Global Progress in Addressing Inequality: The Elusive, Encouraging Role of Foreign Direct Investment

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At first glance, Foreign Direct Investment (FDI) seems to offer governments, policymakers and advocates several ideal opportunities for reducing economic inequality. Each investment usually requires a significant amount of lead time, during which the scale, location, labor force composition, and community engagement of a project can be negotiated. The sums of capital involved are significant, large enough to change in local, sometime even national, income levels.

Company decisions about which employees will be hired locally and trained, as opposed to transplanted from abroad, are often still under deliberation. They may have more flexibility in workforce design because they may be incorporating new technology rather than relying on entirely

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established methods of operation. Further, foreign direct investors usually locate with a long-term investment in mind, and they may want to demonstrate goodwill through being flexible on at least some workforce and community engagement issues.

Host nations, especially developing nations, often see scores of opportunities where a new foreign direct investor could make a difference: wage levels, training opportunities, gender parity in hiring, health insurance, and medical clinics, among others.

However, inequality *per se* has too infrequently been an explicit, actionable goal at the transactional level. Thus, sweeping but crude tools such as tax policy and social safety nets have been regarded as viable forums and battlegrounds for governments and issue advocates concerned about inequality. But new investors have been allowed to plead at the 'brick and mortar' level that addressing inequality is irreducibly complex, and thus insoluble and permanent. This conveniently hearkens back to the complacency that is, literally, an article of faith in some parts of Western society—"The poor will always be with us," as Matthew 26:11 states.

This sense of resignation is especially pronounced with respect to the intersection of inequality and FDI. It is commonly remarked that the stakes are too large to allow for untested economic and social ambitions; that the domestic public agencies, international finance institutions, and private investors are too numerous; that the agendas are too intertwined and contested; and that the causes of economic problems—let alone solutions—are too difficult to isolate. Consequently, neither development agencies nor development finance agencies (which support private investments in the developing world) have had a consensus about how to attack inequality.

Fortunately, this situation is changing quite rapidly. Some of the problems that have remained entrenched since the Victorian era of the global economy are finally beginning to budge. The development finance community is steadily gaining more and better information about income inequality, which provides clearer roadmaps on where and how to address issues. New technologies are enabling tracking of specific factors that figure heavily into inequality, such as the degree of financial inclusion. The legal structures of investors are becoming more flexible. All of these changes are cause for optimism.

ENDURING CHALLENGES

Early FDI

A bit of historical context is worth noting. The origins of the modern global economy trace back to the Industrial Revolution during the Victorian

Age, regarded by some of the first wave of globalization. Advances in steam technology enabled railroads and steamships to markedly increase the reach and speed of travelers and goods. Telegraphs allowed information to travel over longer distances. For the first time, world population reached 1 billion and then doubled in the space of a single century, growing from 1 billion to 2 billion and dramatically increasing demand for foreign commodities in the rapidly urbanizing economies of Europe and the United States.[1] These forces would yield long-term consequences.

In the fifty-year period from 1865 to 1914, Great Britain invested more than 4.1 billion pounds abroad, an astounding sum comparable to 5.4 percent of its GDP.[2] For comparison, this would be tantamount to American companies investing $1.2 trillion abroad over such a period. British investment, of course, was driven by cold calculations of risk-adjusted rates of return. The combination of new technology—including railroads, steamships, electrification—and capital markedly raised expectations for new markets and profits.

At the same time, a larger animating idea came to the fore, which was the realization that global commerce was so powerful that it could be used for the betterment of the poor in distant nations and regions that hosted investment. Hence Scottish missionary David Livingstone's prescriptions for Africa—Christianity, commerce, and civilization.[3] This prescription distilled several propositions. First, raising standards of living was feasible at a global level. Second, commerce was a vehicle for conveying the ostensibly superior values of more advanced economies. Third, value-centric institutions such as Christian churches were helpful in the enterprise of transformative capitalism. These new paradigms represented a milestone. One does not debate today whether reductions in inequality are proceeding inexorably due to, say, population growth or technological innovation alone. We debate them in the context of the responsiveness and efficacy of institutions, contests among competing societal values, and the degree of pragmatism associated with different economic interventions.

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Over the years, Livingstone's role in advancing colonization has rightly been the subject of contentious debates. However, his advocacy for transnational commerce as both an economic force and a vehicle for education and institutions did represent a genuinely new and important wrinkle. Livingstone was steeped in biblical teaching. Yet, he was also optimistic about the use of commerce—specifically, foreign direct investment—for reducing poverty and inequality. Further, he grounded his view in a belief system, Christianity, that was above and beyond the transient agendas and interests of any company, advocacy organization, or government.

