27 Policy coherence and responsible business conduct

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The annual investment gap across the Sustainable Development Goals has almost doubled since 2015. The green transition and the fight against poverty require a significant additional investment to achieve these goals. This chapter highlights the importance of private investment and foreign direct investment, in particular, to help developing countries raise incomes through quality jobs and increase environmental sustainability by enhancing innovation and access to green technologies. It argues that more coherence between development policy and measures aiming to create an enabling environment for sustainable business and to promote responsible business conduct (RBC) are needed to maximise the positive spillover effects of cross-border business activity and to prevent unintended side effects.

Key messages

- International investment has a crucial role in accelerating the green transition and eradicating poverty. However, OECD countries' policies to foster its contribution to sustainable development lack co-ordination.
- In the face of emerging supply chain due diligence obligations, OECD countries need to leverage their development policy to support an enabling environment for responsible business conduct in developing countries and enable multinational enterprises to continue engaging there.
- The OECD plays a crucial role in developing policy guidance and best practices in responsible business conduct, analysing such policies' effects on trade and investment, and making recommendations to support sustainable business practices to reduce poverty.

The sustainable development agenda faces a major investment gap

In June 2023, the world crossed the halfway point of the 2030 Agenda. There is little reason to celebrate. The international community is on track for only 15% of the targets defined under the 17 Sustainable Development Goals (SDGs). Moreover, the annual investment gap across the SDGs has almost doubled since 2015 – standing now at USD 4 trillion – and is estimated to increase by USD 400 billion per year (OECD, 2022[1]; United Nations, 2023[2]). Investment needs are particularly dramatic for the green transition and the fight against poverty.[1]

International trade and investment contributed to lifting roughly 1 billion people out of poverty between 1990 and 2017 by bringing them into more productive jobs. Yet the COVID-19 pandemic and increased trade tensions between key global economies have reversed some of this progress (World Bank, 2023[3]). As a result, 575 million people, or 7.0% of the world's population, are still expected to live in extreme poverty in 2030 compared with 10.8% in 2015 (United Nations, 2023[4]). The creation of decent jobs is crucial for countering this trend. On the African continent alone, between 8 million and 11 million youth are expected to enter the labour market every year in the coming decades, but only about 3 million formal jobs are created annually (Munyati, 2024[5]).

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The green transition accounts for over half of the SDG investment gap, with renewable energy generation, energy efficiency, and other transition-related technologies and sources facing enormous investment needs. In developing countries, these needs are even more striking: while installed capacity in renewable energy needs to increase by a factor of 2.5 in the most advanced economies, it needs to grow by a factor of 25 in least developed countries (UNCTAD, 2023[6]).

The private sector has a crucial role to play in accelerating the green transition and getting the world back on track in the fight against poverty. Through innovation and investment in low-carbon and resource-efficient products, services and solutions, it is a key actor for achieving a green economy. And private companies account for 90% of jobs in developing countries on average (ILO, 2024[7]). International investment, in particular, can help developing countries enhance growth and innovation, access more sustainable technologies, create quality jobs, and develop human capital, thus raising living standards (OECD, 2022[8]).

However, the ways in which OECD countries try to foster the contribution of international investment to sustainable development are not sufficiently co-ordinated and sometimes even conflict with each other. While countries use development policy tools to mitigate risks for investors and improve the business environment in developing countries, emerging supply chain due diligence obligations, albeit well intentioned, risk making business activity in developing countries more challenging. This chapter highlights the importance of private investment for sustainable development. It also shows that more coherence between development policy and policy measures aiming to foster RBC is needed to maximise the positive impact of cross-border business activity on sustainable development.

