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IMPERATIVES FOR INVESTMENT THROUGH ECONOMIC COOPERATION

by

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presented to the

Forum on

**"The Greater Mekong Subregion:
Investment Opportunities through Economic Cooperation"**

Bangkok, Thailand

November 24, 1994

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I am very pleased to be here today and to be associated with this important forum. The organizers of the forum honored me by requesting that I address you today. They have also admonished me to be brief.

The subject of this forum is investment opportunities through economic cooperation. Behind the desire for investment and for economic cooperation is the desire for development. That word "development" may mean slightly different things to different people, but most of us would agree that development involves qualitative changes that make things better, that improve life for people. So what we are really looking for involves a qualitative dimension; not just any investment but "good" investment; not just economic cooperation but "good" economic cooperation. We want a combination that will make things better for people.

Now this, of course, raises obvious questions: what is good investment? How does one determine when investment is good for development? What is good economic cooperation? What kind of economic cooperation is good for development?

We have with us today leaders of the six Mekong countries as well as distinguished representatives of the private sectors of Asia and Canada, all of whom are concerned about development. We also have with us representatives of organizations whose very existence is based on bringing about development. I am speaking, of course, of the Asian Development Bank and my organization, the International Development Research Centre. There is only one reason for the existence of our two organizations and that is to facilitate development... to make things better for people. If we are not succeeding in doing this or if development ceases to be necessary, then there is no reason for our continued existence.

We have been trying to bring about such development for quite a few years and we have invested quite a lot of money in the name of development. There are lots of people who claim that we haven't done a very good job. Many environmentalists, for example, claim that our investments have made things worse, both for people and for the environment; many social organizations claim that we have made the rich richer and the poor poorer. The truth, in my opinion, is that we are like most successful investors: we have made many good investments and we have made some bad investments.

We've made enough of these investments in development -- both good and bad -- and we've been at it long enough that we should be able to give a clear account of what we have learned.

What I would like to do in the next few minutes is to share a few of these lessons. What have we really learned about development? What is needed if development is to occur?

I will suggest that there are six factors that make up the very complex key to development and I will refer to these as the six "i's".

The first "i" not surprisingly is *investment*. What has been demonstrated clearly over the last quarter century is that investment is essential if development is to occur. The converse is also the case: without investment development does not occur. It is also clear that investment may lead to economic growth but not to development, not to qualitative change that improves the human condition. Investment is a necessary condition but not a sufficient condition to development.

The second "i" is *incentives*. Investments fail in the absence of incentives and we have had many, many examples of this over the past three decades. Badly distorted markets, financial instability or pricing policies that ignore the cost of natural capital -- the environment -- have been shown consistently to prevent development or to wipe out development gains that have previously been made. The conclusion here is not, however, that unrestricted market competition is the best path; getting the relative prices right has not always proved conducive to development. It is much more complicated than that, as experience in this region of the world has proven. What is imperative for development, however, is the provision of a consistent package of incentives, principally through market mechanisms, but also with flexible policy instruments (industrial policy, for example) which may actually "distort" pure market forces in order to get the incentives right.

The third "i" stands for *institutions*. If we have learned anything from our experience of the past quarter century it is, in my view, that development simply does not occur with any consistency in the absence of strong institutions. Included here are strong fiscal and monetary institutions, institutions for banking and credit, legal institutions that protect property and ensure both individual and collective rights, legal and institutional arrangements that protect the environment, social institutions that distribute social goods and government institutions capable of mediating market excesses and market failures.

So we have learned that the first three factors that explain where development has occurred and where it has not occurred are investment, incentives and institutions. Not much new here you may say; Adam Smith told us in the 18th century of the importance of investment and incentives; the imperative of institutions has been a point of emphasis in business schools for most of this century.

The development puzzle is, in fact, a great deal more complicated. Let me add the remaining three factors ... the remaining three "i's". From here on, matters become considerably more complex.

The fourth "i" stands for *information*. And information, as we know, when it is organized meaningfully, becomes knowledge. Starting with the liberalization of capital markets in the 1970's and accelerating to the globalized marketplace of today, it has become increasingly clear that information and knowledge are essential to development. Those who can access, process, adapt, take ownership and innovate around information and knowledge systems will profit. Those who cannot will be increasingly marginalized. Indeed, the very basis of economics must now be altered to take account of this new reality. No longer does it make sense for economics to refer to "land, labor and capital" as the three factors of production; today's largest factor of production is, by far and away, information and knowledge.

Development today and certainly development tomorrow depend on more than being just able to keep up with the incredible pace of scientific and technological advances; tomorrow's development will depend on being at the leading edge of those advances. Electronic and biological wizards have created entirely new modes of human interaction, allowed us to alter the evolution of plants, animals and humans, and have created machinery that is so sophisticated that we are forced to try to figure out how humans and machines can best co-evolve.

The fifth "i" is the word *inclusion*. Let me take a minute to explain this one. We

used to speak of a world divided into the two categories of the North and the South. The North was rich and the South was poor. The New World Order with its global marketplace is changing that, making geographic boundaries meaningless. It has become much more accurate to speak of the "included" and the "excluded". The New World Order is in the process of spreading the "included" around more. There are many and there are going to be a lot more in the South. It is also spreading the "excluded" around more -- a higher percentage of them are going to live in the North. The problem with this is not the geographic shift but the fact that the number of "excluded" is growing rapidly both in numbers and as a percentage of population.

