FDI Qualities Policy Toolkit:

Polices for improving the sustainable development impacts of investment

Consultation paper, March 2021

The FDI Qualities Indicators report, published in 2019, addresses the impact of FDI on inclusive and sustainable development and, together with the forthcoming Policy Toolkit, will provide guidance to OECD and partner countries on how to attract investment that boosts innovation, quality jobs and skills, gender equality, and the low-carbon transition. The Policy Toolkit is planned as a deliverable for the OECD Ministerial Council Meeting 2022 and is a strategic component of OECD’s efforts to support the 2030 Agenda and the Sustainable Development Goals.

This draft paper for public consultation includes five chapters: Chapter 1 provides background on the FDI Qualities initiative and presents the main pillars of the Policy Toolkit and the methodology of its development. Chapters 2-5 include draft Policy Toolkits for each of the following sustainability clusters:

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- Job quality and skills (lead: Fares.Alhussami@oecd.org)
- Gender equality (lead: Letizia.Montinari@oecd.org)
- Low carbon transition (lead: Iris.Mantovani@oecd.org)

Readers are advised that the development of this work is in its initial stages. Commentators from all stakeholder groups are kindly invited to provide written comments and feedback on this consultation paper. Please send comments to Martin.Wermelinger@oecd.org by 31 May 2021 (extended deadline).

Contact: Martin Wermelinger, Project Manager, FDI Qualities Initiative (Martin.Wermelinger@oecd.org)
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This chapter provides background on the FDI Qualities initiative. It describes the rationale for developing a policy toolkit helping policymakers to improve the policy mix and institutional arrangements to enhance the impact of FDI – the qualities of FDI. The chapter presents the main pillars of the policy toolkit and the methodology of its development. It concludes with a tentative timeline for the implementation of the project.
1.1. Context

Foreign direct investment (FDI) can play a crucial role in making progress toward the Sustainable Development Goals (SDGs). From the viewpoint of the host country, it can, for example, enhance growth and innovation, create quality jobs and develop human capital, including for women, and raise living standards and environmental sustainability. By linking domestic firms to multinational enterprises (MNEs), it serves as a conduit for domestic firms to access international markets and integrate in global value chains (GVCs).

Realising the potential benefits from FDI is not a given: among countries receiving FDI, some have benefited more than others and, within countries, some segments of the population have been left behind. Maximising benefits of FDI in host countries and minimising potential risks associated with FDI may not be a primary concern for profit-seeking investors and may not receive sufficient attention by policymakers seeking to attract investment. While, in principle, FDI has the potential to advance sustainable development, private sector incentives and both home and host country policies, including with respect to responsible business conduct (RBC), require careful consideration as they play a critical role in realising this potential.

How FDI relates to sustainable development in different country and policy contexts is still unclear. The OECD launched the FDI Qualities initiative in 2018 in an effort to fill this information gap, and following a request of OECD Member Country Ministers related to the 2015 update of the OECD Policy Framework for Investment (OECD, 2015[1]). The initiative is an important element of the OECD Action Plan on the SDGs and provides new evidence for discussion at the OECD and other international policy fora (OECD, 2016[2]).

In a first phase of the initiative, the OECD produced the FDI Qualities Indicators (Table 1.1). The indicators focus on four clusters derived from the SDGs; namely, productivity and innovation; employment, job quality and skills; gender equality; and low carbon transition (OECD, 2019[3]). They provide insights on how investment supports sustainable development across countries and thereby help policymakers to identify where FDI-sustainability trade-offs may exist and where to focus policy efforts. Taking into account the country-specific context, policymakers can use the FDI Qualities Indicators to assess how FDI supports national policy objectives, where challenges lie, and in what areas policy action is needed. They also allow countries to benchmark themselves against regional peers or income groups, which can help identify good practices and make evidence-based policy decisions. The development of the indicators (including the selection of SDG-based clusters) benefited from a highly interactive process thanks to the FDI Qualities Policy Network, involving policymakers from OECD and partner countries; development cooperation practitioners; private sector and civil society; international organisations and academia; and experts from policy communities across the OECD.

