

THE BROOKINGS INSTITUTION  
BROOKINGS CAFETERIA: The power of private investment for the developing world  
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(MUSIC)

DEWS: Welcome to the Brookings Cafeteria, the podcast about ideas and the experts who have them. I'm Fred Dews.

Foreign aid money from governments is getting scarcer. And in the U.S. private philanthropy exceeds U.S. government funds in the foreign assistance realm. But what about the role of business and private capital and development reducing poverty and alleviating hunger? So called impact investing is now one of the most important trends in addressing some of the world's most pressing problems.

On today's show, Homi Kharas, the Interim Vice President and Director of the Global Economy and Development Program, speaks with Phillippe Le Houérou, the President of the International Finance corporation, about the IFC's new report on impact investing.

To tee up that conversation I spoke with Homi myself about the report and the work of the IFC.

Also on today's show, Senior Fellow David Wessel addresses three questions raised by President Trump's tariffs on Chinese imports.

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And now, here's my conversation with Homi Kharas, followed by his talk with the President of the IFC.

So, explain first of all what the IFC is and what it does.

KHARAS: So the IFC is part of the World Bank Group, but unlike the main World Bank agencies that lend money to governments, the IFC lends money to private companies that are investing in developing countries.

DEWS: So this report that you'll be talking with the IFC President about is on impact investing. What is impact investing and how should we think about it in relation to traditional investing and to philanthropy?

KHARAS: Well, traditional investing is a matter of putting your money into places where you think your financial returns will be highest. With impact investing you start to think not just about how much money you can make in the short run, but also about how the investments impact on environmental and social aspects. And what we've seen is that in many cases, by thinking about those kinds of considerations, you actually improve your financial returns in the long run. So impact investing is not about a tradeoff between financial returns and environmental and social benefits, it's actually a way of trying to think about how do I maximize my financial returns over the long run.

Philanthropy of course is about the social and environmental side, but without thinking about the return on money. So it's to some extent quite a different business and the kinds of activities that philanthropists get engaged in consequently are quite different.

DEWS: So I know you discuss it in the interview, but just to get our listeners started thinking about it, what's the scale of impact investing that the IFC is talking about? I mean how much money is involved here?

KHARAS: Well, in some sense almost any investment could become an impact investment. And I think what IFC would argue is that all of the investments that it has always done have always been impact investments, they just didn't call it that and didn't give it that kind of a branding. But they always thought about how does my investment actually affect the broader development prospects of this country.

The power of impact investing is really that it's trying to harness market forces, it's trying to harness business and say that if we do business right, if we do business in a way that does not try to take

advantage of all of the loopholes and distortions that we know exist in many of our markets, then we can end up in a better place.

And so, really, when we think about the size of the impact investing market it can be trillions of dollars. And the report I've seen talks about \$21 trillion as the impact investing market, but actually that's just a shorthand way of saying that almost every investment, whether it's a public investment or a private investment, ought to consider environmental and social issues as well as financial returns.

DEWS: So last question before going into the interview, in what ways does the IFC's report on impact investing intersect with the research that you're leading in the Global Economy and Development Program?

KHARAS: One of the things that we do in Global Economy and Development is think about ways that the Sustainable Development Goals can be achieved. The Sustainable Development Goals are targets for 2030 for development in all countries in the world. And what we quickly came to appreciate is that we're not going to achieve these Sustainable Development Goals if we don't bring business in as a central partner.

So impact investing is actually very central to trying to get business to understand how they can do things in a way that both helps business by increasing profitable opportunities for them, and at the same time contributes towards the Sustainable Development Goals.

DEWS: Well, great, Homi. Thanks for setting up the interview and thanks for doing the interview that our listeners are about to hear.

And now, here's Homi Kharas with IFC President Phillipe Le Hou  rou.

KHARAS: Thank you, Fred.

Phillipe, IFC has put out a report called "Creating Impact: the Promise of Impact Investing". Everybody is talking about impact investing these days. Why did IFC decide that it wanted to produce this report?

