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A NEW STRATEGY TO LEVERAGE BUSINESS FOR INTERNATIONAL DEVELOPMENT

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CONTENTS

A NEW STRATEGY TO LEVERAGE BUSINESS FOR INTERNATIONAL DEVELOPMENT

Robert Mosbacher, Jr.

EXECUTIVE SUMMARY

To tackle global poverty, it is essential to craft a new and dynamic approach to economic development that reflects the realities of a 21st century global economy and incorporates the participation of a wide variety of new players, particularly from the private sector. While investment, trade and innovation all represent basic components of building healthy economies, this paper focuses primarily on strategies to increase both in-country and international private capital investment in order to create jobs. To that end, it concentrates on two areas: strengthening and reforming the existing structures, coordinating mechanisms and policies that support U. S. economic development efforts; and improving public-private partnership models to promote broader financing to local businesses, greater human capital support and technical assistance and improved physical and ICT infrastructure. In particular, it recommends that the U.S. government:

- Create greater capacity at the White House to coordinate and leverage the full range of economic, social and humanitarian instruments of the federal government with respect to strategic private sector partnerships for development;
- Provide the Overseas Private Investment Corporation (OPIC) with the authority to invest in a portion of the equity for projects that it finances with either a direct loan or a loan guarantee;
- Offer more creative political risk insurance products to encourage broader investment;
- Accelerate economic recovery and growth by using multi-stakeholder funds more effectively to leverage private capital investment;
- Coordinate USAID technical assistance grants more effectively with lending programs such as those of OPIC;
- Launch a "Bizcorps" program – modeled after the Peace Corps – to connect developing-country entrepreneurs and investors through a program focused on generating professional business plans;
- Build a standing capability to deploy multi-disciplinary teams of experts to partner with local policymakers and business communities in assessing impediments to and opportunities for stimulating short and long-term growth;
- Incentivize investment by committing to and delivering on strategic critical infrastructure projects.

INTRODUCTION

Among the three principal tools of American foreign policy—defense, diplomacy, and development—it is generally agreed that development is the area most in need of overhaul. Whether it is fighting poverty in the developing world, rebuilding a nation after years of conflict, or helping stabilize a failing or failed state, the United States government's track record in the development field is mixed at best. There have been great successes in areas such as disease prevention and treatment, and disaster relief, but there have also been glaring failures.

Global poverty is as intractable as ever, despite decades of public and private sector efforts to provide help and opportunity for the world's most vulnerable people. The fact that every major industrialized nation shares in this disappointment is of little comfort to the 40 percent of the world's population that lives on less than $2 per day. Their plight is not only a human tragedy, but a source of growing political instability and violent extremism.

Corruption and poor governance account for a significant part of the problem, which is why the Millennium Challenge Corporation was created. It is based upon the principle that aid is more effective when it is tied to good governance, economic opportunity and investments in the people. However, corruption and poor governance are not the only reasons why so little economic progress has been made. Another major culprit is the manner in which most donor countries, international financial institutions and civil society organizations approach economic development. Simply put, most have failed to recognize and embrace the notion that the principal way to create sustainable economic development is through private sector investment and growth.

Given all the challenges facing American foreign policy, one might ask: why do the shortcomings of the U.S. government's current approach to economic development matter so much? Stated simply, if the United States can help enable more people to provide for their families through economic growth and opportunity, then it has advanced the objectives of peace and stability. After the need to be safe and secure from violence or harm, there is no greater human aspiration than the desire to provide for one's family. This is shared by every society, culture and religion.

Therefore, it is essential to craft a new and dynamic approach to economic development that reflects the realities of a 21st century global economy and incorporates the participation of a wide variety of new players, particularly those from the private sector. This new approach should be pursued with the same intensity as improving governance and social service delivery. It should focus fundamentally on job creation, seeking to finally establish a vibrant middle class in countries where ones do not exist.

