software products that “we believe can transform the marketplace relative to storage technologies.”

The complexity of the products and the need for quality, predictability and time-to-market are motivating factors in StorageTek’s decision “to look for partners in India where IT workers have capacity we couldn’t find in the US,” said Bauer. Also, “Indian companies have a structure about how to do this work in a way that enables it to be managed remotely.”

But identifying companies that have unique technologies has become very complicated and new companies are springing up overnight. Bauer has found that “boutique and niche firms are learning how to do product development and they are offering products to us that we can embed in our solutions. They will become the technology product companies of the future.”

Once the need for quality is satisfied, costs enter the equation when deciding on a location. “The cost per engineer in the US, Japan and Europe can range from four-five times higher than an engineer in India.

“A key project offshore with a large team enables substantial cost savings. Consequently, StorageTek has been able to invest in two more projects and the net result is the creation of more jobs in the US.”

“My head count in Louisville is going up this year as a result of our ability to get some of these products to market and begin to generate revenue.”

While there are savings in labor costs, there are invisible costs that should be factored into outsourcing or offshoring such as communications and the time it takes to transition the work from one country to another. According to CIO magazine, Bauer said, “A full year of issues and reduced effectiveness should be anticipated.”

Despite the fact that Indians and Americans speak a common language, cultural differences can hamper communication. “A very positive aspect of the culture in India is that people are very respectful and well-mannered — so much so that they are reluctant to deliver bad news. The person on the India team is not apt to tell you ‘we’re bleeding red and we need to do something differently.’ We work hard on addressing this problem through metric systems and status reports but with mixed success.”

Indians will assign a literal meaning to the spoken word so “assume that exactly what you ask for will occur, which is usually not what you really want.”

Potential problems

The India experience is uneven. “The infrastructure is not keeping up. Roads and telecom are limiting our ability to actually take advantage of people over there.” And looking ahead at where the next crop of software engineers will come from, Bauer sees potential problems.

“I think we need to make changes in the education system both in the US and India. There is insufficient cross learning between technology education and business education. The people I have in my engineering organizations are frequently very good technologists but they have a hard time understanding a business plan.”

And there aren't enough people skilled in the old technologies. “We need mainframe skills,” said Bauer. “Everyone thought that mainframes, those gargantuan machines that predate PCs, were heading for obsolescence but that hasn't happened,” she said. “Every large bank in the world has IBM mainframes and they will have them for a long time. But mainframe skills are dying in India because the education has been focused on the emerging open systems domain.”

Perhaps equally disturbing is “an aspect of rigidity in India’s educational system which is limiting to the creativity of the technologists that we work with. If India figures out how to introduce that element of creativity, they will be an incredible force in terms of this sort of software development.”

In fact, said Bauer, “the next Bill Gates may already be in India.”

Barbara Bauer is vice president of Software Engineering and Development at StorageTek, a public company headquartered in Louisville, Colorado, with over 7,000 employees located in 32 countries. Prior to StorageTek, Bauer led a consulting firm BTB Associates, Inc., where her major initiatives were software engineering assessments, enterprise solution implementation planning for large companies and program and project management. She was also an executive at US West where she led an initiative to achieve CMM L2 for the corporate and e-business software development organizations. Her academic credentials include a BS and MS in physics and the Stanford Executive Program.

The real cost of offshoring, whether external or internal, is as high as 45 percent of the value of the work/contract due to initiation and ongoing tasks. —CIO magazine, Forrester
Outsourcing is an important topic for Colorado, which ranks first nationally in the concentration of IT workers.

Outsourcing: What the numbers mean

Outsourcing in Colorado’s IT sector is prevalent “but the scale is not as great as reported in the press,” said Manuel Serapio, who shared with the Forum key findings of his study “International Outsourcing in Information Technology: Trends, Developments and Implications for Colorado,” sponsored by the Colorado Institute of Technology.

The press seized on a 2001 Bardhan & Kroll study which noted that 14 million jobs were at risk to offshoring, said Serapio. “But what the Bardhan study did was identify four or five attributes of jobs that can be outsourced. They then put these together with Bureau of Labor statistics and calculated the number of jobs that incorporated the attributes. That’s how they came up with 14 million jobs at risk, and some newspapers misinterpreted this as the number of jobs that will be lost to offshoring.”

Fourteen million is an unrealistic number because “a lot of the IT jobs are not in IT companies; they’re in law firms, real estate and small accounting practices — companies that do not have the scale of size to make outsourcing worthwhile. So only a small portion of the 14 million jobs is actually jobs at risk or subject to international outsourcing.”

The same holds true in Colorado where there are about 10,700 high tech companies, 33 percent of which have less than 10 employees. About 38 percent have 11 to 50 employees.

The study addressed four major issues:

■ How much outsourcing is going on, and to what extent will it continue?
■ What factors drive the decision of companies to outsource or not to outsource?

