A Framework for Constructive Capital: Investment, Integrity, Impact

Oxford Analytica Foundation Contributors

Project Manager:
Catherine L. Young
Director,
Oxford Analytica Foundation

Lead Author:
Dr. Isabella D. Bunn
Senior Advisor,
Oxford Analytica Foundation
Member, Oxford Analytica
International Advisory Council
Research Fellow in Governance
and Global Ethics, University
of Oxford

Expert Contributors:

Prof. Don De Amicis
Professor of Law, Georgetown
University Law Center
Co-Director, Center on Transnational
Business and the Law
Former Vice President and General
Counsel, Overseas Private
Investment Corporation

Bennett Freeman
Principal, Bennett Freeman
Associates; Associate Fellow,
Chatham House
Former Senior Vice-President for
Sustainability Research and Policy,
Calvert Investments
Former Deputy Assistant Secretary
for Democracy, Human Rights and
Labor, US Department of State

Hung Tran
Senior Fellow, Atlantic Council
GeoEconomic Center
Former Executive Managing
Director, Institute of International
Finance
Former Deputy Director, Monetary
and Capital Markets Department,
International Monetary Fund

Margaret Wachenfeld
Managing Director,
Themis Research
Senior Research Fellow, Institute
for Human Rights and Business
Former Senior Advisor to UNICEF
and the International Finance
Corporation

Center for International Private Enterprise Contributors

Kim Eric Bettcher
Director, Policy and
Program Learning

Frank Brown
Director, Anti-Corruption &
Governance Center

Eric Hontz
Director, Center for
Accountable Investment

Anna Kompanek
Director, Global Programs

Ritika Singh
Program Officer, Global Programs

© Copyright 2022 Center for International Private Enterprise (CIPE); all rights reserved.
Executive Summary

*A Framework for Constructive Capital* presents a market-oriented approach for supporting private capital flows and foreign direct investment based on a multi-dimensional foundation of systemic integrity.

The Framework aims to deter the negative consequences of Corrosive Capital and reinforce the positive conditions for Constructive Capital. It upholds transparency, accountability, and the rule of law as a basis for equitable, inclusive, and sustainable economies. The need for such a Framework is based on the experience of the Center for International Private Enterprise (CIPE), which works with business organizations and communities throughout emerging markets to build prosperity and democracy.¹

<table>
<thead>
<tr>
<th>Corrosive Capital</th>
<th>Constructive Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opaque capital flows lacking market orientation with motives to exploit governance gaps to influence economic, political, and social developments in recipient countries.</td>
<td>Well-governed investment flows that serve transparent, market-oriented, and accountable purposes at both funding sources and destinations.</td>
</tr>
</tbody>
</table>

CIPE has elaborated these two contrasting concepts of capital flows to encourage good governance across a range of institutions and create an enabling environment for business and entrepreneurship. A solid foundation of integrity, along with the participation of a vibrant private sector, will help support investments with a constructive impact. Local economies will benefit from new opportunities, including through connections to global value chains. Moreover, such factors will also stem the flow of investments with a corrosive impact.

CIPE is collaborating with the UK-based Oxford Analytica Foundation to address how countries can develop effective policy frameworks to foster Constructive Capital flows.² This Framework has evolved as a response, reflecting a perspective across jurisdictions, institutions, and business communities. This report identifies a series of *Cornerstones for Constructive Capital* which create both a normative and practical foundation. It proposes a model for bridging governance gaps through mutually reinforcing linkages between investment, integrity, and impact. Notably, this can enhance the positive financial flows that contribute to building inclusive economies. Supportive trends in responsible business and investment are reviewed, and potential avenues for action at various levels are outlined. Overall, the Framework for Constructive Capital can serve as a catalyst for awareness and engagement across a wide range of stakeholders. It comes at a time of profound challenges across the globe, offering prospects to help shape a resilient and equitable recovery.
Part One: Introduction

*Framework for Constructive Capital* presents an innovative approach for supporting private capital flows and foreign direct investment based on a comprehensive foundation for systemic integrity. The Framework upholds transparency, accountability, and the rule of law as a basis for equitable, inclusive, and sustainable economies.

