International Market Perspectives - Investing in the Emerging Markets

by
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I'm really quite familiar with the remarkable work of Carlyle and the interests of all of you as investors, and so you might wonder why is it that I'd have the temerity to come and talk to you about the activities of the World Bank.

Some of you will know that we deal with the five billion people out of the six billion people in the world, the five billion coming from the developing countries and the one billion from the developed countries in which you predominantly invest. That one billion has 80 percent of the global GDP. It's not surprising that you would invest there. And our five billion, have 20 percent of the global GDP.

Well, I'm anxious to talk to you because in the meetings at the World Summit on Sustainable Development (WSSD) in Johannesburg from which I've just returned, there was a lot of comments that the meetings were taken over by the chief executives of global corporations. However, it is estimated that in the next 25 years, the world becomes eight billion, and seven billion out of eight billion will be in developing countries. And by the year 2050, it's thought at the moment that the world will top out at nine billion, with approximately eight billion out of nine billion living in today's developing countries.

But it's also thought that the 20 percent of global GDP in developing countries will grow to 40 percent, and that, of course, indicates that in a world where we'll then have $140 trillion of GDP, that you will have between $50 and $60 trillion of business being done in developing countries; and that the rate of growth in the developing countries anticipated by almost any measure will be double the rate of growth in the developed world.

So, for business leaders and ultimately, though I'm not suggesting immediately, for investors, there has to be an interest in the economic development and the economic growth of developing countries. I think Carlyle, from reading some of the material, has put the toe in the water in China and in India and maybe in other places as well, looking at the technological developments. One of the things that we're deeply engaged in at the Bank is to try and bring about an environment in which investment can be sponsored, supported, and expected in developing countries.

In the latest decade the growth in private investment in developing countries has been encouraging. In the ten years from 1990 to 2000, investment in developing countries moved from $30 billion a year to a
peak in 1997 of $300 billion a year. In 1990, the $30 billion was half the size of the then overseas development assistance. At its peak in 1997, it was six times the size of development assistance.

These numbers illustrate that the balance has moved very significantly for people in development institutions and for the World Bank in particular to try and understand and relate to the interest of private investors in direct investment as well as the interests of investors in portfolio and venture investing.

In the last couple of years, the amount of Bank financing has gone down considerably with the international stresses, but, interestingly, foreign direct investment in the developing countries has stayed somewhere around $150 to $170 billion. So some people are still seeing interest and activity and profit in the developing world, and as you might expect, much of it is going to the ten countries that you would anticipate, including India, China, and Brazil, and some of the more attractive of the smaller countries.

I'm not here to sell you that investment, but I am here to tell you that I think it's an issue of development that you need to think about. And the reason that the chief executives were in Johannesburg were additional to the investment interests, because they recognize that there were other issues that would affect their profitability and, indeed, their survival in the long term.

Coming, as we do, close to September the 11th, one of the things that happened on September the 11th, 2001, was that for people like me, and maybe for people in this room, too, the myth of two worlds was definitely proven wrong. When I grew up and was in my early days in my professional career as an investment banker, I thought of myself as safe in the developing world. When at an early age I went to India and to China and Brazil and to some other developing countries, my parents would sort of look at it with a sense of pride and then, well, they know I'll come back one day, get all that nonsense out of my head, and become an investment banker or something in the United States or in Australia or in England where I'd be safe.

Well, of course, on September the 11th, 2001, we were confronted with the image of the World Trade Center in New York collapsing and a confrontation between issues of developing countries and issues of Wall Street and Pennsylvania and of the Pentagon, issues of Afghanistan, issues of fundamentalism being right in our heartland. For anybody that doubted the aspect of globalization that most issues today are global, whether it be environment or health or terror or crime or drugs or trade or finance, anyone that may have thought that before September the 11th, surely doesn't think it now.

In fact, the endpoint of that set of issues has been the realization that the issue of poverty and the issue of equity and the issue of instability is really an issue that affects all of us. In fact, we realized that the issue of poverty, with half the world living under $2 a day, and one-fifth of the world living under $1 a day, and with uncertainty as to the
future, that issue is no longer a distant issue - that the issue of poverty is the issue of peace.