International outsourcing
Definition
“The phenomenon of locating IT-services and other business processes in optimal off-shore locations, largely enabled through recent advances in communications technology, to leverage differences in wage levels and the availability of skilled labor across borders.” —McKinsey and Company

■ How will international outsourcing impact IT jobs in Colorado and in the United States?
■ What are the policy implications of IT outsourcing/offshoring trends in Colorado?

Serapio acknowledged that the discussion has become very emotional. “It’s difficult to refute the fact that outsourcing is costing US jobs, but it’s also difficult to measure the numbers exactly.” Figures vary from high to low depending on whether they’re coming from opponents or proponents. However, “both sides are using figures that are inaccurate.”

The topic of outsourcing is especially important to Colorado, which ranks first in the concentration of IT workers. “Ninety-eight out of 1,000 Colorado workers in the private sector are in IT.” (Note: Outsourcing and offshoring are used interchangeably.)

Why India?

Thirty-four Colorado companies were involved in Serapio’s study which included some of the largest employers in the state as well as small entrepreneurial companies. Of the 34, “the majority was in financial services and IT consulting/services. Two were in telecommunications and four or five in software.

“Twenty-two of the companies were outsourcing, 12 were not. The bigger companies — telecom and software, for example — are very aggressive in their outsourcing activities,” said Serapio.

“Slightly more than half of all companies interviewed said they outsource to India.”

Why is India getting so much of the action? Companies in this study cited three factors: the availability of a well-educated, English-speaking workforce that can be employed at competitive wages; a favorable technological infrastructure; and growing strengths in fields such as applications software development.

“Lower labor costs, access to high-quality employees and the flexibility to augment the workforce as necessary were the major reasons companies gave for their outsourcing decision,” said Serapio.

* International Outsourcing: Trends, Developments and Implications for Colorado
Research Objectives:
■ Identify key trends and developments in the international outsourcing activities in IT by companies in Colorado.
■ Address the factors that influence the decision of Colorado companies to engage in international outsourcing in IT, including decisions pertaining to investment and establishment modes and partner choices.
■ Assess the impact of international outsourcing on IT employment in Colorado companies.
■ Explore policy and programmatic options in regard to how Colorado could best address the opportunities and challenges of international outsourcing.

—Professor Manuel Serapio

Manuel G. Serapio, Jr. is associate professor and program director of International Business at the Business School, University of Colorado at Denver and Health Sciences Center (UCDHSC). He received his Ph.D. from the University of Illinois at Urbana-Champaign. Professor Serapio’s research and teaching interests are in foreign direct investments, the internationalization of research and development, international alliances and cross-cultural management. He recently completed his sponsored research for the Colorado Institute of Technology, International Outsourcing in Information Technology: Trends, Developments and Implications for Colorado.
Companies not outsourcing said they already enjoy a price advantage in the marketplace and, therefore, it isn’t necessary for them to pursue lower labor costs outside the US. “They also cited proximity to customers, the dynamic and complex nature of their business and a company culture that stressed hiring Colorado workers as reasons for keeping the work at home. Others feared a potential customer backlash should jobs be sent overseas."

Thirty-six percent of the companies interviewed for the study said “their spending on international outsourcing next year will be somewhat more than in 2004; 36 percent said it would stay about the same. ‘My immediate reaction is that increases in outsourcing here in Colorado may not come from those companies already doing it,’” said Serapio. “Increased outsourcing may come from companies not yet engaged in it or just beginning to test the waters.”

**IT enrollments down**

The study exposed some glaring gaps in IT education. “One of the things we found in this study is the nature of work is going to change. While technical competence will continue to be very important, most future jobs are going to require expanded skills. These skills include project management, communication and consulting—the ability to manage and work with a global workforce—and a greater knowledge of the business,” said Serapio.

But to a large extent universities are not graduating IT students to succeed in this new world of work. “Most IT graduates finish with excellent technical skills, some management skills but very poor communication skills. They have little in the way of consulting and project management skills.”

To remedy this situation, “IT departments must work more closely with other business disciplines such as international business, human resources and accounting.”

Unfortunately, the slump in the IT sector has caused a corresponding slump in IT enrollments at universities nationally. Companies in the study expressed concern about looming shortages of local talent. “According to respondents, a lot of the existing IT systems in use are old by current standards but they’re not going to be replaced. Many of the people who are knowledgeable about those systems will retire in five years, leaving a void in the workplace.”

These circumstances are reminiscent of the past when outsourcing became a solution for so many companies. “Most of the bigger companies started outsourcing prior to 2000 when the economy was doing well and qualified workers were in short supply. Outsourcing then was a quick way to fix the problem,” said Serapio. “Five years from now, should history repeat itself, companies will outsource to an even greater degree. We have to do something to break that cycle.”

**The many facets of outsourcing**

Terms, concepts

Says CIO.com: “Outsourcing is a trend that is becoming more common in information technology and other industries for services that have usually been regarded as intrinsic to managing a business. In some cases, the entire information management of a company is outsourced, including planning and business analysis as well as the installation, management, and servicing of the network and workstations. Outsourcing can range from the large contract in which a company like IBM manages IT services for a company like Xerox, to the practice of hiring contractors and temporary office workers on an individual basis.”