LE HOUÉROU: Well, thank you, Homi, and thank you for hosting this meeting at the Brookings first. And I think it was a very interesting panel.

And the "why" is very important, in fact. What we discovered in IFC is that all these impact funds that were mushrooming here and there, we had something to say about it because for now 62 years IFC has been created to be de facto an impact investor, but we didn't have the words to say it. So our job was to go to the toughest markets -- and this has, by the way, evolved over time since 1956 -- and try to make as much development impact as we can. And very recently, two years ago, we finally quantified our ex ante impact for every project that we have, from 1 to 100.

So based on this experience and the formatization of this experience, we decided that maybe it's time, like we did for the green bonds with the Bank and others, like we did for the Equator Principles, but some principle up there, because know that markets need transparency and that will be a way to improve the growth of this market, because without transparency the growth we believe will be only temporary.

KHARAS: So you talk about impact, but of course there are so many different types of environmental, social, governance impacts in the world. How can we ever measure these on a single scale?

LE HOUÉROU: Well, that's a tough one. But I don't think there is a single scale. So that's why we came out not with a measurement. We have our own measurement system in IFC, called the AIMM, which is pretty complicated. And you can see on the website we try to explain it better. But we don't want to impose on anybody because there are many different impacts. You can have an impact. You can have an impact if you want to do some health impact, or you can have education impact, you can have poverty impact. We have our mandate. Article I of IFC is about development. So that's what we are and we try to find an index for that.

But other people, there's a lot of imagination out there, a lot of ideas. So let them grow and we can learn from each other. So that's the good thing.

The key issue for us was -- that's why we talk about principles -- is we want to lay out what is the rule of the game before you can say I am in impact investor. And these rules of the game, we came up with nine, but frankly, to put it in plain English, it's basically what is your intent, then what is your investment thesis, and what do you do, the operational side of it, the process that you have, and then the measurement and the capacity to be audited. So that will be I think a major step forward. So you don't put the straight jacket on what is an impact, because impact can be many things. And you and I can agree to disagree on many different things. But at least we can agree on the minimum set of principles that will qualify on impact and then the measurement system, let it free, but then report. That's the key. And that I think we will mutually learn from each other. That's the beauty.

So it's a dynamic thing as a dynamic system, not a static system.

KHARAS: A lot of people still worry that as soon as you start to talk about impact and doing good, that somehow you are compromising your financial returns.

So what's been IFC's experience over time in terms of the tradeoff or the lack of a tradeoff in their development impact and financial returns?

LE HOUÉROU: That's the core question in fact, because this market is not going to move and not going to kind of deliver on their promise, as we say in the title if indeed these two things don't go hand in hand. Because we believe that the real market, the big market, is about financial returns. So we're talking about a new category of investors, and that's a shift of generation, that wants the returns and the impact both. They want the cake and eat it too, if you want.

Now, we have to be very humble about that. And I can talk only about the IFC. So as I said, for 62 years we have been at it in the toughest markets, because impact investment can be in the suburbs

of Paris or in Bethesda, as I said earlier. But we are in IFC engaged in emerging markets and more and more into development economies and fragile states. Now, that's tough.

So we think that we know a few things about that and what we see in our own data -- and again, this is only IFC -- is that in fact we can indeed have impact and returns. In fact, we beat the MSCI from 1988 to 2016 -- from memory. We delivered better results. But what I found even more interesting is that the low middle income countries deliver more returns than the upper middle income countries. So there we can elaborate why and how, but that's our track record in IFC.

Again, we are designed to do the toughest things in the toughest market, and we have been doing it for now 62 years, being pushed in fact. The first deal was in Brazil, now our latest deal we go all the way to Afghanistan these days. It's not big, but we tried and we succeeded to find deals in the toughest places and have the returns.

