The Role of Private Capital in Accelerating Foreign Direct Investment Flows to Developing Countries

Michael Bleyzer

Where Opportunities Emerge
The 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
The Brave New World

- Scientific Breakthroughs
- Technological wonders
- Open Society
- Space travel
- Genetic engineering
- Accessibility of art
- Freedom of self-expression
- Democracy triumphs
- Market economy flourishes
- Worldwide prosperity is within reach..

- Polarization
- Envy
- Misery
- Poverty
- Hunger
- Illiteracy
- Terrorism
- Radicalism
- Hatred
- Corruption
<table>
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</thead>
<tbody>
<tr>
<td>Ten richest countries *</td>
<td>$13,951</td>
<td>$21,629</td>
<td>$27,715</td>
<td>$31,965</td>
<td>$38,671</td>
<td>177%</td>
</tr>
<tr>
<td>Ten poorest countries *</td>
<td>$152</td>
<td>$174</td>
<td>$180</td>
<td>$180</td>
<td>$163</td>
<td>7%</td>
</tr>
<tr>
<td>Gap, times</td>
<td>92</td>
<td>124</td>
<td>154</td>
<td>178</td>
<td>237</td>
<td>159%</td>
</tr>
</tbody>
</table>

* by GDP per capita (constant 1995 USD)

Source: World Bank, World Development Indicators, 2003

The gap between the ten richest and ten poorest countries has widened by 159% since 1960.
## Infant Mortality Rate By Income Group

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</thead>
<tbody>
<tr>
<td>High income</td>
<td>35</td>
<td>22</td>
<td>12</td>
<td>8</td>
<td>5</td>
<td>76%</td>
</tr>
<tr>
<td>Middle income</td>
<td>118</td>
<td>79</td>
<td>54</td>
<td>40</td>
<td>31</td>
<td>61%</td>
</tr>
<tr>
<td>Low income</td>
<td>148</td>
<td>128</td>
<td>110</td>
<td>91</td>
<td>81</td>
<td>37%</td>
</tr>
<tr>
<td>Heavily indebted poor countries</td>
<td>165</td>
<td>139</td>
<td>113</td>
<td>105</td>
<td>99</td>
<td>29%</td>
</tr>
<tr>
<td>World</td>
<td>119</td>
<td>94</td>
<td>78</td>
<td>63</td>
<td>56</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: World Bank, World Development Indicators, 2003

*Higher income countries have significantly improved infant mortality rates, whereas lower income countries have not*
## Life Expectancy at Birth By Income Group

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</tr>
</thead>
<tbody>
<tr>
<td>High income</td>
<td>69</td>
<td>71</td>
<td>74</td>
<td>76</td>
<td>78</td>
<td>13%</td>
</tr>
<tr>
<td>Middle income</td>
<td>46</td>
<td>61</td>
<td>66</td>
<td>68</td>
<td>70</td>
<td>52%</td>
</tr>
<tr>
<td>Low income</td>
<td>43</td>
<td>48</td>
<td>53</td>
<td>57</td>
<td>59</td>
<td>37%</td>
</tr>
<tr>
<td>Heavily indebted poor countries</td>
<td>41</td>
<td>45</td>
<td>49</td>
<td>52</td>
<td>51</td>
<td>25%</td>
</tr>
<tr>
<td>World</td>
<td>50</td>
<td>59</td>
<td>63</td>
<td>65</td>
<td>67</td>
<td>33%</td>
</tr>
</tbody>
</table>

Source: World Bank, World Development Indicators, 2003

Lower income group life expectancies remaining below 60 years even today
# Illiteracy Rates By Income Group

<table>
<thead>
<tr>
<th>Adult total (% of people ages 15 and above)</th>
<th>1970</th>
<th>1980</th>
<th>1990</th>
<th>2001</th>
<th>Improved By</th>
</tr>
</thead>
<tbody>
<tr>
<td>High income (select OECD countries*)</td>
<td>13.4</td>
<td>8.7</td>
<td>5.7</td>
<td>3.4</td>
<td>75%</td>
</tr>
<tr>
<td>High income (select Non-OECD countries**)</td>
<td>21.4</td>
<td>14.6</td>
<td>10.5</td>
<td>7.3</td>
<td>66%</td>
</tr>
<tr>
<td>Middle income</td>
<td>34.5</td>
<td>25.6</td>
<td>18.5</td>
<td>13.1</td>
<td>62%</td>
</tr>
<tr>
<td>Low income</td>
<td>64.0</td>
<td>55.6</td>
<td>47.0</td>
<td>38.1</td>
<td>41%</td>
</tr>
<tr>
<td>World</td>
<td>44.1</td>
<td>36.1</td>
<td>28.9</td>
<td>22.9</td>
<td>48%</td>
</tr>
</tbody>
</table>