- **Offshoring.** Exporting work to any country other than your own. The term is used to differentiate between overseas outsourcing and nearshoring.
- **Nearshoring.** The practice of outsourcing to neighboring countries rather than overseas. “In the case of the US, these countries would be Canada and Mexico,” said Serapio. The advantages are proximity resulting in less expensive travel and easier communications.
- **Business Process Outsourcing (BPO).** The unbundling of business services such as payroll and human resources and contracting them to third-party external or foreign-based in-house providers. This is a growing area of outsourcing.
- **Onshoring/Insourcing.** These are interchangeable terms and used in different ways, said Serapio. One way: “Contracting with an Indian company to provide outsourcing services for you, but requiring the services to be delivered on shore in the United States. There’s more of this being done by US companies than outsourcing.”

Onshoring/Insourcing are sometimes used to describe domestic outsourcing, the obtaining of services from an outside provider but within the same country.

Onshoring/Insourcing may also refer to the practice of foreign companies coming to the United States and buying services or research to be distributed to their operations in different parts of the world.

“**Critics of offshore outsourcing** worry that if too much IT-related work is farmed out to other countries, home-grown IT talent will ‘dry up.’ They point out that once a company begins outsourcing overseas, they will find it difficult to reverse the trend and justify paying more in salaries, taxes, and job benefits for the same work they used to outsource. Proponents maintain that the judicious use of offshore outsourcing will help make all IT workers become more productive and allow companies to develop more agile and responsive business models, which in turn, will raise salaries for domestic workers in all countries.” —CIO.com
Companies are going to look for talent wherever they can find it and at the best price they can find it.

Panel Discussion

Outsourcing, India and the future

Moderator Stephen Barnett asked the panel to focus on four main aspects of outsourcing: the forces that drive decisions to contract abroad, the structures and processes needed for managing these ventures, the hurdles involved and the future prospects for what has become a controversial business strategy. Manavendra Misra and Chan Pollock brought their diverse experiences in company operations to the discussion.

Stephen Barnett

Footprint of globalism

“Technology enabled by software has been one of the key drivers of outsourcing and offshoring. Companies utilize technology in delivering their products so they can be more competitive in the marketplace.

“What began to drive this movement was the shortage of skills in this country. At the same time we had workforces being created in other places and supply and demand converged. Demand continues to run very, very fast. This is all part of the footprint of globalism. As long as companies and countries embrace globalism this is going to continue.

“Discipline is necessary if you’re going to manage these processes internally instead of through an outsourcing company. And you certainly need standards and methodologies. If you put distance in terms of the communication between you and your offshore team then you’re going to make the process more complex which in turn will call for a higher level of complexity in the way you communicate. But it also causes you to think through what you’re trying to accomplish up-front and to break it down into pieces that you can manage and control.

Manavendra Misra

High quality talent at best price

StorePerform’s decision to go offshore for talent was based primarily on reducing costs.

“As a start-up – the company is now three years old – you have a limited amount of cash and a limited amount of resources. You have to figure out the best way to utilize them. We felt that if we could reduce our costs to about a quarter to a third of our costs in the US we would be successful.

“Other factors included the ability to have a 24-hour development cycle with our US team working closely with the Indian team, the need to offer 24-hour customer support and to do that in a cost-effective manner; access to high-quality talent, and the opportunity to innovate and to make mistakes without a huge cost of failure attached to them.

“We chose Bangalore because this is where a lot of the developers were coming to find jobs. In January 2003, a year after we founded the company, we contracted with an outsourcing company and set up a small team. We wanted to take it one step at a time, learn from our mistakes and go from there.

“When a lot of communication is needed between the team and the customers, that has to be done over here in the US. We’ve added a significant number of people within the Denver team on the development side. And we brought people from here to there, sent people from here to there to facilitate that communication.

“When we started we had a small team of 10 developers and they could easily communicate with each other without leaving their cubicles. But when you transform that to a much larger team and across oceans, you have to have formal processes. We’ve worked hard on that and we’re still not there.

“Amongst the Indian team there was a significant amount of turnover. Initially we thought it was just the outsourcing company we were working with. Since then we’ve discovered that turnover is an inherent problem in Bangalore. So we’ve come up with a solution and established a legal entity in India. Right now we have a team of about 50 in Bangalore and we’ve kept a small group from the outsourcing company that we were working with.

“The market for talent is absolutely crazy in Bangalore, much worse than the Silicon Valley market in 1999. Recruiting was a huge problem when we started; there were too many companies chasing too few people. We were an unknown company and developers, though they liked our message, would choose to go with name-brand companies like IBM or MicroSoft. But rather than tell us of their decision they’d just go completely silent since people there often have a hard time communicating bad news.”