Why? One thing I want to say is the way I think about it in IFC is like baseball with three bases. The first base is we need profits. Why? Because you would not have impact if the company goes bankrupt. So that financial sustainability is key, because then if you have the profit, then you ask for the impact. But if you don't have the profit, the impact will be really ephemeral, and that's not the game we're in. The third base for us is additionality, which means if (inaudible) Citibank or other financiers want to go without us, all the better. We are going where we have additionality, financial and otherwise, including the standards, by the way.

KHARAS: So IFC lends money or provides equity to private companies, but there's still a lot of skepticism out there that private companies will actually be a driver of social good. In fact, many people look at private companies as being the source of some of the biggest environmental problems that we have, as not treating labor well and resisting organized labor. In fact, even of trying to bribe governments to get contracts and things like that.

So there's this history and the perception of how the business sector has not always really advanced these goals. And now, suddenly, we expect them to turn around and say actually this is good for the bottom line.

How do you reconcile these two different narratives on what business actually does in what you described as some of the hardest places?

LE HOUÉROU: We are not naive. We see that there's all kind of private sector. The private sector we are interested in are the private sector that is responsible. For me responsibility is a key word. So we have more and more of these responsible investors and operators, so on that we're not worried. We see more and more of that. Why? Because there's pressure, and it's good for the bottom line in some sense because the world has shifted. We are not back in the '50s, we're not back in last century, we're not back in the '80, we're now in an era where large companies have shareholders that are demanding. And by the way, this shift of generation is going to accentuate these strengths.

So it's not the kind of turn on, turn off, it has been an evolution over the last 30 years that certainly we have witnessed. I mean it's not by chance that the Equator Principles, which is exactly what you say -- do no harm first. So don't destroy the environment, be socially responsible. We're created at the demand of the international banks, multinational banks, doing project finance 15 years ago. And this has been growing.

So I think capitalism is evolving, it's not fixed in time. So we believe that there is a kind of responsible capitalism that is growing. Now, is it a straight line, is it fast enough? That's for everybody's judgment, but I believe this is happening and this is happening more and more. And one of the things that I like the most in this job is when I meet clients that tell me, you know what, 10 years ago you forced me to do this kind of water treatment because of environmental standards and I was against it -- I, the investor -- because it will increase the investment costs. But you know what, because I did that, I



was able to jump to the next level. So instead of being a small in scale enterprise, now I'm a large, now I'm multinational. One of our clients had told me that. That's rewarding, so it's good business.

Being responsible is good business in the long run. It's not for kind of a fly by night investors, we're talking about serious ongoing businesses. And I think that being responsible is critical, as you said, and it starts by do no harm, but now we want to go even further. It's not only do no harm, but do good, even pushing the envelope. And we believe there is a market out there. Now, will it materialize overnight? I don't think so. But in the next 10-15 years, I think it may.

KHARAS: So being responsible some people interpret as having a rather longer time horizon than let's say the quarterly reporting time horizon of many publicly listed companies. When you at IFC think about your time horizon and having impact, what are we talking about? Are we talking about one year, are we talking about five years or ten years or longer?

LE HOUÉROU: On the impact it can be 20-30 years. And because you have not only the impact of one project -- and I will take the case of Turkey in energy, so it's very practical. So Turkey had the big blackouts. I mean I'm talking such years ago it was a major problem. Then they reformed the whole sector and that allowed -- I'm taking a lot of shortcuts here -- but with the World Bank pushing some reform with the government, the private sector started to invest. And now more and more have renewable energy that were invested privately, which will never have been able to be invested on public debt. And the impact is what? You can take one project or you can take all the projects that were allowed by this shift in policies, and that is over 30-35 years.

So I think for me the long run is really long, and development for me is also a repeat gain. In one sector what is the cumulative impact of what you're doing. The good, but also the bad. If you pollute -- and one industry can pollute, another one can pollute, so you have these cumulative effects. If you had only one, it's not a major problem, but if it's 50, then you have a problem. Cumulative impact is also important and we're just scratching the surface now, because today what we do is the impact of one

discreet project -- I'm going to take shortcuts here -- but think about a period of 10 years where you can really have the full project. First you have the construction period, but then you have to kind of have a steady state for some time. So we take 10 -- it's kind of an average. But remember, that is one project at a time and we do it, but then what we have to think also harder and that may be our next frontier for ourselves, the cumulative impact. What did you do in that sector. So you have to think sector beyond the project itself.