This is not a trivial point, as support for reducing inequality *abroad* had never been prominent, much less pervasive and sustained, among social reformers and economists. In the mid-1800s, social advancements such as the abolition of slavery and equality for women were proceeding haltingly but overwhelmingly in a positive direction. The notion of addressing inequality through a systematic remaking of capitalism was similarly expansive. However, unlike the abolition of slavery and the improvement of women's rights, the push to reduce inequality in a sweeping way through the use of global commerce saw its stock rise and fall repeatedly, and that variability affected the scale and types of resources available for its advancement.

By 1899, the ideology associated with FDI was less a matter of Livingstone's sunny intrepidness and more in keeping with Rudyard Kipling's lament of the colonies as "the white man's burden." Investments that focused on the rapid, low-cost exploitation and export of natural endowments came to predominate and notions of civilizing the "savages" were set aside.[4]

Later on, influential thinkers within the developing world lost faith in the development role of FDI also. From the 1950s through the 1970s, dependency theory and the "New International Economic Order" theory held that the transnational capitalism of the West caused or exacerbated poverty in the developing nations. This had concrete, institutional implications for "development finance" agencies, which were created to provide loans, equity investments, and insurance to private companies investing or trying to raise capital in the developing world. The development finance arm of the World Bank Group, the International Finance Corporation, was regarded as an "irrelevant oddity" within the development community during its early years in the mid-1950s, according to its former CEO.[5]

In the modern era of global development—that is, since the founding of the Bretton Woods institutions in the aftermath of World War II—anyone who assumed or hoped there would be constant or steadily rising support in the global development community for reducing inequality through FDI was disappointed.

The Impact of Corporate Laws

In the Victorian Age, one also finds the origins of the contradictions and confusion associated with the broader societal role of companies, especially large enterprises with global operations and FDI.

In 1844, for example, Great Britain eliminated the charter requirement for companies, meaning that private businesses no longer need to prove to the Crown or Parliament that their operations would benefit the general public. Far from being vassals of the state, private companies in the Anglo-Saxon world were now free-standing "little republics," with no obligations other than profits and obeying the law, said British statesman Robert Lowe.[6]

Almost as soon as companies were freed from broader social obligations, however, they began to turn back toward aiding the poor amid labor strikes, protests, and backlashes of public opinion. One contemporary called this newfound motive the "sagacity of self-interest." In the United States, Henry Ford, Andrew Carnegie, Joseph Wharton, and George Pullman, among others, provided direct or indirect subsidies, education, and housing to their employees, often through "company towns." Such initiatives were regarded as idealistic by capitalism's defenders and exploitative by its critics.

Yet the jurisprudence around the formal rights and responsibilities of companies has been slippery. In 1886, the U.S. Supreme Court for the first time stated, in the *Santa Clara* decision, that a corporation was a person for purposes of the Fourteenth Amendment.[7] To this day, in the *Hobby Lobby* (2014) and *Citizens United* (2010) decisions, among others, the implications of corporate personhood are still being litigated. One matter is clear, however. The corporate "person" has retained a large, ill-defined degree of freedom, but not a legal obligation to advance the interests of non-shareholders as well as shareholders. Employees, consumers, suppliers, and local communities can all benefit directly and economically from a corporation's decisions, but such benefits are vaguely bounded.

Measuring Inequality

Another factor to be considered when surveying major factors that influence inequality is the absence of an explicit mandate among development institutions, development finance institutions and transnational firms to reduce inequality *per se* in developing nations. Such institutions work to ameliorate privations, improve health care and education, strengthen the rule of law and key institutions, create advantageous investment climates, fill gaps in finance for companies and governments, and advance overall economic progress for people in poorer nations.

In doing so, development institutions consider metrics such as Gini coefficients, which measure income or wealth inequality, in setting regional and national priorities. But inequality itself is rarely, if ever, a metric of project-level or program-level effectiveness. To put a finer point on it, one would be hard-pressed to find evidence of any development agency expert or staffer being demoted, fired, rewarded, or promoted because of a change in a Gini coefficient.

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Even forward-thinking enterprises with a mind toward long-term impacts can be oblivious or inattentive to inequality of impact or opportunity. Innovative tech firms, for example, are pouring into the developing world, hoping to establish a market foothold with younger populations there. However, they frequently bypass local startups, angel funds, or venture capitalists, thereby reducing any opportunities for local skill development or technological advancement, let alone equity or leadership participation in rapid-growth firms with massive earning potential. Venture capital investment in Africa now tops $1 billion annually, a four-fold leap since 2015.[8] However, a 2018 study of tech startups in east Africa found that 90 percent of funding had gone to firms with foreign founders.[9] Even more disappointing is the fact that foreign companies market themselves as African in origin, tout their social responsibility, and then cash out early. One entrepreneur termed it "digital recolonization."[10]

Altogether, this is a sobering picture. Addressing inequality through foreign direct investment requires knowledge of the fickle global opinion surrounding the viability of FDI. Support within the global development community, in particular, has waxed and waned. Addressing inequality has often been viewed as a macro problem, rather than an actionable, project-level objective. Within corporations, the legal allowance for addressing inequality has been robust, but explicit mandates and expectations have been rare, and incentives have been weak or in constant competition with other development objectives.