The FDI Qualities Indicators were launched by the OECD Secretary General at the Second OECD Roundtable on Investment and Sustainable Development in 2019 and highlighted that this work is a strategic component of OECD’s efforts to support the 2030 Agenda and the Sustainable Development Goals (SDGs). At the Roundtable, leaders from international organisations (ITC, UNCTAD, World Bank), OECD and partner governments and the private sector highlighted the relevance of this work and provided strategic guidance for the next steps of the FDI Qualities initiative. The Investment Committee (IC), the Development Assistance Committee (DAC), the Development Centre (DEV), Business at OECD (BIAC),

1 A dedicated session on leveraging private investment for the SDGs, with specific reference to the FDI Qualities work, took place at the 2021 OECD SDG Council on the implementation of the OECD Action Plan on the SDGs on 1 March 2021. See https://www.oecd.org/sdgs/. Switzerland and Senegal are providing political support to the FDI Qualities initiative and had roles as keynote speakers in the Council session.

the Trade Union Advisory Committee (TUAC) and OECD Watch all support the FDI Qualities initiative and offered to join forces in the continuation of the work, and particularly, to develop a policy toolkit for the OECD Ministerial Council Meeting in 2022.

### Table 1.1. FDI Qualities Indicators by sustainability cluster and outcomes

<table>
<thead>
<tr>
<th>Cluster</th>
<th>Objective</th>
<th>Outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Productivity &amp; innovation</td>
<td>Provide information on the extent to which foreign MNEs and their linkages with domestic firms, enable productivity growth and enhance innovation capacity through knowledge and technology transfer</td>
<td>Labour productivity; labour productivity growth; product innovation; process innovation; R&amp;D expenditures; use of foreign technologies;</td>
</tr>
<tr>
<td>2. Employment, job quality and skills</td>
<td>Explore how FDI relates to employment and job quality in host countries. Job quality is essential to ensure that employees can work productively. Investigate to what extent foreign MNEs invest in human capital and skills, directly through in-house worker and manager trainings, and indirectly through knowledge transfers to domestic firms.</td>
<td>Job creation per unit of FDI; employment growth; wages; job security (temporary work); worker safety (injuries); skill intensity; on-the-job training; technical skill shortage/surplus</td>
</tr>
<tr>
<td>3. Gender equality</td>
<td>Examine how FDI is associated with gender equality in host economies, particularly focusing on gender equality outcomes in the labour market</td>
<td>Gender employment equality; gender wage equality; skill development and career progression, women entrepreneurship</td>
</tr>
<tr>
<td>4. Low carbon transition</td>
<td>Study the extent to which FDI relates to carbon footprint, and how FDI is contributing to the low-carbon energy transition.</td>
<td>CO2 emissions; energy efficiency; renewable energy</td>
</tr>
</tbody>
</table>


The indicators are now an integral part of OECD Investment Policy Reviews. Recent reviews include dedicated chapters on FDI Qualities (e.g. Egypt, Indonesia and Thailand) (OECD, 2020[4]; OECD, 2020[5]; OECD, 2021[6]). A stand-alone FDI Qualities Assessment of Ireland was produced to inform IDA Ireland’s new strategy launched in 2021 (OECD, 2020[7]). OECD Development Centre’s Multi-Dimensional Country Review of Viet Nam (OECD, 2020[8]) and the forthcoming review of El Salvador make extensive use of the FDI Qualities Indicators. The indicators have provided the analytical base for capacity building activities and workshops and regional assessments on FDI Qualities in Southeast Asia, the Mediterranean region, and Eastern Partnership countries (OECD, 2020[9]; OECD, 2021[10]). While the priority of the work during the second phase is on policies and institutions related to FDI Qualities, the indicators will also be updated as part of this process and some extensions are being considered (e.g. in the area of FDI in low carbon infrastructure).

The notion of FDI qualities has come to the forefront of international policy discussions. The World Bank has been calling for a framework that differentiates across types of FDI and their various socio-economic impacts (Echandi, Krajcovicova and Qiang, 2015[11]). UNCTAD launched its Investment Policy Framework for Sustainable Development in 2015 (UNCTAD, 2015[12]). Scholars of the International Institute for Sustainable Development (IISD) and the International Centre for Trade and Sustainable Development (ICTSD) developed an indicative list on the sustainability characteristics of FDI (Sauvant, 2017[13]) and argue that policies matter for improving the distribution of FDI benefits (Sauvant et al., 2020[14]; Sauvant, 2021, forthcoming[15]). In academic circles, a new strand of research examines how different types of investment have different repercussions on the domestic economy (Alfaro, 2017[16]; Alfaro and Charlton, 2013[17]; Farole and Winkler, 2014[18]). A recent publication by experts from various fields studies how investment could be governed in the context of challenges related to sustainable development (Aisbett et al., 2018[19]). For each of the sustainability dimensions covered in the FDI Qualities initiative, existing research and policy discussions are reviewed in dedicated chapters (Chapters 3-6).
1.2. Rationale and objectives

The FDI Qualities Policy Toolkit, together with the FDI Qualities Indicators, will provide advice on how governments can enhance the contribution of FDI to meeting the SDGs. To address the complex mix of policies and institutions necessary to ensure that foreign investment contributes to the greatest extent to achieving the SDGs, the policy toolkit will focus on the nexus between the general policies and approaches of the OECD Policy Framework for Investment (PFI) with more specific policies in each of the following clusters: productivity and innovation; employment, job quality and skills; gender equality; and low carbon transition. It will clarify different transmission channels of FDI impacts, map and profile national policies – and importantly – the international policy regime, identify key institutional players involved in these policies and discuss policy coordination across institutions.