KHARAS: So for you in fact there are two types of impact, there's the direct impact of your intervention in any particular project and the indirect impact of actually creating a market and creating more opportunities in the sector as a whole in any particular country?

LE HOUÉROU: Well, I cannot say it better than you just did. I mean this is exactly what I'm trying to do in IFC. And it's not easy, but it's happening. I just came back from Africa. I mean it was really a rewarding trip -- taxing but rewarding because you can see it in action. As I said earlier, we're creating a mortgage market that will allow the lower middle class to have access to 25 year loans in Kigali for very affordable housing apartments, starting at \$29,000 for a 2 bedroom apartment. This is designed with our age guidelines, which it's a construction guideline that enable to have 20-30 percent savings in water and power compared to the average construction. So this is great. So we created something. In Africa we are creating today a new solar generation market. So it is possible, but that means a lot of work upstream and that means for IFC to work upstream with governments, to work upstream with our colleague in the World Bank, to think beyond the transaction. But you need the transaction, because if you're a reformist and you say I'm going to open the sector and nothing happens, as a minister, you're in trouble. So the two do go together. You have to have the reform, say okay, we'll create some space for the private sector, but then the private sector has to come. And usually they can be timid.

So that's the role that I envisage for IFC to kind of go jump in, be a first mover.

KHARAS: Yes. In fact one of the things I remember is that when the World Bank was advancing structural adjustment in many countries there were some countries, like Bolivia, who said, look, I've done everything you've told me to do and nothing has really happened. So it's very important that you get that.

So that leads me to ask, how do you see the receptivity in countries of these new kinds of approaches? I mean surely there are some countries who say, look, we're just about to embrace the market and market solutions and now here you are and you're coming and you're loading us with all kinds of additional requirements and criteria, et cetera, and it's slowing us down.

LE HOUÉROU: That's true. But we cannot compromise on our standards. We have the standards. I mean we have a board of directors and they have been vetted, we have an ombudsman to make sure that we stick to our standards. And this is for good reason, because I do believe that in the long run sustainable is a key word for me. It's sustainable financially, but also sustainable environmentally, sustainable socially.

KHARAS: But do your clients in developing countries welcome this as being a way of accelerating their development, or do they worry that this is going to slow down their development, at least in the let's say medium run?

LE HOUÉROU: Well, as I said, the first reaction -- it depends if you talk about the sector wide approach and then you talk to the government, or you talk to individual clients, private clients. Individual private client is what I told you earlier.

We had a lot of experience where we were a driver for increasing the cost of investment because of our standards. If you want to have ways that is better than the ways that you had in mind, then that's more costly, for example. But, again, I think that we are in some sense, pushing the boundaries. And it's true that we cannot take any investors, so investors that want to work with us are investors that are ready to make this extra mile, this extra effort. But the track record is pretty good

because those that do make these extra efforts end up into much nicer places. In fact I have in mind as I'm talking to you this entrepreneur in Mali. He bought as part of privatization a rundown public hotel, refinanced the refurbishing from A to Z, and we pushed a lot more expenditure, which is not good for your internal rate of return in the short-term. But now he has a whole chain of hotels across West Africa and he's thanking us incessantly, because without that I don't think he would have been able to get to the financing necessary to kind of multiply. And, by the way, it was also a way that he can replicate some good practices.

So it's not a yes or no answer, and I'm not trying to avoid the question here. But, yes, it is more difficult, yes, this is why we may be slower than commercial banks to have a line of credit, because we look, we turn a lot of stones. And despite that, yes, we will make mistakes and, yes, we will have to learn from them and, yes, we will have to correct them.