The chief executives that were in Johannesburg were talking about social issues. They were talking about environmental issues. They were talking about sharing the world. They were talking about the responsibility of business to be responsible social citizens in the investing that they're doing in developing countries.

Again, I don't address that particularly to you or the investment philosophy of the Carlyle Group, but I do say that the issues of equity, the issues of poverty, the issues of global stability are ultimately the fundamental issues which will determine the issue of global peace.

I know that, today, you've talked about Iraq. I know you've talked or will be talking about other immediate political issues. But the more fundamental issues that I see - and I have traveled now to 120 countries - is this fundamental question of equity in development.

In fact, by 2025, when the world is eight billion and seven billion are from developing countries, you'll have a Europe that is smaller than it is today, that is older than it is today, and you'll have two billion more people in developing countries and two billion more people moving into towns and cities, with the attendant opportunities for investment and for problems that go along with it.

So my purpose in accepting your invitation was to come to say to you that - as you listen to the investment objectives of the different funds, as you look at your own investment perspectives - If you're going to leave something to your kids, and if you're going to leave a world to your kids that has some stability in it, you must look at some of the issues that we're addressing on a day-to-day basis - environmental issues, social issues, poverty issues, equity issues - issues that certainly in my education did not feature tremendously, though which I believe now are ultimately at the core of issues that will affect the long-term stability of your investment programs.

It is not to say that you should rush out now and be a hero. But I would say to you that in your various fields, you cannot leave it just to others. The issue of private sector involvement, the issue of social responsibility, the issue of environmental responsibility, the issue of equity, the issue of social justice are issues which perhaps didn't feature when I was building my own firm, but which now feature very strongly in the minds of many corporate chief executives.

Lou Gerstner [Louis V. Gerstner, Jr. chairman of the board of IBM Corporation since 1993] talked to you today about changing the culture in an organization. I worked with him to find ways to change the culture in our institutions. But one thing that we came around to in the seven years we have worked together on this, was the recognition that for a company like IBM or the World Bank, a culture change needs to include the issue of social responsibility, the issue of environmental responsibility, and the issue of projection into areas of education and health and activities for all people everywhere.
Consider this discussion important in addition to what you may discuss today. It's not intended to divert you from your immediate investment objectives. But it is to say to you that if groups like this - sophisticated investors, determiners of corporate policy - don't have in mind these fundamental issues, then we're going to be in major difficulties, because it cannot be passed off to all the other people that are making investments. It needs to be part of your considerations. I guess that's what I've learned in seven years, not to become someone whom you would regard as radicalized or green or off the wall, but someone who is thinking about the world that we're going to leave to our children. The fundamental issues are issues of environment, of resources, of equity, of planetary responsibility, because the image of the World Trade Center was the image of a wall coming down between the developed and developing world. And you can no longer think of investments or peace or stability without giving a thought to the sort of issues that we're addressing.

Thank you.

Question and Answer Session

Question: Thank you very much for that thoughtful presentation. It's very provocative. My question is: Could you be a little more specific in terms of operationally how some of those goals could be achieved? And by that, I mean that, when I heard you talking, that's a great set of challenges to us in the First World. My view is that if through Carlyle's investments or through institutional investments or personal investments we can help developing countries become richer, then many of these problems begin to solve themselves. So how operationally can the World Bank or institutional investors encourage countries to develop a rule of law, develop more democratic institutions, develop market-based systems which will be the means to ends that you so well described?

Mr. Wolfensohn: The framework that is agreed in Monterrey, where there was recently a conference Financing For Development Conference, is one of a new partnership in which there is a recognition that the developing countries themselves have a minimum set of steps that are required to attract investment and support. The first is to strengthen governance, to strengthen the capacity of the government. The second is to have a legal and judicial system which is fair and equitable, which, I might say, is probably not the case for the majority of developing countries. The third thing is to have a financial system which is clear and transparent and where the business community operates in a transparent and appropriate way. And the fourth is a system which fights corruption in all its forms.

Those, if you like, are the four fundamental principles as preconditions to education and health and infrastructure and all the other things that are necessary for a coordinated approach to development.