This policy toolkit is a natural extension of the PFI whose wide use in country-specific Investment Policy Reviews and regional programmes on investment has contributed to a greater understanding of investment climate good practices and has demonstrated the importance of good governance and policy coherence, non-discrimination, responsible business conduct and effective investment promotion and facilitation, among other areas. Although the PFI as such is not yet ripe for another update, the half decade since the first update has brought a number of global concerns into sharper focus, notably with respect to inclusiveness and sustainability: climate disasters and the Paris Agreement; COVID-19 and the possibility of future pandemics; the persistent productivity slowdown; persisting gender gaps and growing inequality; and many other areas. The PFI can contribute in these areas by shaping market signals for investors so as to sustain investment while also helping to channel investment into socially desirable outcomes, but ensuring these outcomes will also require more tailored policy advice.

The policy toolkit builds on the PFI, and particularly on dedicated PFI chapters such as on green growth and human resources development, to provide specific directions on policy and institutional reforms to enhance the impact of FDI on sustainable development. Set in different contexts and at different stages of development, countries will have different priorities, resources and options available to leverage FDI to advance sustainable development. Just like the PFI, the policy toolkit is not prescriptive. Adequate policy choices depend on host country conditions (e.g. market access; labour market conditions including wage levels and availability of skilled labour; taxation; and industrial structure), and the type and motives of FDI.

By encouraging a structured process for formulating and implementing policies at all levels of government, the policy toolkit can be used in various ways and for various purposes by different constituencies, including for self-evaluation and reform design by governments, and for peer reviews in regional or multilateral discussions. The policy toolkit can be used individually or in combination with broader assessments of investment climate reforms (e.g. OECD Investment Policy Reviews).

The policy toolkit is primarily targeted to national governments, and their implementing agencies, interested in reflecting on and improving their whole-of-government policy mix and institutional arrangements. The inclusive and multi-stakeholder process in developing the policy toolkit, facilitated primarily through the FDI Qualities Policy Network (see Section 1.4), also ensures it to be a practical instrument for a number of other stakeholder groups. Businesses can use the policy toolkit to benchmark their operations against what might be considered as good sustainability performance of foreign investors in the selected SDG areas; but the policy toolkit will, in its first edition, not have dedicated recommendations to businesses. Businesses, possibly supported by investment promotion agencies, and civil society can use the policy

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3 The OECD Guidelines on Multinational Enterprises, together with a number of other standards such as the UN Guiding Principles of Business and Human rights, provide recommendations, agreed by adhering governments, on responsible business conduct, i.e. how businesses can avoid harm to people and the planet and improve positive contributions to society. Other OECD tools, such as the DAC Blended Finance Principles, provide guidance on how governments/development agencies and private investors can partner for dedicated projects in support of sustainable development.
toolkit for policy advocacy purposes, highlighting potential opportunities of national and international policy communities with regards to FDI and sustainable development.

Beyond the guidance for national governments, the policy toolkit will have a specific component to advance the discussion on the role international investment agreements (including bilateral investment treaties, broader trade and investment agreements and other international standards related to investment) might have to enhance FDI impacts on sustainable development. It will primarily identify considerations, options and questions to help the international trade and investment community think about the ways in which they can maximise the potential of investment and other related agreements to promote FDI that makes positive contributions to our societies and economies. The current draft of the policy toolkit includes, for each sustainability cluster, a dedicated section on the international investment regime (see Section 1.3). In the next iteration, a stand-alone chapter will be included to inform the policy debate at the international level, including as part of the OECD work agenda on the future of international treaties that address investment-related issues led by the Investment Committee.

The policy toolkit will also strengthen the link between development cooperation and policy reforms of the recipient country to enhance sustainability impacts of FDI. This responds to a demand by Chairs from the Investment and Development Assistance Committees at the 2019 OECD Roundtable on Investment and Sustainable Development (see Section 1.1). As part of the development of the policy toolkit, the two Committees have since organised a joint session on how investment policymakers and development partners can coordinate actions to boost investment and the qualities of investment during the COVID-19 recovery and beyond. The policy toolkit will include a dedicated component providing guidance to development partners on the ground to tailor and coordinate their private sector development programmes in line with the policy toolkit and PFI-based recommendations. This component will also leverage and expand existing OECD tools such as on transition finance, impact investing and blended finance. A stand-alone chapter on the donor component will be included in the final FDI Qualities Policy Toolkit.