So, again, it's a dynamic equilibrium, but all in all I think the world is moving towards that. And there is a recognition. There are more and more studies that show that what I'm telling you is true. For example, on gender, we just had the paper showing that when you have more diversity, a gender representation in (inaudible), you have better results. Now, this is a correlation. You can ask a lot of questions, but more and more we have these kind of things that when you do good environment and social standards and implement them, you are more sustainable financially. But we are at the beginning. We need to document it. That's why I'm a bit prudent. We need to document it and we need to be very systematic in doing it as we go and in the years to come.

KHARAS: Do you find that now developing country governments are also asking you for help in thinking about their regulations, their corporate law, their stock exchange commissions, how they might embed or mainstream these kinds of principles into all of their investments?

LE HOUÉROU: Again, I am maybe biased because I just came from a long trip in Africa, but most African leaders -- there's a new generation, first, of African leaders -- and I think the debate about it's all

public or private, this is passé, this is finished, this is over. So everybody realizes the PPP world, de facto, whether we like it or not is public private partnership. This is the name of the game, which is true everywhere. I mean everything is regulated, from the banking sector to health, education.

So what do I see? I see now more and more government coming to us and to say, with different words, I have a big problem. I have a young population, I have X number of new jobs to create every month. And in aggregate for Sub-Saharan Africa is 1.7 million jobs every month. So you can create 1.7 million fonctionnaire or civil servants, but that's not going to happen with the tax pre ratio and then the tax comes from where? Or you can have immigration. But, frankly, you have the private sector and it will be a mix of everything. But the more you can do on the private sector, the better. So they understand that extremely clearly. And then they come to us and say how do I do it, because it's easy on the paper, it's obvious, but how do you do it. In Guinea Conakry, where I spent three hours with the president, Alpha Condé, to go, listen, you know, you have a lot of distortion in this market, that market. So if you left that, I can do that investment, I can do this investment. So we have the if-then type matrix and there is a lot of appetite for that, by the way.

So I think that we need to organize ourselves, organize ourselves in IFC. But also we're not alone. With the World Bank and other partners to say there's a lot of need for advisory. To illustrate, because I may sound a bit kind of theoretical like this, in Guinea Conakry, one of the main drivers of the economy is basically aluminum. They have the bauxite, so they export the bauxite. This is multi billion. And there is very little kind of local content. And you know you consume a lot. So we created an exchange for small and medium scale enterprises to cater to the needs of these very large enterprises. And it's a dynamic system, to it's not just much dot com, there is feedback on the standards on the quality, and then there is a link with line of credit through the banks so that working capital is financed. So we can have these kind of solutions by sector, by subsectors, but we need to be deliberate about it.

So the if and then approach, if you do this reforms or this type of things, we can do that much more. That is what I see more and more government asking me. And in fact, it's very weird, because in the Spring and Annual Meetings I thought in IFC I would see only private sector CEOs and bankers and companies, but I see more and more governments, ministers of finance, sometimes prime ministers, coming and saying I have this problem, can you help. And then we do it one case at a time and try to deliver on that.

And the last point, because very few people know, in IFC we have more advisory officers than we have investment officers. So we do it a lot. The problem now is to make sure that we do it in a more coordinated way, that investment and advisory work hand in hand, so you don't have advisory running one way, investment running the other way. The sum of these two is more than the total, so we want to do exactly the opposite, so that's what we're doing right now.

KHARAS: Well, this all sounds very exciting. It sounds as if you're really trying to reform financial markets, you're creating opportunities. I was really struck by your comment about value chains and taking an entire sector approach in designing these kinds of integrated solutions that really build sustainability into everything you do.

Phillipe Le Houérou, thank you so much for joining us on this podcast.

LE HOUÉROU: Thank you, Homi.

DEWS: You can find the report on impact investing on IFC.org.

And now, here's Wessel's economic update.

WESSEL: I'm David Wessel and this is my economic update.