I have to tell you that within the last 12 months this has received a tremendous setback by the example in the developed world. I cannot tell you how many times I've been handed either a local newspaper about a
well-known American company that is no longer with us or commentaries on
the behavior in the First World. And that is a very sad, and I hope
temporary, setback to our ability to bring about change in the developing
world. But it is serious and it's real. And it has an impact
immediately, particularly to the people that we've been lecturing for a
long time. Those preconditions are there. But then if there is to be
assistance from the so-called developed world, there are a number of
things that need to be met.

The first is openness of trade. It doesn't make a lot of sense to get
developing countries to develop their capacities in terms of
manufacturing or agricultural produce if they're not permitted to export.
That alone would make a huge difference.

The second thing is agricultural subsidies. Just to give you two
numbers, roughly today overseas development assistance runs at around $50
billion. Agricultural subsidies run at around $350 billion a year. That
is lunatic if you're thinking about - it's a billion dollars a day in
agricultural subsidies, seven times the amount of development assistance.
We had a huge victory in Monterrey because the United States over three
years will increase its development assistance from $10 to $15 billion
and Europe will go up $6 billion.

Having said that, there's a lot that can be done at the individual and at
the corporate level. Corporations can just be interested in providing
education and health programs, and they can be interested in sponsoring
programs against AIDS in Africa. They can get their young people at
night to teach local community leaders and people how to use a computer.
Or some of the young people can give classes on how to put a financial
statement together. There are hundreds of different ways in which
companies that are concerned can, in fact, demonstrate some sense of
social responsibility to a community, and I'm not talking about things
that necessarily make the headlines. I'm talking about an attitude. And
for all too many investors and all too many companies, this doesn't occur
as being an issue. I think there are a lot of very practical things that
can be done, and if anyone is interested, that's one call you can make to
me, and I'll be glad to put you on to the people who are working closely
with these issues.

Question: I've been dealing a lot with India. If you take India, for
example, there are many states. You have some states where the
population is coming down or is stable and some states where the
population is going up. And if you look at the reasons why, you will
find out that it is a question of education. In the states where the
population is stable or going down, you will find good educational
systems. So I think education - and maybe you may comment on this - is a
very important factor. Maybe more than just money investment, why don't
we invest a big part of our development aid into education, pure
education. There's less corruption and there is less waste in this.

Mr. Wolfensohn: The number one item on our agenda is Education For All,
and, in fact, it will be discussed at the end of this month at the Annual
Meetings of the World Bank and the IMF in a program that is designed to
give every child primary school education and thereafter build the secondary opportunities for tertiary education.

There is absolutely no doubt that education, and, in particular, education of women and girls, is at the core of the development process. Gender equity, of all the things I've learned, is central. If you can educate and engage women in the active process of building a country and remove from them stigma and abuse and all the things that unfortunately purvey existence in many parts of the world as a woman, you can make a huge contribution.

We are really focusing on that, but are in the midst of a debate on this. And when it was suggested in Monterrey we immediately jumped on it and said, well, let's take now immediately a fast track on this program. We are, by the way, distinguishing in the country of India, with a billion people, between the states because, as you correctly say, some states are doing a better job than others. We are trying very hard to introduce this, but where we're running into problems is at the moment is that you say to the donors "there's a price tag on this of X billion." We're starting with 18 countries that meet the requirements of those positive states, and five other countries that would bring us to over 60 percent of the kids that are out there. We're finding a tremendous reaction from donor governments who are suddenly saying, "Well, should we be financing these continuing expenditures? And can we stick with it for ten years?" Because these issues of education and health and water are not overnight fixes. They're about changing cultures, and they're issues that require up to five-to ten-years to seek resolution of.

What you'll see in the next year or two is really the moment of truth on all these hopes. The international community and you as voters are going to be put to the test as to whether - subject to the conditions I said earlier with the developing countries doing their part - the money and the support is going to be available. But you are absolutely right that education is central, but so, too, is health, because if you don't deal with the health of kids, in many countries you get them already mentally affected by the time they get to school because of inadequate food and improper treatment. So it's a complicated issue, but you've put your finger on something which is absolutely central.