1.3. Building blocks

The policy toolkit will be a practical instrument aimed at helping policymakers to assess the relationship between FDI and sustainable development in the four SDG-based clusters described in previous sections (productivity and innovation; job quality and skills; gender equality; and low carbon transition) and identify opportunities for policy and institutional reforms to enhance such impacts.

For each of the clusters, dedicated policy toolkit chapters identify what outcomes are in the focus and why improving these outcomes are pressing ambitions to achieve the SDGs and objectives under the Paris Agreement on climate change (Figure 1.1, green box; see Chapters 2-5). The chapters then include two main sections: the first is on impacts, establishing a detailed understanding on how FDI relates to sustainability outcomes in the selected cluster, both directly and through spillover effects (Figure 1.1, orange box); the second is on enabling policies, providing an overview of the regulatory framework, proactive policies and programmes and international agreements and standards influencing FDI impacts on sustainability (Figure 1.1, blue box). The scope and focus of these two main sections are further described in the sub-sections below.

The institutional framework that governs policy formulation and implementation on FDI Qualities differs from country to country. The approach that governments pursue to organise the institutional framework reflects their policy objectives and the priority they give to specific FDI Qualities clusters and can greatly

5 http://www.oecd.org/dac/transition-finance-toolkit/
influence their success in attracting FDI that creates direct and spillover impacts on sustainable development.

By encouraging policymakers to ask appropriate questions about the impacts (the qualities of FDI in their economy) and on their institutions and policy settings, the policy toolkit offers a diagnostic framework to identify potential economic, socio-economic development, policy and institutional gaps and weaknesses that limit the direct impact and spillover potential of FDI on the domestic economy; and to outline opportunities to strengthen FDI transmission channels on sustainable development.

Each of the substantive chapters (Chapters 2-5) includes a preliminary list of questions for governments to assess FDI transmission on sustainable development and to discuss what policy and institutional reforms could be prioritised. The final draft of this policy toolkit will provide an overarching chapter with concrete guidance on how governments can use the policy toolkit, moving from the diagnostic tools to policy actions and considerations for institutional improvements. In order to develop more concrete guidance, the assessment of FDI impacts and transmission channels, and that of the regulatory framework, proactive policies and international agreements and standards will need to be compared. It will also require an assessment of governmental and non-governmental institutions in charge of these policies and a good understanding of their coordination mechanisms. Policy and institutional action will vary depending on policy priorities, existing FDI transmission outcomes and country context. The mapping of policies and institutions and the pilot country studies planned for the development of this policy toolkit will help advance the shaping of the overarching chapter and provide useful practice examples informing the substantive clusters more broadly (see Section 1.4 for an outline of the planned mapping and pilot studies).

**Figure 1.1. Transmission of FDI impacts on sustainable development**

![Diagram of FDI transmission channels and sustainability outcomes](image)

*Source: OECD*

**The relationship of FDI and sustainable development**

FDI can have a variety of effects on sustainable development in host countries. These effects are influenced among other factors by the characteristics of FDI. They depend for instance on whether the investment involves a new establishment (e.g. new project or a subsidiary) or the acquisition of an existing company; the motivations for the investment (e.g. efficiency seeking or market-seeking); in which sector and location (metropolitan areas or less developed regions) it takes place; what type of foreign firms are
involved (large or SMEs); and what corporate culture and management practices, often determined by policies on responsible business conduct in origin countries, the investment brings with it.

FDI effects involve several transmission channels (Figure 1.1, orange box). Impacts might result from foreign firms’ direct operations in the host country. For example, foreign firms often have a technological advantage over domestic firms and might invest in high value added activities, which improves productivity outcomes at the economy-wide level. Foreign firms might invest in renewable energy and would thereby reduce CO₂ emissions, but the same firms may not create many jobs in host economies, particularly for women.

Foreign firms’ operations also have spillover effects on domestic businesses arising from their value chain relationships with domestic firms; market interactions through competition and imitation effects; and labour mobility of workers between foreign and domestic firms. The premise underlying the existence of FDI spillovers is that foreign firms are more productive, technologically superior and more skill-intensive and, in turn, benefits might spill over to domestic firms. The direction and magnitude of the combined direct and spillover effects of FDI may vary across sustainability outcomes and could thus involve trade-offs. Framework conditions – such as economic structure and development, domestic firms’ characteristics and skills of the domestic labour force also determine the extent to which direct and spillover impacts take place.

