Executive summary

Even before the outbreak of COVID-19, it was estimated that achieving the Sustainable Development Goals (SDGs) would require investments of USD 2.5 trillion per year. This gap may since have increased by as much as 70%. Fulfilling the commitments made in the Paris Agreement and curbing climate change will require that investment in renewable energy triple by 2030. Foreign direct investment (FDI) is rapidly shifting out of fossil fuels and into renewables, accounting for 30% of global new investments in renewable energy in 2020, but more investment is needed. FDI is an important source of finance for sustainable development, creating approximately 180 000 jobs every month worldwide. Foreign firms are known to be more productive than domestic firms, pay higher wages and offer women greater opportunities for career advancement. Yet, as the FDI Qualities Indicators reveal, the sustainable development effects of FDI are not always positive, with some countries benefitting more than others and, within countries, some segments of the population being left behind. Impacts can also differ across different areas of the SDGs as some sustainability objectives are mutually reinforcing while others present trade-offs.

The FDI Qualities Policy Toolkit is designed to help governments identify priorities for policy and institutional reforms that can strengthen FDI impacts – or sustainable investment – in four SDG areas: productivity and innovation; job quality and skills; gender equality; and decarbonisation. Each chapter covers one of these area and provides detailed questions to reflect on and assess the policy conditions that influence the impacts of FDI in that area – questions that take into consideration countries' priorities and different levels of development. The Toolkit supports the implementation of the OECD Recommendation on FDI Qualities for Sustainable Development. It complements the OECD Policy Framework for Investment and can be used for self-evaluation and reform design by governments, for country-specific and regional Investment Policy Reviews and for stand-alone FDI Qualities Reviews.

Why the contribution of FDI to sustainable development does not always materialise

FDI can contribute to sustainable development through several channels that need to be carefully examined in order to assess impacts and identify reform priorities. The Toolkit identifies four channels of impacts. The first is the direct operations of foreign firms in host countries, such as deploying new technologies that advance decarbonisation or digitalisation, introducing better gender practices or creating quality jobs and training workers. These operations also have spillover effects arising from three indirect channels: their value chain relationships with domestic firms, whether buyers or suppliers; market interactions through competition and learning effects; and the mobility of workers between foreign and domestic firms. These channels can facilitate knowledge spillovers, and in turn raise productivity and living standards. They can also support the diffusion of better environmental, labour or gender standards.

Positive impacts of FDI on sustainable development do not always materialise if, for instance, foreign firms source their inputs irresponsibly, underpay female employees, or generate significant carbon emissions. Potential adverse effects of FDI also depend on the ability of the host economy to adjust factors of production in response to the arrival of foreign firms. For instance, FDI can crowd out domestic SMEs and

worsen income disparities if skills shortages are severe and labour mobility is low. Addressing these challenges and other market failures to maximise the contribution of FDI to sustainable development requires policy interventions – FDI Qualities policies – that act on the different channels of impacts.

What can governments do?

The Toolkit identifies FDI Qualities policies across the four SDG areas covered in the report, and categorises them based on a mapping of policies and institutions in OECD and non-OECD countries. The mapping reveals that FDI Qualities policies involve many policy domains that go beyond those that are conducive to investment in general and, in turn, that policy responses do not fit neatly within any single governmental department or agency. It provides a compendium of good practices and shows that the majority of the identified policies do not explicitly target FDI. However, the way they affect the contributions of foreign and domestic firms to sustainable development can vary, and it is therefore crucial that policy making consider these differentiated impacts. The Toolkit is structured around five principles:

- **Governance.** The institutional setting governing sustainable investment can be highly complex, raising the likelihood of co-ordination failures. Strategies and plans on investment and different SDGs should be coherent and linked to an overarching vision for sustainable development in order to minimise potential trade-offs across policy objectives. More inclusive inter-ministerial co-ordination mechanisms are essential for effective design and implementation of these strategic frameworks. Good governance also requires public consultations, social dialogue and monitoring and evaluation mechanisms to assess existing policies and promote solutions to emerging issues that are driven or amplified by FDI, including digitalisation, climate change and the future of work.
- **Domestic and international regulation.** Open, transparent and non-discriminatory policies provide the foundation for an investment climate conducive to sustainable development but they are not sufficient to tackle the major societal and environmental challenges. A condition for sustainable FDI is that domestic legislation fulfils international standards related to climate action, job quality and gender equality, or sets national standards that are even more ambitious than international ones. Aligning investment and trade agreements with sustainable investment goals is also important to reinforce domestic law and encourage responsible business conduct.
- **Technical and financial support.** Targeted support may be warranted to address market failures that hinder sustainable investment (e.g. R&D costs, environmental externalities, skills mismatches, gender disparities in the workplace) but provision of such forms of support should be transparent and subject to regular review. Governments often use tax incentives or subsidised loans and grants to promote investment in specific activities, sectors and locations. Financial support is sometimes conditional on specific criteria or activities that can help promote sustainable development. Technical support either directly provided or subsidised by governments is an effective means of developing domestic capabilities and enhancing the potential for FDI spillovers.
- **Information and facilitation services.** Insufficient, inaccurate or costly information can create barriers to investment or lead to sub-optimal decisions by economic actors. Investment promotion agencies (IPAs) are key players in bridging information gaps that may otherwise hinder the realisation of foreign investments, and their potential sustainable development impacts. By linking investors to local partners IPAs are essential for the realisation of FDI spillovers. Other information services can include awareness-raising campaigns to help change traditional norms at the root of gender inequality, or information on the carbon emissions embodied in products to raise public understanding of the carbon footprint of their consumption choices. Encouraging corporate disclosure of social and environmental risks through ESG reporting frameworks can help investors assess and communicate their responsible practices and promote due diligence in supply chains.
- **Development co-operation.** Development partners devote a significant portion of their resources to supporting the private sector, by financing initiatives to improve the investment climate, develop

business capacities and build physical infrastructure. Governments and the donor community should work together to identify financial and technical assistance solutions to support policy reforms and implementation, promote alignment with international standards, reduce exposure to social and environmental risks, and support the private sector. Identifying existing donor assistance can help assess alignment with national priorities on investment and sustainable development.

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