Leveraging the private sector for sustainable development

The private sector is a key driver of sustainable development

Sustainable development cannot be achieved without the private sector. In developing countries, private businesses account for 60% of gross domestic product, 80% of capital flows and 90% of jobs on average (OECD, 2017[9]; USAID, 2021[10]). While most private investment is undertaken by domestic firms, international investment can provide crucial advantages to developing countries. Not only does it bring additional capital to countries constrained by limited domestic resources, it also enhances productivity and upskilling and contributes to higher wages and living standards.[2] Moreover, it fosters innovation and helps disseminate new technologies and sustainable business practices across borders.[3] In the energy sector, for example, foreign direct investment (FDI) accounts for 30% of new investments in renewable energy globally, and over 70% of energy FDI in non-OECD countries went to renewable energy in 2021 (OECD, 2022[8]).

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With almost 70% of global outward FDI originating in OECD countries in 2022[4] (OECD, 2024[11]), companies from these countries are the leading international investors globally. Many of them are also in the vanguard on sustainability indicators such as environmental or social performance (OECD, 2022[8]). Facing high standards and consumer expectations on sustainability in their home countries, companies often bring their corporate culture with them when trading with and investing in third countries, lifting standards along their supply chains.

Policies harnessing the private sector for sustainable development lack coherence

In line with the commitment of the Addis Ababa Action Agenda to mobilise all resources to finance sustainable development, development co-operation actors in OECD countries have increasingly partnered with the private sector. Between 2012 and 2022, more than USD 415 billion was mobilised from the private sector by official development finance interventions (OECD, 2024[12]). More recently, geopolitical tensions and efforts to diversify supply chains have led to additional initiatives leveraging private investment for development. OECD countries are trying to maximise the positive impact of their companies' operations in developing countries in two major ways (OECD, 2023[13]).

First, they leverage different development policy tools to create conditions in developing countries that are conducive to attracting and retaining FDI. These include promoting good governance, the rule of law and a favourable business environment through political dialogue. Such measures are often complemented with technical assistance and capacity-building activities for partner governments and micro, small and medium-sized companies in developing countries. OECD countries also strategically use development finance to mobilise additional private investment in developing countries through blended finance, e.g. by mitigating associated risks or addressing bottlenecks. For example, the Africa-Europe Green Energy Initiative under the Global Gateway of the European Union engages European and African public and private sector actors to increase electricity production and access to energy, promote energy efficiency, support reforms for a conducive regulatory environment for private investment, and foster market integration. Concrete projects under this initiative include the launch of the West African Power Pool Coordination Centre in Benin, the rehabilitation of the Kariba Dam in Zambia and the construction of a Power-to-X hydrogen power reference plant in Morocco through a public-private partnership (European Commission, 2024[14]).

Second, OECD countries encourage their companies to ensure high standards of RBC in their own operations and along their supply chain. Since their initial adoption in 1976, the *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct* (2023[15]) and their guidance have had a profound impact on government policies and business practices in this area. While the guidelines are voluntary for companies, a growing number of jurisdictions have introduced binding legislation in this area in recent years. For example, France (2017) and Germany (2021) adopted laws requiring companies above a certain size to conduct due diligence along their supply chains globally and prevent and address negative consequences associated with their business activity (German Federal Ministry of Labour and Social Affairs, 2024[16]; French General Council for the Economy, Industry, Energy and Technology (CGE), 2020[17]). With the recently adopted Corporate Sustainability Due Diligence Directive, such obligations will soon apply across the European Union (European Parliament, 2024[18]).

Yet, there is an inherent tension between measures encouraging companies to invest more in developing countries and laws making them responsible for what happens in their supply chains in these countries. This may lead to unintended consequences. Companies may react to the reputational, financial and penal risks resulting from binding due diligence legislation by withdrawing from developing countries with weak governance frameworks rather than staying and helping improve the situation. At the same time, the higher fixed costs per supplier caused by due diligence requirements risk leading to a reduction in the number of suppliers, with small companies often replaced by bigger ones (German Federal Ministry for Economic Affairs and Climate Action, 2022[19]). In a recent survey of 2 400 internationally active companies, 23% of those directly affected by the German Act on Corporate Due Diligence Obligations in Supply Chains indicated they were withdrawing or considering withdrawing from high-risk countries or stopping trading with them. Even 13% of the companies covered indirectly by the law considered withdrawing from such countries since the directly covered companies they supply often require them to prove their compliance (German Chamber of Commerce and Industry, 2023[20]). In another survey of 400 German companies, 24% stated they were reducing their number of suppliers and avoiding suppliers whose compliance was hard to verify (Federal Association of German Industry, 2024[21]). In anticipation of the EU Corporate Sustainability Due Diligence Directive, several coffee roasting companies substituted away from African smallholder coffee farmers towards bigger farming companies in Brazil and Viet Nam, which are expected to better cope with the associated certification requirements (Kafsak, 2023[22]).