“There’s been a significant amount of salary inflation and we’ve addressed this by providing equity in the company and more interesting work. The team has full responsibility end to end – from product management to the delivery of the product on some of our product lines. So we’re developing some of the skills that just didn’t exist in India.

“Travel in both directions is necessary. It’s extremely important for the senior management here.
to go and communicate the vision to the folks over there. As for the future, companies are going to look for talent wherever they can find it at the best price they can find it. So everyone get used to it.”

Chan Pollock  
Capitalism 101

Speaking from the perspective of internal IT operations, Pollock said, “The key word in IT is balance and some of the issues are exactly the same as the issues relative to product development.

“When you’re developing an internal product for your business, you want to do it as cost-effectively as possible in the shortest time possible. And you want to find a balance between IT as a cost to avoid and IT as an enabler of productivity.

“A flexible labor pool is also important. If you need 10 Java engineers this week, your partner offshore can help you source those jobs quickly and without the overhead connected to recruiting.

“Outsourcing/offshoring is nothing but capitalism 101. It has nothing to do with tax incentives for going overseas as some politicians claim. It’s all about scale. If you can get work done for $1,000 instead of $100,000, tax incentives don’t enter into your thinking. The only consideration is Can I get it done in a reasonable amount of time for the lowest amount of cost at the highest quality.

“We also chose not to go with the big sourcing firms. I’m sure they would have taken our business but I wanted to be sure I had the attention that a smaller firm would give me. We used very small boutique firms, 50 to 150 employees. With one of the companies we were actually their first US customer. Yes, I was taking a risk. A moral of my story is to take your risks with things that don’t matter out of the chute. If you’ve never done this before it’s hard work. It’s very hard to manage; it’s not something that you can just let grow on its own.

“My pet peeve is about how the politicians have turned this into something it is not. Outsourcing is a very small percentage of what an IT organization does. In my case it was less than 5 percent and it was all the stuff that my US-based workers wanted nothing to do with because it was boring.

“The educational institutions need to be teaching the higher level things. And the commodities are going to go where we can get work done for the lowest cost, the highest quality and in the quickest amount of time. India has offered us that opportunity but there are plenty of other places where you can do this.

“Incidentally, why is it called outsourcing if you’re a manufacturing company putting a disk drive from China in a PC, but it’s called offshoring if your company is sourcing labor? It’s the same thing, you need the same contracts, it’s just people versus product. But the people aspect is much easier to politicize than product ever will be.”

Barnett: In addition to the successful outcomes that we’ve heard about there are many failures out there. Those are the companies that chose to just throw it over the fence and hope something good would happen. They didn’t know how to project manage and you have to do that whether the company is next door or an ocean away.

Pollock: There’s also in many cases extreme cultural internal resistance to this sort of thing. I always built it into my managers’ objectives that their bonus depended on making something like this work.

Guest: What you’re getting from an Indian university is a very highly qualified individual with the ability to absorb knowledge. I’d like to see companies in the US develop more effective training methods, working with local universities and actually creating courses where the individual can plan a career path that includes movement into higher level positions. With that kind of a plan they’re less apt to be job hopping for higher pay and more likely to stay at a job where they have growth opportunities.

Barnett: One of the things that Andersen Consulting did years ago was develop a career development model relative to the skills that were needed. In fact, part of our offering was career development and career advancement. There needs to be a pathway, a way to guide the employee and a way to measure performance. This concept of ongoing development is important not only to companies but also to universities as they look at how to begin developing programs that are more appropriate for today’s rapidly changing environment.

Misra: About the political aspect, I think we need to distinguish between the macro level and the micro level. At the macro level things will work themselves out over time. At the micro level there are people who are losing jobs and we have to figure out a way to make sure that the pain is diminished. Sending them to a two-year community college, as President Bush wants to do, and getting them retooled is not going to work.

Barnett: Politicians talk about the number of unemployed but they don’t talk about the number of employed and how that number has grown in this country. As you reflect on this complex issue, I think some of these things need to be put in the proper perspective. •
Industrialized nations are challenged to deal with aging populations and declining fertility rates.

Emerging effects of worldwide demographic changes

Global demographic changes have the power to reshape the world as we know it, said Richard Bard in his address to the Global Executive Forum. The accelerating changes include “a shifting of the world’s wealth, an aging of the industrial nations and an emerging middle class in developing nations,” said Bard. “All these things will impact the world’s economy and perhaps our lives.”

Bard referenced an economic symposium sponsored by the Federal Reserve Bank of Kansas City which found that “as people in the industrial nations get older, they get healthier and live longer. Providing the necessary social programs translate into real costs and a real burden to governments.”

At the other end of the spectrum, fertility rates are declining and the gap between those retired from the workforce and those still enjoying a productive working life is getting wider. So the dependency ratio of the old to the young is rising.

“The reason the US boomed and the reason Japan boomed at one time is because coming in behind us were all these young people who worked the jobs and created the economy for the people who were retired,” said Bard.

But the baby boom of 1946-1964 is long over and increasingly the number of young people earning money and contributing to the economy does not balance out with the number of people receiving pensions and other social benefits.