Crucially, the conditions for well-governed financial flows must be strengthened at both their source and destination. Successful local implementation depends on mutually reinforcing linkages between investment, integrity, and impact. The Framework builds on the contributions of a vibrant and responsible private sector, along with stakeholder collaboration. It holds relevance across jurisdictions, institutions, and business communities. Grounded in a renewed commitment to trust, such a strategy will foster investments with a constructive impact and stem the flow of investments with a corrosive impact. As outlined below, global challenges have brought new urgency to the need for Constructive Capital. The crises in public health, economic stability, and political cohesion pose significant challenges to good governance.

**Constructive Capital** refers to financial flows that are well-governed at the funding source and destination. It supports markets and the rule of law, promotes transparency, and improves governance by holding governments accountable for ensuring a level playing field for the private sector. Such benefits often represent positive externalities of purely market-driven investments. These constructive investments tend to be drawn to businesses and local markets that support sustainable and equitable economic growth. When taken in the aggregate, they can enhance returns and increase future business opportunities. At a tipping point, constructive capital can spark a cycle of investment and business environment improvements. This further supports the development of robust market institutions and good governance. As global standards of business conduct rise, decision-makers who control capital investment that is subject to the rule of law, strict anti-corruption oversight, and comes from transparent sources grow increasingly reluctant to invest in less open markets.

The Center for International Private Enterprise (CIPE) engages with business organizations and economic policy think tanks, primarily in emerging and frontier markets, to strengthen democracy through private enterprise and market-oriented reform. Such work focuses on building strong institutions to create an enabling environment for business and entrepreneurship to flourish, and on helping local economies attract Constructive Capital and connect to global value chains. CIPE and the Oxford Analytica (OA) Foundation joined forces to address the question of how countries can develop effective policy frameworks to encourage Constructive Capital flows. The OA Foundation provides research and analysis in support of projects seeking to deliver positive social, environmental, economic, or political impact. It draws on a network of experts in subjects such as global governance, investment law, economics, development finance, sustainability, and corporate responsibility.
I. The Need for Constructive Capital

The need for a Framework for Constructive Capital is heightened by current risks as well as opportunities. During a period of converging crises across the globe, can the promotion of Constructive Capital help ensure a resilient recovery? The following themes consider the emerging context.

A key driver of efforts to support Constructive Capital is the need to deter Corrosive Capital. The descriptions developed by CIPE demonstrate the stark contrast in impacts. Moreover, the pervasive effects of Corrosive Capital may lead to further deterioration in the conditions that support Constructive Capital. The COVID-19 crisis has exacerbated long-standing challenges in integrity and anti-corruption efforts. In addition, as various sources of investment retrench, Corrosive Capital may find more inroads. This may further impede the institutions of effective governance.

**Corrosive Capital** refers to cross-border financing, whether state or private, that lacks transparency, accountability, and market orientation. It is the inverse of constructive capital. This type of investment undermines trust in institutions, weakens the rule of law, promotes opacity, and may exert monopoly power. CIPE developed the corrosive capital concept to identify such transactions. These include many flows from authoritarian regimes into emerging markets. Cumulatively, these corrosive capital investments represent a fundamental threat to democracy and inclusive markets. Investments that are opaque in origin, beholden to political pressure, or lack oversight often undermine the same market institutions that attract constructive capital. When certain levels of corrosive capital dominate the market, it can lead to a destructive cycle of endemic corruption and weakened institutions. This creates a toxic business environment that stifles local business innovation, diminishes equality and impedes development prospects.

However, four positive developments can be highlighted. A global effort is underway to achieve the United Nations (UN) Sustainable Development Goals (SDGs) by 2030. As explained in this report, CIPE views SDG 16 as an over-arching goal that is essential to achieving this agenda. The Cornerstones of Constructive Capital, for example, reinforce SDG 16 and its focus on peace, justice, and strong institutions. Notwithstanding setbacks, the momentum for the goals will continue, along with significant sustainability financing from public and private sources. The alignment with Constructive Capital may provide new opportunities.