While investment, trade and innovation all represent basic components of building healthy economies, this paper will focus primarily on strategies to increase both in-country and international private capital investment in order to create jobs. To that end, it will focus on two areas: strengthening and reforming the existing structures, coordinating mechanisms and policies that support U.S. economic development efforts; and improving public private partnership models to promote broader financing to local businesses, greater human capital support and technical assistance, and improved physical and ICT infrastructure.

For all of these changes to work, the relationship between the U.S. government and businesses operating in the developing world must be fundamentally reshaped. In particular, policies and authorities must be adjusted so that U.S. agencies are better informed and empowered to create partnerships. Moreover, a comprehensive approach to the private sector must be undertaken that provides greater access to debt and equity for small and medium- sized enterprises (SMEs), devises new and more relevant insurance products to protect against today's political risks, uses donor funds more effectively to leverage private capital investment, makes technical assistance more plentiful and available to launch new ventures, taps the immense human capital of business-minded Americans, and tackles critical infrastructure needs to connect more producers to markets. By reimagining the role of the U.S. government in engaging the private sector in international development, there is an opportunity to redefine how America achieves its foreign policy aims and how it promotes its values abroad.

HOW DID WE GET HERE?

In assessing how best to redesign our current approach to economic development, it is important to have a sense of perspective. Without trying to catalogue all the mistakes we have made, one way to explain the problem U.S. development programs face is to use the old adage about giving a man a fish. As the story goes, "Give a man a fish, you have fed him for a day. Teach a man to fish, and you have fed him for a lifetime." Recently, U.S. Secretary of State Hillary Clinton suggested modifying the maxim to read, "Teach a woman to fish, you feed a whole village for a lifetime." However, both of these approaches are limited; instead of concentrating solely on "giving them fish" and "teaching them to fish," we should focus more on encouraging investment in the fishing industry.

Assuredly, we have provided fish. Wealthy countries, particularly the U.S., have been very generous. Whether it is donations of money or materials, there has been an abundance of assistance provided over the past 50 years, most of it provided with the best of intentions. Moreover, the combination of foreign aid and philanthropic giving has saved millions of lives and mitigated many disasters.

We have taught countless others to fish as well. Indeed, there has been no shortage of advice and technical assistance for programs or projects all over the world. The United States also continues to devote significant resources to helping build the capacity of governments and societies to function better so that institutions can serve their people more effectively. Economic capacity building, which seeks to establish the rule of law or business-friendly investment codes, is essential for broad-based, long-term growth.

Still, providing financial assistance and/or advice alone has not been sufficient to beat the cycle of poverty in most developing countries. In some cases, it has made the situation worse by creating a crippling form of dependency. What has been missing is a concerted effort to use all the relevant instruments of the U.S. government to help mobilize and facilitate private capital investment, which creates jobs and generates economic growth.

Yet the U.S. government gives scant attention to private capital investment as an immediate front-line foreign economic development tool. This happens for a variety of reasons. Perhaps the most challenging reason is that entrepreneurial capitalism—as manifested by private sector investment—is not well understood by most economic development policymakers and practitioners, much less by diplomats. Very few have any real business experience, and most assume that the "private sector" is so averse to risk that investment in poor developing countries is unlikely without the adoption of a host of legal and regulatory reforms. While no one doubts the benefits of economic reform, such as establishing the sanctity of contracts in a society, such reform invariably takes time to implement—if it happens at all. The U.S. government repeatedly makes the same mistake in assuming that little can be done to stimulate economic growth in the meantime.

Even when the U.S. government is anxious to encourage and support short-term investment and growth, such as in Afghanistan and Pakistan, it struggles to make it happen. Studies are usually conducted to assess what sectors of an economy have potential for growth, but there is no standard or consistent process for translating economic opportunity and need into business investments that will create jobs. For instance, in Afghanistan, we have known for years that in order to convert farmers from growing poppies to more legitimate crops, we need new investment in agricultural infrastructure, such as more cold storage facilities and juice processing plants. And yet, even in such a critical region, there has been no systematic effort to attract such investment and facilitate it.