Yet, there is hope.

CHANGE IS COMING

More and Better Data Is Available

Foreign direct investment is a uniquely potent force in the global economy. Prior to a precipitous drop caused by the COVID-19 pandemic in 2020, FDI levels topped $1 trillion every year since 2005 and will likely return to such levels in 2022 and beyond. Of particular relevance to the issue of inequality, FDI represents the single largest source of external financing for developing nations, far outstripping official development assistance or remittances.[11]

FDI in developing nations is also the lifeblood of countless new enterprises that introduce cutting edge technology and best practices to a host nation, otherwise known as "greenfield" projects. This enables the so-called "leapfrogging" effect, wherein consumers and businesses can skip several generations of technology in one step. An example of this would be consumers in least-developed countries who have had no electricity in their homes, but who gain access to low-cost cell phones.

The quantity and quality of foreign direct investment has thus passed an important threshold to become a permanent fixture of economic, financial, and social research. Researchers examining the interrelationships of multinational enterprises and FDI found earlier this year that "52 articles … were published between 1980 and 1999, 145 were published between 2000 and 2006, and 303 were published between 2007 and 2020."[12] The implication of the trendline is clear. However much inequality may rise or fall on the global political agenda from decade to decade, there is now a well-established cohort of researchers generating new data, analysis, theories, and potential solutions at the juncture of FDI and inequality.

Additional and higher-quality information is essential to reducing inequality and convincing decision-makers, whether in the public sector or private sector, that inequality baselines can be efficiently measured and progress can be validated. Historically, Gini coefficients served as a starting point for debate, but they rarely point toward concrete, unambiguous solutions. They do not indicate whether the driver of inequality rests in the bottom, middle, or upper-income cohorts. Nor do they account for embedded cultural factors such as ethnic or gender discrimination. Other methodological challenges, too, have posed hurdles. Research that reviews inequality across nations, for example, fails to account for dramatic regional differences within nations. Research into nations that have large amounts of economic activity in the informal sector (unregulated, unmeasured, untaxed) fails to accurately reflect the true extent of the challenge. Transnational factors such as wars, migration, and displacement by famines or environmental problems may also prevent accurate data collection or interpretation.

Fortunately, improvements in data-gathering and digitization are starting to make headway in solving these problems. Over the past decade, the World Bank Group has invested in developing its "PovCalNet" database, which includes microdata from household surveys across 164 countries for the purpose of tracking progress of the Sustainable Development Goals.[13] A multi-stakeholder consortium of development agencies and foundations, meanwhile, has created the World Inequality Lab Database, which integrates data from national accounts, surveys, and tax records, among other sources.

Public and Private Digital Identity Systems

New, local sources of data complement these initiatives at an increasing rate. In recent years, forty-six countries have created digital ID systems that are used for delivery of public services. Another 119 countries have instituted bare-bones digital ID systems and may use them for delivery of public services in the future.[14] One industry analyst now estimates that 3.6 billion people will be carrying some form of national digital ID card by the year 2021.[15] In the developing world, a diverse set of nations has moved to adopt digital ID cards, ranging from small nations such as Rwanda and Estonia to larger nations such as China and India. This has made a marked difference in the volume of economic data available for research and planning purposes, but it has also provided a platform for targeting factors that contribute to inequality. India's biometric ID program, for example, successfully collaborated with the nation's financial institutions to markedly reduce the number of people without bank accounts.[16]

In parallel, private sector financial institutions and nonprofit organizations have been forging ahead with card-based services and mobile wallets for a variety of purposes, ranging from distribution of foreign aid and remittances to microfinance and microcredit to small- and medium-sized enterprise supply chain management. This ecosystem of global payments is expanding in every direction: business-to-business, consumer-to-business, business-to-consumer, and consumer-to-consumer accounts.

The players in this market encompass billions of users and amass unprecedented amounts of information about the income status, economic prospects, and purchasing patterns of consumers and small businesses, including the very poor in developing nations. As artificial intelligence and machine learning continue to improve, financial technology companies will become ever more sophisticated in targeting their interventions, whether for market expansion or social objectives such as reducing inequality.