“The demographic changes in the world and their economic impact are the reverse of what economists projected would happen 20 and 30 years ago,” said Bard. “There was a common notion back then that as families got wealthier, they’d be able to afford a bigger house and be able to feed more kids. The family unit would get larger and nations would have a steady stream of working-age people to contribute to the economy. This hasn’t happened.

“Statistically, it takes 2.1 babies per woman to replace ourselves,” said Bard.

According to the CIA World Factbook, the world’s fertility rate is 1.14 percent, falling significantly short of that replacement figure. Russia 0.45%; US 0.92%, UK 0.29%, China 0.57%, France 0.39%. The median age in these countries ranges from 31.8 years in China to 38.6 in France.

Some countries are doing better. Saudia Arabia has a fertility rate of 2.44%; Pakistan 1.98%; Indonesia 1.49%; India 1.44%. The median age in this group is younger, ranging from 19.4 in Pakistan to 26.1 in Indonesia.

“Economists look at people between ages 15 and 64 as being the productive people,” said Bard, adding that this group is in decline worldwide. The table above illustrates what this means in terms of providing for the aged. “In Japan, for example, by the time 2050 rolls around, every person working will have the burden of someone else on his shoulders. That’s a huge problem for them.”

Projections for the United States look a lot better. “One of the reasons for this, both in the population increase and the lower dependency ratio, is something called immigration,” said Bard. “It’s not talked about in a positive way a lot of times but immigration is very valuable and something that’s missing in Europe to a large extent. The US was founded by immigrants and immigration is the engine of our growth economically.”

Instead of politicizing immigration, “we ought to find ways to make ourselves more attractive to new arrivals, educate them and...
The price of energy has been going up, but we’ve been able to absorb the impact because of our high GDP.

Longer work period, shorter retirement in future?

Illustrated here is a current picture of the phases people pass through as they move from youth to old age. To reduce the costs of public pensions, the OECD* says that people should work longer and spend less time in retirement.

<table>
<thead>
<tr>
<th>Country</th>
<th>Education</th>
<th>Work</th>
<th>Retirement</th>
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<tbody>
<tr>
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<td>50%</td>
</tr>
<tr>
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<tr>
<td>Mexico</td>
<td>80%</td>
<td>10%</td>
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</tbody>
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Percent of life spent in different states

*Organisation for Economic Co-operation and Development

make sure they’re productive.

Productivity is a big issue as people get older and leave the workforce. Governments are grappling with ways to reduce the huge costs of public pensions and other entitlements. Bard used a chart (above) showing the percent of a person’s life spent in education, work and retirement in selected countries. “One way to reduce the costs is to change the amount of time someone is on pension,” said Bard.

“Countries like Belgium, France, Italy and Germany have compressed work periods and more time when the state is paying retirees to do nothing. In Mexico, you essentially work and then you die. I’m not suggesting that would be a good thing. But people aren’t looking for a check; if they’re still healthy, they’re looking to be involved. And if we can find ways to bring them back in, make them more a part of the production engine, we could also solve the problem of entitlement costs.”

US outlook good

Things are looking up for the US economy, said Bard. While “not yet robust, the economy is rebounding in response to the stimuli of cheap money, tax incentives and government spending related to funding a war.

“The inflation rate is at 2 percent, a level the Fed is comfortable with, and long-term interest rates are about 200 basis points lower today than they were a couple of years ago.

“Industrial output has turned around. We actually have tremendous increases in throughput and capacity utilization of our plants in this country.”

The low exchange rate of the dollar has also helped the economy. “The dollar is a great bargain. We have a tremendous amount of foreign capital coming into the country. Foreign investors are buying US companies based more on a feeling of security than return on investment,” said Bard. “Chinese investors are quietly buying US manufacturing companies, a hedge, I think, against environmental issues and shortages in China.”

That the economy isn’t robust is due to several factors. Tourism worldwide is down since 9/11 and there’s a lingering uncertainty about what tomorrow might bring. Although the business cycle has kicked in, “CEOs still aren’t ready to stick their necks out and say they can rely on what’s going to happen next quarter,” said Bard. Overall, however, “the economy is headed in the right direction and the outlook is good provided there are no environmental shocks such as corporate scandals, major acts of terrorism or steep jumps in the price of energy.”

Energy is “one of the risks to the outlook,” said Bard. “The price of energy has been going up but so far we’ve been able to absorb the impact, mainly because of our growing productivity and the high service component of our GDP. We import about 4 billion barrels a day of oil. The $20 higher price per barrel amounts to less than 1 percent of our GDP. Since 1973 when we all waited in line at gas stations, the amount of energy it takes to create a dollar of GDP has dropped in half. It helps that in the US we’ve moved away from energy-eating factories to a service economy.”

There are many reasons for rising energy prices, much of them due to soaring demand, especially in places like China, said Bard. “With roughly 20 percent of the world’s population, China is the second largest user of petroleum products and consumes 49 percent of the world’s coal.”

