

THE SOCIAL INVESTOR IN A GLOBAL FINANCIAL SYSTEM

By Hernan J Pisano, April 2008

As globalization keeps its rampant and seemingly inexorable ride, the financial implications of international social investing become apparent for all economic players, and painfully so for Social Investors. The current international finance environment, marked by the dollar devaluation, the global financial markets crisis and the international trade liberalization has a significant impact on social investing.

1. - The Dollar Devaluation



Used to the matchless status held by the dollar as the globe currency of choice, U.S. social investors have seen the impact of their invested dollar shrink proportionally to the dollar devaluation. The ubiquitous Dollar/Euro benchmark tends to overlook the appreciation *emerging* currencies had against the dollar. According to the U.S. Federal Reserve Data, using the dollar values of 2000 as a baseline, each 2008 dollar provided 25.80 % less help in Thailand, 45% less in Brazil, 15% less in India, 15% less in Sri Lanka and 18% less in China.

This “helping power” erosion has been experienced unevenly by the actors in the

international social investment field. Big investors such as governments, multilateral organizations, and some NGO’s had access to advanced Foreign Exchange (FOREX) risk hedging strategies including futures contracts, options and other more complex derivatives, and thus they kept their “helping power” intact, isolating themselves from the FOREX market’s volatility.

Either because of their inability to attract financial managers skilled in FOREX hedging and/or their inability to access the derivatives market, smaller-scale investors (a bracket made up for the most part by social investors and philanthropists) have seen their “helping power” significantly eroded. Some actors, losing their advantage as the dollar devalue have been unable to keep operational costs at bay and have been forced to “go out of business”, as they become a sub-optimal solution and other organizations with stronger currencies are now doing the job.

Last week’s Federal Reserve’s interest rates decrease down to 2.0% will likely keep the dollar at the current low prices for the foreseeable future.

2. - The Financial Markets Crisis

On the *funds sourcing* side, the worldwide “deleveraging” of the financial markets and

the feverish debt sell-off experienced in the last months made investors (both return and socially motivated) even more risk averse, and liquid capital even more scarce.

The planned new regulation for the financial markets currently in the works in the U.S. congress is likely to obliterate the liquidity levels we experienced in recent years (e.g. the planned requirement for trading houses to keep a leverage level at the 10 to 1 ratio, significantly below their 33 to 1 of shops like Bear Sterns just six months ago). The cash dry-up will affect Social Investing just as it is affecting the Private Equity sector, whose size and quantity of deals is close to one third below what they were in the same period in 2007. Given the inertia of the government and grant making processes, we will see the effects of the funds drought in the first semester of 2009.

Combined, the dollar depreciation and the financial markets crisis will have a significant impact at “ground” level. Social “investees” are facing increasing challenges. Many of them are inserted in economic ecosystems whose development hopes were put in incipient exporting sectors, much in the lines of the FMI advice and the Washington Consensus ideas. Dollar-denominated exporting revenues made exporters increasingly less competitive and the

relentless laws of competitive advantage are putting many of them out of business, raising unemployment across the

emerging economies. Latin American economies, with significant linkages with the U.S., are particularly vulnerable to the fate of the dollar.

Adding to these complications, the momentous rally of commodities and food prices, the rising worldwide inflation, and an impending U.S. recession lay a gloomy outlook in the emerging economies. In short, more help will be needed and fewer dollars will be available.

3. - Global Trade

The thorough implementation of the Washington Consensus ideas pushed worldwide tariffs down by more than 15% in the last 20 years. As a consequence, emerging economies have growth significantly, fueled by the possibility of selling their goods into developed markets. However, the successes of these policies have not come without some caveats.

First, the Gross Domestic Product (GDP) computes economic output and inflation but *not* the dollar depreciation. Since GDP is denominated in dollars, a GDP increase does not necessarily mean a real increase in



economic output, or purchasing power. (Oversimplifying for illustrative purposes, Thailand might have increased their GDP by 25% since 2000, but that is a 0% real economic output, if we input 25% dollar depreciation).

Second, research sponsored by the World Trade Organization (WTO), suggest a worrisome positive correlation of within-country inequality and trade liberalization.

The United Nations GINI index, designed to measure inequalities within the countries, suggests a widening gap between rich and poor in some emerging economies that

successfully implemented trade liberalization policies. An illustrative example of this phenomenon of steady growth and increasing inequality is Chile. Chilean's often praised macroeconomic figures reveal a sustained growth of nearly 6%, on a compounded annual basis over the last 20 years, and a noteworthy reduction in extreme poverty levels now similar to those of developed economies. At the same time, it ranks in a distressing tenth place among the most asymmetrical income distributions in the world.



4. – Food For Thought

Looking forward, the cost-conscious, impact-oriented international social investor and policy maker might want to consider the following suggestions:

(a) Policy makers and practitioners should encourage the use of non-speculative derivatives to *hedge FOREX risk* both through managerial education and regulation aimed to increase smaller players' access to the derivative markets in emerging economies (b)

In order to preserve their "helping power", social investors might invest in the U.S. or in countries that *present positive historical correlation with the dollar*, like Mexico and Central America. Opportunities to help in countries where the dollar is still powerful

abound (Honduras, has 21% of its population living with less than \$1 a day and 44% with less than \$2) (c) Organizations *designed for sustainability* are in better position, particularly if their funding strategy combines U.S. funding with local currency sources (local philanthropy) or local revenues (social enterprises) (d)

Macroeconomic metrics such as GDP must be paired with *microeconomic* data, in order to understand intra-country disparities in wealth. That way, for instance, some of the poorest population in Chile would not be left outside the "radar screen" only because Chile's macroeconomic success.