In other words, economic development continues to be viewed as a sequential process of first "building capacity" followed by private sector investment; seldom does it pursue both at the same time. It is also assumed that unless a country can attract foreign direct investment on some significant scale, it cannot grow economically. This too is incorrect. A new approach is necessary.

FORGING A NEW RELATIONSHIP BETWEEN GOVERNMENT AND BUSINESS OPERATING ABROAD

Although private sector investment is the principal means of generating sustainable economic growth, a new approach must redefine the complementary roles of various public sector players, including U.S. government departments and agencies, international financial institutions and multilateral development organizations.

A number of international financial institutions have already come to understand the critical role of private sector investment in development, including the Overseas Private Investment Corporation (OPIC), the Inter-American Development Bank (IDB), the African and Asian development banks and the International Finance Corporation (IFC), the private sector arm of the World Bank Group. These institutions have been leading the way in helping facilitate private sector investment in emerging markets. The IFC, for example, financed more than $14.5 billion in private sector projects in the past year and is becoming a major component of the World Bank Group's portfolio. This expansion, along with the increased focus of other international financial institutions (IFIs) on the private sector, represents a dramatic departure from traditional public-sector-driven economic development of the past and offers new opportunities for stimulating growth.

The level of coordination, however, among the public sector players and the degree of cooperation with the private sector parties must be improved significantly or new public-private partnerships will not work. To that end, there are several steps that should be taken even within the U.S. government.

Coordination and Policy Reform

First, starting with the executive branch of the U.S. government, a position should be developed with sufficient authority and support at the White House to bring together the relevant inter-agency players and to help coordinate and leverage the economic, social and humanitarian resources of the federal government with respect to strategic private sector partnerships for development. It would make the most sense to house this capacity under the existing deputy assistant to the president and deputy national security adviser for international economic affairs, a position held jointly at the National Security Council (NSC) and the National Economic Council (NEC). Inherent in any attempt to build a stronger partnership with the U.S. private sector is the need to establish a common portal for communication and engagement. That is one of the many reasons why it is critical to have a focal point of coordination at the NSC and NEC for the inter-agency players. While this expanded White House capability should not be the conduit for all conversations, it should at least serve as the clearinghouse for strategic initiatives. Only the White House can command the participation and accountability necessary to coordinate effectively all U.S. government resources, including the Departments of State and Defense.

The position must be supported adequately and should serve as the focal point for formulating coordinated strategies, assigning tasks to those entities most qualified to undertake them, and holding the respective players accountable for executing the plans. The White House should serve as a convener, coordinator, and overseer, rather than an operations office, playing the role of "honest broker" of various tools that the inter-agency players bring to the table. This way, the White House can assure that private sector economic development stands on the same footing as improving governance and delivering social services.

Next, the U.S. government must initiate a new dialogue with American businesses operating abroad. The goals should be to explain the strategic objectives of the U.S. government in various countries, to encourage their feedback, to welcome their voluntary assistance in meeting those objectives, and to offer opportunities to partner with the government on certain investments. Obviously, these would be approached as mutually agreeable partnerships.

Conducting the preliminary analysis of opportunities and needs, including realistic assessment of the impediments, is the first step toward achieving more functional private-public partnerships. This step should then be followed by inviting U.S. businesses in the relevant sectors to take a closer look at the available opportunities. In terms of the breadth of outreach to the U.S. private sector, any business that is contemplating a significant presence in a targeted country or has done so in the past should be contacted. However, particular attention should be focused on businesses that work in sectors more catalytic to job creation and economic growth.

After these measures have been taken, the U.S. government should be prepared to partner with these businesses to facilitate their investment and mitigate risk. Although the opportunities may not initially appear that attractive to investors, it does not mean support from the U.S. government cannot be used to help make them more attractive. While there are certain public sector tools already available that enable the U.S. government to play that role, there are others that need to be strengthened, clarified or created.