* Selected OECD countries include: Italy, Korea, Rep., Portugal, Spain, Greece

** Selected non-OECD countries include: Barbados, Brunei, Cyprus, Hong Kong, China, Israel, Macao, China, Malta, Netherlands Antilles, Puerto Rico, Qatar, Slovenia, United Arab Emirates

Source: World Bank, World Development Indicators, 2003

Higher income countries have had a significant improvement in literacy rates
Global Inequities Exposed

- Greater awareness due to the global revolution in communications
  - Exchange of information has improved tremendously
  - Poor are now better able to recognize their growing income disparity
  - Many groups of poor have become more dissatisfied leading to resentment, frustration and desire to change the current world order
- Developed countries cannot isolate themselves from these inequalities
  - Rise of terrorism shows that they are not immune to tensions and resentment around the world
- There is a clear need to replicate the Wealth Creation Capacity in developing nations
How to Replicate Wealth Creation Capacity

Wealth Creation Chart

- Improved Quality of Life
  - Higher Income
  - Lower Unemployment
  - Improved Social Stability
  - Protection of the Poor
  - Higher Budget Resources
- Higher Rates of Economic Growth
- Investments in Education and Health
- Foreign and Domestic Private Investments
- Improved Business Environment
- Macroeconomic Stability
- Economic Liberalization
- Reform of the State and Legal System

- Can be accomplished through carefully targeted assistance and active engagement
- Macro-level economic development and micro-level business development
FDI is the Key that Starts the Engine of Growth

- Countries able to attract large inflows of foreign capital are able to achieve above average levels of GDP growth
- FDI is the largest and most stable source of foreign financing for developing countries
- Emerging markets have been attracting $150B per year
  - In 2001, five developing countries (China, Mexico, Brazil, Poland and Chile) received over 60% of these inflows
  - Rest of the world does not offer attractive business environments and is therefore left out of the loop
## Net Capital Flows to Emerging Markets

(USD, Billions)

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<tbody>
<tr>
<td><strong>Total Private</strong></td>
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<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>12</td>
<td>151</td>
<td>193</td>
<td>227</td>
<td>133</td>
<td>78</td>
<td>87</td>
<td>47</td>
<td>43</td>
<td>80</td>
<td>113</td>
<td>94</td>
</tr>
<tr>
<td><strong>Foreign Direct Invest</strong></td>
<td>13</td>
<td>81</td>
<td>101</td>
<td>116</td>
<td>144</td>
<td>156</td>
<td>175</td>
<td>166</td>
<td>181</td>
<td>143</td>
<td>144</td>
<td>145</td>
</tr>
<tr>
<td><strong>Portfolio Flows</strong></td>
<td>4</td>
<td>113</td>
<td>24</td>
<td>83</td>
<td>63</td>
<td>11</td>
<td>20</td>
<td>-4</td>
<td>-51</td>
<td>-53</td>
<td>-23</td>
<td>-17</td>
</tr>
<tr>
<td><strong>Comm. Bank Loans</strong></td>
<td>-5</td>
<td>-44</td>
<td>67</td>
<td>27</td>
<td>75</td>
<td>89</td>
<td>-108</td>
<td>-115</td>
<td>-87</td>
<td>-10</td>
<td>-8</td>
<td>-35</td>
</tr>
<tr>
<td><strong>Net Official Loans</strong></td>
<td>26</td>
<td>4</td>
<td>50</td>
<td>-2</td>
<td>42</td>
<td>58</td>
<td>8</td>
<td>-13</td>
<td>21</td>
<td>7</td>
<td>10</td>
<td>-16</td>
</tr>
</tbody>
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1. Includes Developing and Transition countries, Israel, Korea, Singapore, Taiwan, and Israel
2. 2001 prices

<table>
<thead>
<tr>
<th>TBI Key Investment Drivers</th>
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</thead>
<tbody>
<tr>
<td>1. Liberalization and Deregulation of Business Activities</td>
</tr>
<tr>
<td>2. Stable and Predictable Legal Environment (the Rule of Law)</td>
</tr>
<tr>
<td>3. Privatization, Public Administration reform and Corporate Governance</td>
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<tr>
<td>4. Removal of International Capital &amp; Foreign Trade Restrictions</td>
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<tr>
<td>5. Facilitation of Business Financing by the Financial Sector</td>
</tr>
<tr>
<td>6. Reducing Corruption levels</td>
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<tr>
<td>7. Minimization of Political Risks</td>
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<tr>
<td>8. Improving Country Promotion and Image</td>
</tr>
<tr>
<td>9. Macroeconomic Performance</td>
</tr>
</tbody>
</table>
Country Ratings

Macroeconomic Performance

Countries: Bulgaria, Romania, Serbia, Ukraine, Albania, Bosnia, Croatia, Macedonia, Moldova, Slovenia, Chile, Estonia, Hungary, Poland, Czech Rep