Internet access, meanwhile, is increasing along with the use of non-financial apps on mobile phones. Together, search engines and apps are generating and gathering vast amounts of data about citizens that can be analyzed by region, occupation, gender, ethnicity, age, health, and other factors. Already, if a user frequents a suite of Google applications, such as its search engine, YouTube, and Gmail, the company is able to collect more than thirty types of information about that person and refresh it day after day.[17]

While any conclusions about the impact of this data on inequality would be premature, one can begin to see how the landscape of economic possibilities is changing. Intrinsically data-rich enterprises, such as mobile banking or digital healthcare delivery, will increasingly be in sectors where inequality baselines can be firmly established and progress can be tracked over time in nations, regions, or even cities.

Further, one can easily imagine that sectors that currently have less data-centric operations may soon be asked by development agencies, advocacy groups, and nonprofits to install digital systems, whether radio frequency identification (RFID) or blockchain, to track compliance or progress. World Wildlife Fund of Australia and Boston Consulting Group's Digital Ventures, for example, launched a blockchain-based program to track seafood, helping people avoid illegal, environmentally damaging, or unethical products, and exposing seafood companies that are employing slave labor. As prototypes are refined and proven in the field, there will be demand for their wider use.[18]

Will anyone in the corporate world answer the call to work on inequality? As noted above, there are no strict requirements for transnational corporations to work on issues such as inequality. Incentives vary widely. Consumer goods companies tend to be more concerned about protecting their brand equity. Business to business companies less so. Within companies, there may also be considerable divergence. Board members may be eager to sign on to global agendas for climate change, digital equality, health care, biodiversity preservation, and the like. However, major shareholders and CEOs may not. Many times, companies will sign on to initiatives with the best of intentions and their level of interest will wane.

New Players

Four types of organizations, each increasing in number and sophistication, are now adopting explicit inequality mandates or achieving capacity to more easily require such mandates from their partners or clients.

First, development finance institutions are continuing to grow markedly in size and, to a lesser extent, in number. For decades, they have operated under the radar in the development community. However, they have been allocated ever more support, such as capital increases or expanded authority to offer more products and services, in recognition of their outsized impact and ability to operate on a self-sustaining basis. The Trump administration, for example, in one of its few new development policy initiatives, chose to markedly increase the size of the Overseas Private Investment Corporation, granting it the flexibility to finance investments that explicitly address inequality.

Second, private "benefit corporations" were largely unheard of a generation ago. Benefit corporation laws allow corporate boards and CEOs to formally incorporate environmental and social objectives into their operations, as well as the financial interests of shareholders. Benefit corporations are steadily increasing in number, and provide unambiguous support for social objectives including living wage initiatives. More than thirty states have passed benefit corporation legislation.[19]

Third, social enterprises—nonprofits that rely on commercial models to achieve their objectives—are also becoming more prevalent. According to one estimate, the social entrepreneurship sector currently employs around 40 million people and engages over 200 million volunteers globally—and is growing.[20]

As these revolutions in development begin to combine and improve the effectiveness of measures to reduce inequality, especially pertaining to foreign direct investment, it will be worth watching to see whether the focus of efforts begins to change.

Last but not least, multi-stakeholder alliances are increasing in number, allowing multinational firms, development agencies, and foundations to effectively outsource work on inequality. The World Wide Web Foundation, for example, is dedicated to increase internet access and equality around the globe. It has 160 partners, including Google, Facebook, and Bloomberg from the private sector, and the World Bank, United States Agency for International Development, and The Rockefeller Foundation from the development and nonprofit world.

As these revolutions in development begin to combine and improve the effectiveness of measures to reduce inequality, especially pertaining to foreign direct investment, it will be worth watching to see whether the focus of efforts begins to change. Those who aspire to reduce inequality have often focused on either ameliorating deficits in well-being with respect to health care, nutrition, education, et cetera, or on increasing income levels. New organizations and tools may allow inequality advocates to begin focusing on ever-narrower slices of inequality and inequality of opportunity as well.

SUMMING UP

Deep, widespread poverty and inequality are unsolved challenges. The proliferation of ideas such as impact investing, development finance and emerging markets has not reduced inequality. Neither increased FDI nor increased capitalization of development finance institutions has eliminated some of the original challenges associated with addressing inequality.

The international community, however, has identified innovative ways to work around such obstacles and gain momentum in addressing inequality. The biggest hurdles are no longer shortages of capital, varying trends in development thinking, the legal limits of corporations, the dearth of actionable information, or the lack of a cohort of organizations with capabilities of sufficient scale and transnational reach. It is now about tapping into sheer will, clear vision, and decisive leadership, especially among the CEOs of firms who originate, shape, and carry out foreign direct investments. ***f***

ENDNOTES

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