Supportive trends in responsible business and investment have continued – and in many ways accelerated. This bodes well for CIPE’s strategies, which focus on the positive role of business in building inclusive societies. Of singular interest is the rise in ESG-related investing, which focuses on environmental, social, and governance factors. It has transformed corporate governance, along with business operations across the world. It has also revolutionized risk analysis and impact assessment in environmental and social areas. To give a sense of scale, $120 billion poured into ESG funds in 2021, doubling the $51.5 billion in 2020; estimates encompassing broader sustainable investment assets are as high as $35.3 trillion. Constructive Capital can be promoted as a means of enhancing not only ESG factors, but also the underlying conditions for ESG investment outcomes across countries.

With respect to democracy, freedom, and the rule of law, indeed the current international indicators are all heading in a downward direction. Again, the Constructive Capital framework could be relevant in bolstering
such principles, notably at the local level in emerging markets. CIPE also draws on extensive experience in engaging with institutions of global governance.

Finally, a profound re-thinking of the capitalist system is taking shape. The relationship between business, government and society is changing. A key theme relates to fostering shared values, solving common problems, and rebuilding trust. CIPE is well-placed to contribute to such discourse, including through this work on elevating the positive impact of capital flows.

II. The Scope of this Report

The Framework for Constructive Capital is set forth in six parts, including this Introduction. Part Two identifies a set of six Cornerstones of Constructive Capital, creating both a normative and practical foundation. These are: Positive Peace; Rule of Law; Accountable Institutions; Political and Economic Freedom; Social and Economic Inclusion; Values-Driven Private Sector. Concerted action to strengthen each of these precepts will support Constructive Capital flows and curtail Corrosive Capital flows.

Part Three focuses on the bridging of governance gaps, and integrates the concepts of investment, integrity, and impact. It offers expert overviews on each of these topics, including capital flows, anti-corruption accountability mechanisms, and innovative approaches to economic, social, and sustainability impact assessments. The dynamics of such connections, which are relevant to both the public and private sectors, can help identify appropriate policy responses or other actions. This integrated approach to investment, integrity, and impact can be applied to multiple areas of the Framework.

Part Four reviews supportive trends in responsible business and investment, including sustainability. It addresses business and human rights, due diligence, ESG standards and reporting, and new forms of stakeholder engagement. Across sectors and jurisdictions, companies are re-aligning their governance and strategies, and influencing the broader business ecosystem. Such trends reinforce the key role of a values-driven and vibrant business community in ensuring the conditions for Constructive Capital.

Part Five considers the advancement of Constructive Capital by various stakeholders, including companies, government agencies, independent business associations, investment authorities, and civil society organizations. There is scope for further research at the local and international levels, as well as new collaborations to identify practical strategies.

Finally, Part Six offers concluding observations on reinforcing themes. The process of raising awareness and taking concrete action will yield a persuasive case for the concepts in this report. Moreover, in April 2022, CIPE launched a new Center for Accountable Investment. It is well-placed to carry forward this work and build momentum for the implementation of the Framework for Constructive Capital.
A Framework for Constructive Capital: Investment, Integrity, Impact

About CIPE

The Center for International Private Enterprise (CIPE) is a core institute of the National Endowment for Democracy and a non-profit affiliate of the U.S. Chamber of Commerce. CIPE’s mission is to strengthen democracy around the globe through private enterprise and market-oriented reform.

Founded in 1983, CIPE partners with local business associations, chambers of commerce, universities, think tanks and advocacy groups worldwide to implement innovative, cost-effective, business-led solutions to complex policy and governance challenges.

Currently CIPE has more than 300 programs or grants in more than 80 countries.

www.cipe.org

About OA Foundation

The Oxford Analytica Foundation offers interdisciplinary research and thought leadership on current developments and emerging trends at the national and international levels. In so doing, it aspires to elevate the quality of decision-making and action on questions of social and economic significance.

The in-house team offers exceptional and diverse experience, skills, networks and expertise across the private, academic and non-profit sector, and a unique ability to convene and inform change-makers.

OA Foundation supports the strategic planning and implementation of projects across a range of themes linked to the Sustainable Development Goals, including rule of law, sustainable development, corporate responsibility, and climate change and conservation.

www.oxan.com/foundation