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A Decade of Direct Investment

There is a sense after the terrorist attacks of September 11 that the world has been fundamentally altered, that new approaches to leadership are required—approaches that are better suited to more fragile times. This may be true for governments and the public sector, but what is needed from leaders of global corporations is much more of what they've been doing for the past decade—investing heavily in the developing world.

Eliminating poverty is now a very high priority for many political leaders, an acknowledgement that poverty is one of the most significant sources of conflict. But building, or rebuilding, nations is far more than just an economic challenge. It is a multidimensional undertaking, involving a daunting set of interdependent elements—health, education, safety, law, regulation, the environment, and public infrastructure.

Although these elements are critical *enabling* conditions, in the final analysis, economic development depends overwhelmingly on the *accumulation of capital*. Developing nations do manage to save diligently, but they have precious little income to save. That's why inflows of capital from the developed world are so critical.

Throughout the 1990s, capital inflows to the developed world increased roughly fivefold. Still, such inflows represented only 1 percent of the developed world's gross domestic product. Compare that with the nineteenth-century wave of globalization, during which Great Britain invested 5 percent of its gross domestic product overseas. If the entire developed world followed suit today, foreign capital inflows could actually exceed domestic savings in all developing nations, effectively doubling the rate of investment. This would be sufficient to reduce the time required to eliminate poverty worldwide to less than one human lifetime.

But it is not just the quantity of foreign capital inflows that matters. The mechanism through which funds are channeled is also critical. Official aid from the public sector is important in certain sectors of developing economies, but in recent years such transfers have been declining under fiscal pressures. Private-sector bank loans have been leading mechanisms in the past, but volatile interest and exchange rates can lead to widespread defaults and debt-restructuring quagmires that may take years to resolve. Minority equity investments, especially through mutual funds, are becoming more popular, but this type of capital can vanish as quickly as it appears, potentially putting currencies at risk.

The remaining mechanism is *foreign direct investment* (FDI), in which global corporations take controlling ownership positions in foreign business units, either through acquisition

COMING SOON:

On Tuesday, April 23, the center will host The Honorable Fidel Ramos, president of the Republic of the Philippines from 1992-1998, as part of our CEO Speaker Series. The Honorable Ramos will share personal stories from his military and political career in the Philippines and describe his current pursuit, the Ramos Peace & Development Foundation.

or by building completely new operations. The lesson of the 1990s is that FDI is by far the most productive channel for directing capital to the developing world. FDI increased by nearly an order of magnitude during that decade and now swamps all other forms of developing-world investment, exceeding official aid by a ratio of four to one.

FDI is much more stable than minority investments. And because the global corporation, through direct ownership, assumes political and macroeconomic risks, fragile banking and financial systems in developing nations are not exposed. Finally, FDI is a much more robust source of capital than public sources, which rely on unpopular tax increases.

The world needs more FDI. Such investment provides more than just capital. It also accelerates the transfer of knowledge and technology to developing economies, further stimulating growth and making it possible to *leapfrog* stages of development. Witness advanced cellular telephone infrastructure in some nations where landline infrastructure is almost nonexistent.

While the dramatic increase in FDI is impressive, it is difficult to assess just how close this level of investment is to its full potential. What is preventing the level of FDI from increasing by another order of magnitude over the next decade?

Clearly, the enabling conditions for significant and sustained FDI are not yet present throughout the developing world. But the challenges of managing a modern global corporation are significant. Many of today's global CEOs, after ten or fewer years of aggressive expansion, still have much to learn.

As economies in the developed world have been weakening and the perceived risks associated with developing-world operations have been increasing, many CEOs may feel the need to retrench and refocus on core operations at home. With any luck, the feeling will not last. ■

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