Where Opportunities Emerge
Country Ratings

Business Liberalization

Bulgaria     Romania
Serbia         Ukraine     Albania
Bosnia          Croatia     Macedonia
Moldova        Slovenia     Chile
Estonia    Hungary      Poland
Czech Rep
Country Ratings

Legal Environment

Bulgaria          Romania
Serbia            Ukraine
Albania           Bosnia
Croatia           Macedonia
Moldova           Slovenia
Chile             Estonia
Hungary           Poland
Czech Rep
Country Ratings

Governance

Bulgaria     Romania
SerbiaUkraineAlbaniaBosnia
Macedonia    MoldovaSlovenia
Chile        EstoniaHungary
Poland       Czech Rep

Where Opportunities Emerge
Country Ratings

Liberalization of International Trade and Capital Movements

- Bulgaria
- Romania
- Serbia
- Ukraine
- Albania
- Bosnia
- Croatia
- Macedonia
- Moldova
- Slovenia
- Chile
- Estonia
- Hungary
- Poland
- Czech Rep

Where Opportunities Emerge
Country Ratings

Financial Sector

Bulgaria  Romania  Serbia  Ukraine  Albania  Bosnia  Croatia  Macedonia  Moldova  Slovenia  Chile  Estonia  Hungary  Poland  Czech Rep
Country Ratings

Corruption

<table>
<thead>
<tr>
<th>Country</th>
<th>Rating</th>
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<tbody>
<tr>
<td>Bulgaria</td>
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<tr>
<td>Romania</td>
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<td>Serbia</td>
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<td>Ukraine</td>
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<td>Albania</td>
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<td>Bosnia</td>
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<td>Hungary</td>
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<td>Poland</td>
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<tr>
<td>Czech Rep</td>
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</tr>
</tbody>
</table>

Where Opportunities Emerge
Country Ratings

Political Risk

Countries:
- Bulgaria
- Romania
- Serbia
- Ukraine
- Albania
- Bosnia
- Croatia
- Macedonia
- Moldova
- Slovenia
- Chile
- Estonia
- Hungary
- Poland
- Czech Rep

Risk Levels:
0 - 10 - 20 - 30 - 40 - 50 - 60 - 70 - 80 - 90 - 100

Countries are ranked based on their political risk ratings.
Country Ratings

Country Image & Promotion

- Bulgaria
- Romania
- Serbia
- Ukraine
- Albania
- Bosnia
- Croatia
- Macedonia
- Moldova
- Slovenia
- Chile
- Estonia
- Hungary
- Poland
- Czech Rep

Where Opportunities Emerge
Overall Investment Drivers – Country Ratings

Aggregate Investment Attractiveness Ratings

Moldova  Serbia  Bosnia  Macedonia  Albania  Ukraine  Romania  Bulgaria  Croatia  Poland  Czech Rep  Hungary  Slovenia  Estonia
TBF Investment Drivers Nonagon

The Bleyzer Foundation
Country Driver Ratings

Business Liberation
Macroeconomic Performance
Country Image
Political Risk
Corruption
Financial Sector
Legal Environment
Governance
Int'l Trade/Capital

EU Accession Countries
Southeast Europe
Best-In-Class
Ineffectiveness of IFIs and Official Aid Programs

Aid flows have failed to bring about sustained economic growth and higher standards of living to recipient countries for multiple reasons:

- Political rather than developmental objectives of foreign aid allocation by donors
- Lack of ownership of assistance projects and programs by recipients
- Lack of coordination among donors in their aid activities
- The practice of aid tying by donors
- Lack of administrative capacity to absorb large aid flows in developing countries
- Inefficient terms of aid use
- Aid fungibility
- Trade barriers imposed by developed countries
International Private Sector As A Solution

Where Opportunities Emerge
What do we propose?

- A private sector initiative – Private World Fund Pilot
  - Focused on the private sector development
  - Demanding business environment improvement as a condition for success and providing financing to make this happen
  - Capable of walking away when promises are not fulfilled
  - Attention of the world media to an experiment in private sector funded economic development

- Why has the private sector not stood up in the past?
  - Economic advice is a “public good”
  - There is a cost incurred by advice provider, but benefits available to all investors

- This “public good” demands “collective” action
A Hybrid Investment Approach

- Total pool of capital split to accomplish two objectives
- Hybrid = Private Capital Investments + Development Assistance
  - First portion structured as a private equity fund
    - Invests in enterprises and helps to modernize economy
    - Looks for superior returns
  - Second portion will finance economic assistance to advance legal frameworks, implement economic reforms and develop institutions
- Suggested methodology – TBI Economic Policy Framework
Conclusions

- The private sector is best placed to help developing countries transition to free market economy based societies
- History has shown that IFIs have not done the job
- OSCE should consider supporting such an approach as a practical way to improve security and cooperation in Europe and the rest of the world
- We would like to discuss this proposal in depth at the 12th OSCE Economic Forum