Demand is not apt to level off. “As the middle class of both India and China grow, the demand for cars and petroleum products will also grow just as it has in the US. It’s an interesting global economy,” said Bard. “I don’t know yet what we’re really going to look like in 2050.”

OECD Member Countries

Twenty countries originally signed the Convention on the Organisation for Economic Co-operation and Development on Dec. 14, 1960. Since then ten more countries have joined.

Members:

- Australia
- Austria
- Belgium
- Canada
- Czech Republic
- Denmark
- Finland
- France
- Germany
- Greece
- Hungary
- Iceland
- Ireland
- Italy
- Japan
- Korea
- Luxembourg
- Mexico
- Netherlands
- New Zealand
- Norway
- Poland
- Portugal
- Slovak Republic
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom
- United States

Population/GDP shares 2000-2050*

<table>
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<th>Country</th>
<th>Share of world population (%)</th>
<th>Share of world GDP (%)</th>
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<tr>
<td>Middle Income</td>
<td>26</td>
<td>23</td>
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| *2050 projections
* Excluding US, Mexico, Korea

Source: US Census Bureau International Database
Workers in Germany earn nine times more than workers in Slovakia, but they’re not nine times more productive.

New EU/Old EU: Overview of labor costs and productivity

There are stark differences in wage scales between the 15 original member states (EU 15) of the European Union and the 10 new states (EU 10) that joined on May 1, 2004, said Donald Stevens in his address to the Global Executive Forum.

The EU 15 includes the western European countries of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom. The EU 10 includes the central European countries of Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

“The EU is an economic community that’s basically the size of the US. It has a GDP of just under $11 trillion,” said Stevens. “When two new countries (Bulgaria, Romania) are added in 2007, the GDP will rise only slightly. These are small and relatively poor countries.”

Stevens presented a table of wage rates (see below) to illustrate how the EU 10 stacks up competitively when compared to Germany. “Even though wages in Slovenia, Czech Republic, Hungary and Poland have moved up fairly rapidly in the last year, they’re still significantly under that of western Germany,” said Stevens.

“The labor cost in western Germany is $31.67, nine times higher than in Slovakia where it’s $3.46.” But higher wages do not necessarily equate to higher productivity. “The workers in west Germany are not nine times more productive than Slovakian workers,” said Stevens. “On this basis, it would be easy to predict that the lower wages and social costs in central Europe would draw increased investment into the region. And that’s what we’re starting to see.

“West Germany has spent the equivalent of US$100 billion per year for 15 years to integrate East Germany into the economy. They’ve had enormous changes in bricks-and-mortar type things and disappointing changes in human resources. Workers in east Germany have not been productive.”

Productivity is an important measure of labor costs. “Since 1989 when the Berlin Wall came down, Czech productivity has gone up 130 percent, Hungary 220 percent,” Stevens said. “France has a very productive work force yet they work a lot fewer hours than most other developed nations.” French workers in 2001 logged 1,532 hours.

With the exception of Korea (2,447 hours) Americans and Japanese put in the most hours: 1,821. Productivity and wage rates in the US are among the highest and the social insurance costs are a lot lower than in the Eurozone.”

The EU 10 countries are relatively poor with emerging economies. How many years are needed for convergence, when they will be on a par with the mainstream of western Europe? “It varies. For the Czech Republic, Slovakia and Estonia, we’re looking at 15 to 20 years; for Latvia, Hungary, Slovenia and Poland 20 to 25 years. Bulgaria, Lithuania and Romania have a longer struggle ahead – 30 to 35 years.”

“The European Union is undergoing change as it continues to enlarge,” said Stevens.

“The argument for enlargement is that developing countries have incomplete institutions. There’s a lack of transparency and the rule of law is weak, which lead to corruption.

Moving these developing nations into the EU is seen as a way to foster stability, transparency and democratic institutions.”

Donald L. Stevens is assistant vice chancellor for Academic and Student Affairs at the University of Colorado at Denver and Health Sciences Center (UCDHSC). He is also managing director of the University’s Institute for International Business and director of the Institute’s Center for International Business Education and Research (CIBER). Stevens also holds an appointment as professor of finance at the business school and was dean of UCDHSC’s College of Business & Administration from 1981 to 1991. Prior to coming to Colorado, he served on the faculties of the University of Tennessee and the University of Illinois and received his Ph.D. in business administration/finance from Michigan State University.
Describing the EU's decision to begin the process to admit Turkey as both a risk and an opportunity, Peter Widmer in his address to the Global Executive posed some questions: "How can a 99 percent Sunni and Islamic nation, which Turkey is, be successfully integrated into the Christian tradition and history of the existing EU? "However, could this be the great opportunity to bring Europe and the Islamic Middle East together for their mutual benefit?"

There is disagreement on Turkey's status as a European country. Not surprising considering that 95 percent of its territory is in Asia. "Turkey has politically sensitive neighbors like Iraq, Iran, Georgia and Armenia," said Widmer. "Can Western and Asian nations work together closely within an organization such as the EU?"