Until recently the dueling tariffs that the U.S. has imposed on imports from China and China has imposed on its imports from the United States, were something like a union going on strike from at a factory. When union and management can't agree, workers walk off the job, hurting themselves and hurting the employer in the hopes that the pain eventually will produce a deal. It looked like President

Trump was using tariffs, which he thinks hurts China more than they hurt the United States, as a way to get China to make some concessions that it has previously refused to make.

And while there is still a good chance that the two sides will come to an agreement, perhaps when President Xi and Trump meet in Japan in late June, there's a growing sense that the two intertwined economies may be disengaging and that President Trump's affection for tariffs may end up radically altering the rules for world trade that the U.S. spent decades putting together.

All this has raised several questions. Question one, why is Donald Trump doing this? A. Because he can. The President can't raise taxes or cut spending or make good on his promises to rebuild America's infrastructure without Congress. He can't do all that he wants to do to block immigrants from coming into our country because the courts won't let him. But the President has the power to impose tariffs and he enjoys using it. B. Because one of the few things that we know Donald Trump has firmly believed in for decades is that trade deficits, particularly bilateral trade deficits, are bad. He thinks the fact that the U.S. imports more from China than China imports from the United States hurts our economy. Never mind that nearly all economists think that is ridiculous. C. Because the President correctly senses that there is a lot of animosity towards China among U.S. politicians, workers, and businesses. When the U.S. agreed to let China join the World Trade Organization in 2001 reformers were on the rise in China and the U.S. expected the Chinese economy to gradually come to resemble ours. For a variety of reasons, that didn't happen. China has not always kept its promises, particularly to U.S. firms that do business in China, and imports from China have been blamed for much of the pain that American factory workers have felt over the past couple of decades, which is probably true for some communities and not for others.

Question two. If tariffs are as terrible as economists and historians say, how come the U.S. economy is still doing so well? A. Imports and exports, while significant, are a much smaller part of the U.S. economy than is the case for China or many other countries. So while the tariffs are very painful for

firms that import parts or finished goods from China, and they're devastating for say soybean farmers, whose exports have been hit by China's retaliatory tariffs, other parts of the U.S. economy are so strong that they more than compensate. Tariffs have raised prices and if they persist at the new higher levels that President Trump has imposed, they will increasingly raise the prices that U.S. consumers pay. But for now, other prices in the economy, healthcare and all that, are rising slowly. So in some cases, they're even falling. So the overall inflation rate has not moved up very much. B. Just wait. Businesses in the stock market had been counting on a deal between China and the U.S., but lately they've begun to worry that this standoff will become a new Cold War. If all this posturing fails to produce a deal, the damage to the U.S. economy will become more evident. Prices will rise, global supply chains will become less efficient, business' willingness to invest will weaken, foreign investment in the U.S. will diminish, fewer Chinese students will come to study here, and so on.

Question three. Why is this dispute proving so hard to resolve? A. Because it's more than about trade. It's more than about electronics and soybeans. It's about U.S. uneasiness about the rise of China and the ways in which its economic model may hurt us, particularly U.S. multinationals whose intellectual property is constantly under attack. It's about Chinese hacking and spying to help Chinese companies steal our businesses' secrets. It's about which country will be the technological leader in the decades to come. It's about two economic powers vying for influence in the world economy. B. Because ultimately this comes down to two stubborn men, President Xi and President Trump. Each thinks the other guy is under more political and economic pressure to strike a deal and neither one can afford to lose face by appearing to surrender to the other.

As I said at the start, workers go on strike -- or they used to when unions were far stronger -- because they think that will bring management to the table. But sometimes the dispute proves hard to resolve. Bitterness lingers, even after a strike ends. And sometimes the factory closes or moves away.



Maybe the tension between China and the U.S. will end soon with a new and more sustainable economic relationship, or maybe it won't.

DEWS: The Brookings Cafeteria podcast is the product of an amazing team of colleagues, starting with audio

Until next time, I'm Fred Dews.