Development policy needs to create an enabling environment for sustainable business

To avoid unintended side effects of due diligence obligations on business activity in developing countries, development policy needs to keep pace with the rapidly evolving RBC policy landscape. Higher expectations and demands on companies alone are not enough to improve social and environmental sustainability standards along global supply chains. Rather, if binding requirements for supply chain due diligence are introduced, it is important that they be accompanied by policies that help create an enabling environment for RBC in the countries where companies operate (International Trade Centre, 2022[23]).

- The amount of official development assistance (ODA) allocated to measures that improve the business environment and mitigate risks of private investors in developing countries has been growing in recent years (OECD, 2023[13]; 2024[12]). Yet, the levels of ODA assigned to RBC are still negligible at this stage. Despite a steep increase in the past few years, total allocations amounted to USD 84.4 million, or less than 0.0001% of total ODA disbursed by OECD-DAC members in 2022[5] (OECD, 2024[24]). Going forward, development policy must complement measures related to RBC more meaningfully. The OECD can support this process by analysing how different RBC policies, particularly binding legislation, affect trade and investment flows between developing and developed countries.
- Conducting research on the constraints that governments of developing countries face in promoting a policy environment conducive to RBC.
- Developing guidance and best practices on how OECD governments can use their development policy tools to help developing country governments create an enabling environment for RBC.
- Collecting and sharing best practices for logistical and financial government support that effectively helps companies in developing countries improve their RBC performance and establish sustainable production practices.

For decades, development policy has catalysed private investment in developing countries. These measures are important for it to keep playing this role in a changing policy context. Ultimately, such complementary measures will help leverage the full potential of international investment for the green transition and the fight against poverty, turning billions into trillions.

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Notes

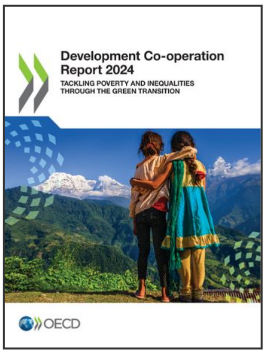
[1] This chapter interprets investment in its broadest sense in line with the 2015 edition of the OECD Policy Framework for Investment, which states, “Investment can take many forms, from physical assets to human or intellectual capital. It can add capacity or simply improve the efficiency of existing assets such as through a change of ownership.” See: https://doi.org/10.1787/9789264208667-en.

[2] Higher productivity of foreign firms typically translates into higher average wages paid to employees. Foreign firms are also significantly more likely to provide training opportunities to workers in order to upskill them and cope with ever-changing global markets. For further discussion, see: https://read.oecd-ilibrary.org/view/?ref=1144_1144750-u5ks4jvtnl&title=FDI-Qualities-Indicators-2022.

[3] For example, foreign firms are 60% more likely to invest in research and development and twice as likely to use new technologies compared with domestic firms. For more detail, see: https://read.oecd-ilibrary.org/view/?ref=1144_1144750-u5ks4jvtnl&title=FDI-Qualities-Indicators-2022.

[4] Authors’ calculations based on OECD data.

[5] However, support to RBC may not always be reported as such, and ODA allocated to RBC may therefore be underestimated. Due to the breadth of policy areas covered by RBC, various projects may directly or indirectly advance RBC-related objectives without being reported as such.



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