With Turkey's admission, "the population of the EU will expand by 15 percent for a 3 percent added GDP. So as in the case of the 10 new eastern countries, there is an initial factor of dilution in the economy. Is this a risk worth taking?"

Negotiations to start

In 1987 Turkey's request to join the EU was rejected on the grounds that they weren't ready. "Last month the EU Commission, which is the executive body, recommended that all EU heads of state at their meeting on Dec. 17, 2004 approve the opening of official negotiations for Turkey's admission. Negotiations will take 15 to 20 years, which will give Turkey plenty of time to meet EU criteria pertaining to legal systems, human rights and minority issues among other concerns to the EU," said Widmer. "All these political criteria must be met or at least firmly committed to when negotiations start next year. However, economic criteria have to be met at the date of joining."

Widmer drew a statistical picture of Turkey:

- Population 70 million, expected to reach 90 million by the time it is admitted to the EU;
- The country is poor with a large agricultural industry that employs 40 percent of the workforce;
- Income level is 26 percent of the EU average;
- 30 percent of the population is under 15 years of age compared to 16 percent in the EU;
- The EU is already the largest trading partner of Turkey, accounting for 40 percent of exports and 35 percent of imports. The corresponding figures for US-Turkey trade are 9 percent for exports and 6 percent for imports. Turkey's most important industries are textiles, clothing and food;
- Inflation is down to 9 percent. Short-term interest rates take longer to drop, they're still at 24 percent;
- GDP growth in the second quarter of 2004 hit 13 percent, making it the fastest growing OECD country. Turkey's efforts to transform its economy as a requirement of EU membership are receiving high marks. "The Organisation for Economic Co-operation and Development has just published a very favorable assessment of Turkish programs for structural and economic reforms," said Widmer.

The 2005 budget stems from these reforms. "It calls for continued strict fiscal discipline as a visible sign of economic stability. The budget was very well received by the Turkish public and by the EU."

On Jan. 1, 2005, the currency will have a makeover. "Several zeros will be lopped off the lira so that one million lira becomes one new Turkish lira. This will have a good psychological effect on the public as it is tangible proof that policies that haven't worked in the past are being corrected."

On the international scene, Turkey has been a good and reliable member of NATO since 1952, and a founding member of the OECD. Turkey has had an association agreement with the EU since 1964 and a customs union since 1996.

Not there yet

Turkey still has a long way to go before it is deemed ready for EU membership. "The main problems are a soaring current account deficit and huge discrepancies in the local economy. The western part of the country is defined by wealth, the eastern part by poverty," said Widmer. The government's treasury suffers because of the black, or unofficial, economy. "It's estimated that 50 percent of the workforce pays no taxes and makes no Social Security contributions." These workers are either self-employed and do business on a cash basis or they work for small businesses that are not registered with the government.

There seems to be unity among the population regarding EU membership: 71 percent of Turks are in favor of it, Widmer said. It will be up to existing EU members to vote Turkey in or reject them again. "There are lots of questions to be debated between now and then in an effort to reduce the risks or at least come to terms with them," said Widmer. "But I think the opportunity for political breakthrough makes the admission of Turkey as important for the whole world as it is for the EU."

Peter Widmer is financial advisor to a small number of wealthy European families. He previously was Chairman of Julius Baer Investment Management, Inc. and Member of the Executive Board of Julius Baer Holding in Zurich, responsible for the company's institutional investment activities outside Switzerland. Prior to working for Julius Baer, Widmer was with Swiss Bank Corporation and London & Dominion Trust and Thomson-Schwab & Co. He holds the Commercial Diploma from the Swiss Business Association.
Panel Discussion

The future of Central Europe

Impressions from the spring 2004 Forum in Vienna

In spring 2004, just weeks prior to EU enlargement, the Forum visited four of the 10 new countries that would forever after be referred to as the EU 10. Based in Austria, Forum members and guests were treated to an up-close look at the Czech Republic, Slovenia, Slovakia and Hungary and learned about the issues affecting their long-term stability. Highlights of the trip were contained in the Spring-Summer 2004 Forum report. In the following discussion members review their impressions in light of what has transpired since their visit.

Panelists: Steven Halstedt, Peter Widmer, Earl Wright and Donald L. Stevens.

Steven Halstedt: We heard some concerns in Austria, which is already in the EU and is a very stable and advanced economy, that the 10 new countries would suck growth from the west because of their lower wage rates and lower tax rates. There was also a concern that there would be immigration from the east into western Europe once the borders were open. But generally speaking most people we talked to were very optimistic about what was about to occur and what the positive effects on their economies were going to be. There were generational differences in how people responded. The amount of enthusiasm was inversely proportional to the age of the person that we were talking to.

Donald Stevens: The older people were more skeptical. They said, Yeah, I did vote for it but I don’t know what it’s going to mean. One guy said that he buys all his stuff in Italy which is just 20 miles over the border. When he comes back he gets a big VAT (value added tax) refund. Now he won’t get that refund because it’s all part of the EU.