Why does this matter? Why should it matter to investors? The answer to that lies in a vast and fast increasing body of evidence that tells us that social inequity is detrimental to economic growth. I would refer you here to a recent issue of The Economist magazine which demonstrates that productivity growth is considerably higher in countries where there is relative equity and significantly lower in countries of deep and growing inequity. Indeed, in that same report, the Economist goes so far as to suggest that, while communism may have been defeated, Marx may well yet be proved right on his prediction of class warfare.

I would also like to draw to your attention a recent and very extensive study **Making Democracy Work** by Robert Putnam, a political scientist at Harvard University. Putnam reviewed vast amounts of historical material in an attempt to understand why some parts of Italy have experienced consistent and strong economic growth while other parts have stagnated. What Putnam found was that a relatively egalitarian, caring and civically conscious community was the pre-condition to economic growth and development. It was not the other way around.

His conclusion is summed up as follows, and here I quote:

".... communities did not become civic because they were rich, but rather became rich because they were civic... The social capital represented by networks of civic engagements seems to be a pre-condition for economic development and effective government... The social capital is built from an investment of the time and caring of individuals: it does not deplete the public treasury."

Putnam's study is only one example of this relationship. There is also a growing body of evidence of the same pre-conditional relationship from the newly-industrial

"tigers" of Southeast Asia.

Inclusion, then, is a fifth factor in the key to development.

The final development lesson that I will mention here is the most complex of all. The "i" here is for *interaction*. It is a process factor which entails putting all the other factors together and managing them in order to make them work. This requires agile managers in both public and private domains, the capacity to build consensus and inspired leadership with a gentle touch. It is this factor and the qualities that go with it that appear to be in very short supply.

These, then, are six lessons that I believe we have learned about development -- the six "i's".

Well now let me say just a few words about how we are currently doing in bringing about development. First, there are some very encouraging economic indicators. Taking the globe as a whole, wealth is being produced more quickly and more extensively (i.e. in more places) than ever before. Indeed, if current trends continue to the year 2015 (and that is a scant 20 years from now) of the 15 wealthiest countries in the world, nine will be countries we currently call developing.

That is the good news and it is good news. But, in my view there is today far too pronounced a tendency to focus on this good news and to ignore almost completely some of the very serious underlying bad news. Economic growth and development are not synonymous. If we want development (i.e. improvement in the human condition) to occur and if we want investments that are going to pay dividends for a long, long time, we are going to have to address the bad news and do so on a priority basis.

The bad news relates to the included/excluded factor that I mentioned previously. Those who are excluded -- that is the number and percentage of people who are not involved in the benefits of economic growth -- are growing significantly and quickly. Again, I refer you again to the recent issue of The Economist. Let me also refer to Business Week, a magazine that is a major voice in North America's private sector. Last month it examined the issue of how "work" is changing across the world, primarily because of innovations in communications and other types of technology.

The report voices a chilling concern. It notes that "workers and managers alike wonder if we are headed toward a world in which half the population is permanently overworked, and the other half permanently unemployed."

This cannot happen; surely it cannot be allowed to happen. But, by all indications, this is exactly where we are headed. And should it happen, then we will inhabit a world of such insecurity and violence that Marx's prediction of class warfare can only become very probable, if not a certainty. And under such conditions economic contraction and even collapse are also near certainties.

An old Chinese proverb tells that if we don't change direction we'll get to where we're going. What responsibilities do private financial interests have in this regard?

Well certainly we must not turn our backs on our entrepreneurial instincts, or for the concern for "the bottom line". If we are to supply even the most basic necessities for all the world's people, we need the vigor, and thirst for innovation, and the acquisitiveness that the private sector provides.

But if investment and productivity are going to translate into anything approximating widespread development, both nationally and internationally, it appears to me that we are going to have to be more creative about synthesizing our acquisitiveness with other human values.

Governments certainly cannot manage this process on their own. Most of them are under pressure to get out of the way of business and to put their own fiscal houses in order. The "bottom line" rules in the last decade of the 20th century, and the "bottom line" is telling governments that excessive displays of compassion for the less fortunate are no longer possible.

We cannot afford to have antagonism between capitalists and governments. It may be that governments are going to have to start looking more like corporations to survive economically, and that corporations are going to have to start behaving more like governments to create social systems that will sustain them.

The point is that we are going to need a lot more cooperation and many new ways of cooperating if we are going to get to where we want to go, rather than to where we are currently going. The creative energies of capitalism need to be blended with the social objectives of equity and human development. This isn't a fuzzy ideal. It is essential if we are going to achieve any degree of economic stability

and to bequeath to our children a world where personal and physical security are possible.

It is important that people concerned with development -- whether they be in the private or public sector -- look for new ways of doing things socially, the way they have scored such dazzling successes at finding new ways of doing things scientifically and commercially.

If this sounds "soft" to you -- not in keeping with the hard economic edge that the marketplace has taught us -- I can only repeat: economic success cannot be sustained in an environment of social failure. That is a strong and clear lesson of history, including the history of development efforts. If we do not deal with the human beings that our modern economy is discarding at an alarming rate, we are doomed to watch helplessly as much of what we have accomplished unravels.

This forum is an excellent occasion to look at investment opportunities. It is an excellent occasion to look at economic cooperation. Much more significantly, however, it may just prove to be an excellent start in thinking together about the context in which investment and economic cooperation find themselves today. That context involves the greatest challenge that global civilization will face in the years ahead -- the challenge of blending the creative energies of capitalism with the social imperative of inclusion -- or, in the simplest of terms, the challenge to meet the challenge of development.