In addition, the U.S. government must launch a similar dialogue with foundations, philanthropists and NGOs operating in priority countries. Although some coordination already takes place—particularly with organizations funded by the U.S. government—much more could be done to leverage their resources and extend the outreach of the United States and the American people.

The point of these dialogues is not to inject the U.S. government into the middle of international commerce or to impede the initiatives of U.S. NGOs and non-profits, but rather to move beyond the haphazard, inconsistent level of communication that exists today and to seek areas of cooperation and mutual benefit.

The U.S. government should be prepared to partner with these businesses to facilitate their investment and mitigate risk

There are many advantages to better and more regular communication. The first is to provide a broader base of information about the economic conditions on the ground to those making decisions in Washington or in the field. The second is businesses that are planning to employ local residents or are already employing them often are much more effective advocates for economic reforms with host government officials than U.S. diplomatic personnel, who usually have a more expansive agenda. Finally, the fact that many American companies pursue significant international business opportunities without coordinating with or sometimes even contacting the U.S. embassy in the relevant country not only speaks to how little value they attach to help from the U.S. government, but it also puts the U.S. at a competitive disadvantage vis-à-vis countries like China, which tend to speak with a single voice.

With a new framework in place to coordinate internally and to attract, communicate and partner with the private sector, the U.S. government's ability to achieve its foreign policy goals will be greatly improved through extended capacity and flexibility. The next section considers specific strategies for leveraging public-private partnerships and considers how such an approach could be adopted.

Creating New Models For Public-Private Economic Development Partnerships

Along with a new commitment to improving the dialogue around public-private partnerships, specific actions should be taken to help these projects achieve scale and reach maximum effectiveness. Historically, many public-private partnerships have taken the form of small demonstrations or pilot projects, or have focused merely on corporate social responsibility-wrapped philanthropic activities. While small demonstrations are often useful in testing a concept, too often these projects have very limited impact and no strategy or capacity for scaling them up to a larger size. Whereas corporate philanthropy and social responsibility (CSR) activities are intended to address some social need in the host environment, these activities are not usually core business functions of the private sector participant. Constructing a health clinic, a daycare center or a school might generate positive publicity and can strengthen ties between the company and the community. However, they are often "one-off" initiatives that do not receive the same attention and focus of the company leadership that an investment in a core business function would. Without discouraging future CSR activities, there is a need for new types of public-private partnerships as part of a more ambitious approach to economic development.

In most fledgling economies, there are five major investment strategies that have the greatest impact on the local population and are highly catalytic to economic growth:

1. Increasing access to credit and capital for small and medium-sized enterprises.
2. Increasing access to affordable housing.
3. Launching leasing companies to rent modern machinery and equipment to local businesses that cannot afford to buy it.
4. Organizing agricultural supply chain and infrastructure providers to enhance the value of local commodities.
5. Broadening access to information and communications technology.

Depending on the country, there are always other areas of potential investment besides these five. However, initiatives in these areas increase the productivity of local businesses and enable them to support larger capital investments in areas like minerals and mining or the building of basic infrastructure.

In recent years, OPIC has supported a number of these types of transactions. To increase financial access, it partnered with the Aspen Institute to establish a $228 million small business lending program in Palestine. This program includes a $50 million commitment from the Palestinian Investment Fund and is administered by seven banks located in the area. OPIC has also supported a $250 million affordable mortgage program in Jordan that is being managed by three banks in Amman. To promote modern machinery, it backed a heavy equipment leasing company in Iraq and a cold storage business for chicken in Afghanistan. To broaden access to ICT, it supported a broadband expansion program in Kenya and Tanzania. In other areas, USAID's Global Development Alliance and Development Credit Authority have also played a role in harnessing the power of the private sector.

However, much more remains to be done. A new approach would entail a significant expansion of the current private-sector-driven, public-sector-enabled investment model and would require greater coordination and collaboration between the two sectors. It would not rely solely on haphazard or serendipitous relationships between public-sector development entities and investors, but rather would be more systematic and organized. In particular, strategies would focus on three goals: expanding financing mechanisms, increasing capacity through improved human capital and technical assistance programs, and bolstering both physical and ITC infrastructure.