Halstedt: We saw both entrepreneurial activity and foreign direct investment in these countries. There was a general level of optimism. I didn’t get the sense that once the borders were open there was going to be a rush of immigration into western Europe. And I don’t think that has happened. I think the concerns on the part of western Europe were a little bit overwrought; they worried that the pie was just so big and now eastern Europe would get a bigger slice than western Europe. I think what is going to happen is the pie will just get bigger. What the EU has done with this enlargement is introduce a well-educated, highly motivated young workforce that’s going to be able to build lots of things and improve the economy for everyone.

Stevens: There’s a contrast between this trip and the one we made in 1992. The workers we saw in Czechoslovakia at the time were so young and seemed so enthusiastic. When Czechoslovakia split into two countries in 1993, Slovakia was at the bottom of the pile economically. There were 300,000 workers that had made tanks and weapons for the (former) Soviet Union and they instantly lost their market. Slovakia went through a huge upheaval and now it looks like one of the brightest areas in the region. Their auto industry is booming and they expect to be producing 5.3 million automobiles in the area around Bratislava by 2008 or 2010. Slovakia’s flat tax of 19 percent is having ripple effects in western European countries where taxes are higher. So now there’s a proposal in the EU for a law that would set a minimum tax at something a lot higher than 19 percent.

Peter Widmer: It’s 24-28 percent.

Halstedt: Last April there was also some concern expressed about jobs moving east and the loss of foreign direct investment.

Widmer: Most of the workforce we saw in Slovakia’s Volkswagen factory was from Romania and Bulgaria. Youngsters who came for the jobs.

Halstedt: I was struck by how modern that VW facility was. It was built so that it could be totally automated at some point in the future when manual labor costs got too high and they had to reduce the workforce.

Earl Wright: They didn’t have the robotics that you’d see in Germany. But they said at $4.25 an hour they could afford to employ a lot of labor and when the rates go up, they were ready to put in more robotics and more technology.

Halstedt: The manager of the plant was a Ger-
Once divided, Europe is coming back together as a people and as a culture. What’s happening is absolutely dramatic.

Robert Halstedt - Guest: With the auto plants coming into Slovakia and the jobs leaving Germany, what do you think that's doing to west Germany and east Germany? What kind of drag is that going to be on the economic well-being of the EU?

Donald Halstedt - Guest: When I went to eastern Europe shortly after it was opened up, the Polish laborer had a very poor attitude about work. Now you’re talking about the youth who are very motivated. Are they simply jumping over a generation?

Donald Halstedt - Guest: I wonder, Peter, how much institutional capability does a country automatically have to it when it becomes part of the EU?

Donald Halstedt - Guest: I think the point has to be made that a lot of investment has happened with the entrance of these countries into the EU. It’s been gradual and a lot of it occurred before the bell rang making their entry official. So there’s been a lot of progress there.

Donald Halstedt - Guest: It’s not possible to put a dollar figure on the value of reuniting people. We don’t have a full appreciation for the French. I wanted to know where the capital flow was going to come from for the infrastructure and for growth. They don’t have internal sources of capital so they have to have foreign direct investment. It was clear that it was going to come out of Vienna and the banks in Vienna.

Donald Halstedt - Guest: There’s a lot of infrastructure that has to be built, and there’s a lot on the government’s side that’s lacking. In Slovenia, for example, they don’t have good property rights laws. If you’re a large company and you can work with the government you can get a lot accomplished. But if you’re an entrepreneur or a small investor, unless you’re really plugged into the government, you’ll have a difficult time trying to get something going from a commerce perspective.

Donald Halstedt - Guest: I think the point has to be made that a lot of investment has happened with the entrance of these countries into the EU. It’s been gradual and a lot of it occurred before the bell rang making their entry official. So there’s been a lot of progress there.

Donald Halstedt - Guest: It’s not possible to put a dollar figure on the value of reuniting people. We don’t have a full appreciation for the French. I wanted to know where the capital flow was going to come from for the infrastructure and for growth. They don’t have internal sources of capital so they have to have foreign direct investment. It was clear that it was going to come out of Vienna and the banks in Vienna.

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Earl Wright is president and CEO of AMG Guaranty Trust, N.A. AMG provides fee-only financial counseling, investment advisory, trust and wealth management services to more than 1600 clients throughout the United States, either directly or through one of more than 50 corporate program relationships. A nationally chartered, non-depository trust bank, AMG Guaranty Trust is headquartered in Denver with regional banks in Chicago, New York and Philadelphia. Wright holds an MBA degree from The Wharton School of the University of Pennsylvania and was honored as a Master in Profession from his undergraduate alma mater the University of Nebraska.

Donald L. Stevens is assistant vice chancellor for Academic and Student Affairs at the University of Colorado at Denver and Health Sciences Center (UCDHSC). (Please see full bio Page 12.)
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