Expanding Financing Mechanisms

Several adjustments should be made in order to maximize the flexibility of U.S. government financing. The first is to provide OPIC with the authority to invest in a portion of the equity for projects that it finances with either a direct loan or a loan guarantee. Although access to credit is essential for SMEs to expand and create sustainable jobs, equally if not more important is the need for access to investment capital in the form of equity. The IFC has that capacity and often takes a 10 percent equity position in companies it finances. Providing OPIC with similar authority, to be used carefully and sparingly, would have a very positive impact on launching or expanding businesses in targeted areas.

Another important tool offered by the U.S. government is the capacity to make direct loans and loan guarantees to finance transactions that commercial banks are unwilling to undertake alone or without risk-sharing. The Export-Import Bank, OPIC and USAID all have authority to finance different types of transactions in emerging markets, as do a host of IFIs.

A third tool already in existence is political risk insurance. Such insurance generally protects the investor against expropriation, currency inconvertibility and political violence. In recent years, private sector companies have made their own products more readily available, reducing the need for public sector insurance. However, that need still exists and the time is ripe for providers, such as OPIC and the Multilateral Investment Guarantee Authority of the World Bank (MIGA), to think more creatively about new products that meet the risks of today.

Few governments, for instance, continue to engage in outright expropriation activities, choosing instead to take more subtle steps that should be considered tantamount to expropriation. This occurs when regulations are changed after a contract is signed, which seriously undermines the value of an investment. Because such a regulatory change may not be regarded as a violation of international law, the investor is unable to collect under most political risk insurance policies. In the 21st century, this needs to become an insurable risk. Moreover, new thought should be given to how to provide insurance for non-political risks, such as futures contracts, weather contingencies or arbitration mechanisms for dispute resolution.

A fourth tool that should be deployed more effectively in support of public-private partnerships relates to the use of specialized multi-stakeholder funds created by wealthy nations to address economic challenges in priority places, such as the Middle East, Georgia or Liberia. Using a portion of these funds to leverage private capital investment would accelerate economic recovery and growth. For example, in the summer of 2008, a $500 million affordable mortgage program was launched in Palestine to support home ownership and facilitate housing construction. The participants of the program included OPIC, the IFC, the Palestinian Investment Fund and the Bank of Palestine. The combined resources of these organizations will help underwrite mortgages to middle-income Palestinian home buyers.

The British government's Department for International Development (DFID) is contributing $20 million to the program to serve as a "first loss" fund. In other words, if the program experiences losses, the first $20 million of such losses will be absorbed by the fund rather than the senior lenders. If the other donor countries that have made commitments to Palestine would earmark some of those dollars to this "first loss" fund, such that it grows from $20 million to $50 million, other banks would join the program as senior lenders, thereby expanding the total resources available for mortgages from $500 million to perhaps $1 billion. This is just one of many examples in which these public sector resources could be used more effectively to leverage private capital investments. The possibilities of these funds are limitless.

Increasing Capacity Through Human Capital and Technical Assistance

A second overarching strategy must be to increase the flow of human capital and technical assistance to worthy partners. Several steps should be taken to make this happen. First, the U.S. government must do more to leverage grant dollars that support technical assistance and enable successful transactions. An example of where technical assistance is needed is in providing greater access to credit for SMEs. Because few commercial banks in developing counties lend to small businesses, the banks need training on how to evaluate risk and structure loans. Most small businesses do not have sufficient collateral to support a conventional credit facility, so loans must be based upon current or expected cash-flow and the reputation of the borrower. By the same token, borrowers need training in how to organize their affairs in such a way as to apply properly for a loan. Commercial banks should shoulder most of the cost of this training, but sharing the cost with the government would be an effective means of incentivizing lenders to get into this space quicker. USAID has the authorities and mechanisms for technical assistance grants, but the agency must coordinate more effectively with OPIC and the other agencies doing the lending. A very small amount of technical assistance in certain projects can make a huge difference in the success of a transaction.

The second step would be to create a more systematic method of connecting the local businesses that have significant potential for growth to investors and financers. As head of OPIC, I often encountered businesses throughout the developing world that had the potential to expand into regional or international markets. However, most fail to realize that potential because of a critical missing piece, a professional business plan.

Providing the resources and expertise to help develop such plans would dramatically enhance these businesses' ability to attract investment capital as well as facilitate their access to debt. A corps of business plan developers pulled from America's vast human capital network of volunteers could provide the connective tissue between entrepreneurs on the ground and investors, both domestic and foreign. As the Obama administration contemplates doubling the size of the Peace Corps, it should also consider launching a "Bizcorps" program—modeled after the Peace Corps—made up of graduates of U.S. business schools.

These graduates could serve on teams and could be dispatched to targeted countries for one to two years with the mission to develop business plans in sectors of fledgling markets that have the greatest potential for growth. Each team would include an advisor or mentor who has spent at least 20 years doing business internationally and in the region, and this pool of mentors could draw upon the ready expertise of corporate retirees who are also seeking rewarding volunteer experiences that impact development. Once the plans are developed, they would be shared with local investors as well as the growing cadre of international private equity players operating in emerging markets. A "Bizcorps" program would help fill a large gap in the economic development process and would enable local businesses to attract more capital and hire more people. It would also provide graduates of U.S. business schools with a very tangible means of garnering practical experience, serving their country and fighting global poverty on behalf of the American people.

Similarly, in any country or region in which the U.S. government sought to "kick-start" economic growth, a multi-disciplinary team of experts from relevant business sectors would be sent in to partner with local policymakers and business people to formulate an analysis. Its mission would be to determine both which economic sectors have the greatest potential for short and long-term growth and the steps necessary to stimulate that growth—in addition to the principal impediments to achieving that growth. Several U.S. government agencies are currently reviewing their human capital strategies—including capabilities to deploy specialized teams when necessary. They should factor in the necessary capacity to perform these types of analyses.

Bolstering Infrastructure Investment

Finally, one of the greatest impediments to economic growth is not a legal or regulatory barrier, but rather a lack of infrastructure. In order to address some of the most pressing needs, we must commit the resources to provide critical physical infrastructure, such as roads that efficiently connect agricultural producers to markets, harbors and airports that facilitate exports, and the means to increase the supply of electricity to a plant so that it can operate two or three work shifts a day rather than just one. We must also put new emphasis on creating the infrastructure necessary for information and communications technology to be widely adopted and allow for new business opportunities and greater efficiencies.

While some of these needs can be met through private sector investment, most of the resources for strategic infrastructure projects such as these must come from the public sector. Identifying and committing the public sector resources quickly for these needs has the effect of encouraging businesses to move forward with plans to expand with the confidence that the infrastructure will be available to support those plans. However, this requires placing a much higher priority on affecting economic development through infrastructure projects operating at a faster-than-normal pace. Often, essential infrastructure projects are undertaken without adequate regard for their economic impact. Still, by focusing on their connection to the growth of the economy, public-private partnerships for infrastructure can provide a wide range of new incentives for investment.

MOVING FORWARD

At a time when the gap between rich and poor countries is widening and unemployment among millions of young people around the world is contributing to political instability and violent extremism, it is absolutely essential that the U.S. government adopt an ambitious new approach to economic development. That approach should be based on the fact that the most effective way to create sustainable jobs and broad-based economic growth is through private capital investment, from both in-country and international sources. It should be aimed at unleashing the economic potential that exists in every single country and the emergence of a vibrant middle class. Finally, it should be based upon forging a dynamic new partnership between the public and private sectors that enables the United States to share with the developing world what is still its greatest competitive advantage, entrepreneurial capitalism.

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