For each sustainability cluster, the policy toolkit will provide a more detailed and refined overview on how FDI relates to different outcomes, including by providing some cross-country empirical illustrations of such relationships. The section on transmission channels and impacts in each chapter concludes with a list of core questions and indicators guiding policymakers in their efforts to better understand FDI impacts and transmission channels in their country context. Specifically, they provide an analytical framework to systematically assess FDI trends, sustainability performance and FDI’s impact on sustainability outcomes through different transmission channels at country, regional and sectoral levels, along with assessing some structural aspects such as the structure of the economy, the position in global value chains (GVCs) and other aspects of socio-economic development relevant for the selected cluster. OECD tools, including primarily the FDI Qualities Indicators, and other data tools are described and can be used to address each one of those questions.

Enabling policies and institutional framework

A key assumption of the policy toolkit is that public policies and institutional arrangements play an important role to enable sustainability impacts of FDI through different transmission channels. A second key assumption is that policies and institutions cannot be considered in silos but it is an adequate and coherent policy mix – including not just investment policies but a variety of policy areas – and coordinated institutional governance that will enable to best leverage FDI in the four SDG-based clusters.

As discussed in Section 1.2, the PFI provides the framework in 12 policy areas for investment climate reforms that are concurrent with enabling investment for sustainable development; PFI-based reforms can be considered as the pre-requisite for a sustainable investment climate. It can contribute to the four clusters of the policy toolkit by shaping market signals for investors so as to sustain investment and by helping to channel investments into socially desirable outcomes. Yet, ensuring improved sustainability outcomes requires more tailored policy considerations and more focus on policies outside the PFI (e.g. labour market policies, gender policies). A thorough analysis of policies at the intersection of investment and complementary policies that will support to enhance the qualities of FDI is the core objective this policy toolkit attempts to provide (Figure 1.1, blue box).

Each chapter of this policy toolkit will discuss in detail what policies are acting upon the transmission channels of FDI on cluster-specific sustainability outcomes (Chapters 2-5). Channelling investment into activities with the highest positive impacts and increasing policy efforts to avoid adverse effects of
investment on people and the planet are therefore warranted. Positive spillover effects may not be automatic and could require targeted interventions to materialise. On the other hand, negative spillovers may occur if, for instance, crowding out of domestic businesses or crowding out of skilled workers from domestic businesses takes place. Most policies are not specifically targeted to foreign firms; they treat foreign and domestic investors alike. Yet, the extent to which policies affect the two groups, and with that their outcomes on sustainable development, can vary. Some regulations directly affect foreign firms’ choice of location and they influence some specific types of foreign firms to invest and will keep away others.

The policy toolkit explains in each sustainability cluster why specific policies are particularly relevant to improve the impact of FDI and to avoid negative consequences on sustainability outcomes. The discussion is structured into regulatory conditions, proactive policies and programmes, international agreements and standards that are key to improve both the direct sustainability impact and the impact through spillovers (Table 1.2).

The policies covered under ‘regulatory framework’ refer, for instance, to SME or gender strategies, investment or labour market legislation, innovation strategies, multi-year strategic priority programmes as well as broader regulatory initiatives. Proactive policies may include specific programmes such as supplier upgrading programmes, matchmaking events, local R&D investment requirements, tax and non-tax incentives that target FDI attraction in specific activities (R&D or low-carbon activities) or local business clusters, skills upgrading programmes relevant to the activity of the MNE, innovation vouchers, as well as other business partnership initiatives involving MNEs and domestic SMEs. The third policy type includes international agreements, mainly regional trade and investment agreements and bilateral investment treaties that expressly address the selected SDG-based clusters in their provisions or otherwise have the potential to influence outcomes in these areas. International standards are also included and relate to any international convention or framework related to the FDI Qualities clusters, such as the OECD MNE Guidelines on Multinational Enterprises, ILO’s Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, or the Convention on the Elimination of All Forms of Discrimination against Women.

In each chapter, the policy section concludes with core questions and indicators that help policymakers reflect on and evaluate, in a structured way, their policy conditions influencing FDI impacts on sustainable development. It aims at identifying systemic gaps and weaknesses that limit the effectiveness of FDI transmission channels. If available, OECD and other indicators are described and can be used to assess the policy environment for FDI Qualities. However, indicators to measure policy and institutional practices in the area of FDI transmission channels are currently not available. The policy toolkit provides a novel typology to collect information allowing to develop indicators and assess enabling policies and institutions for FDI Qualities. While using this typology to map policies and institutions is a useful tool for self-assessment, a growing database of countries covered in this mapping will allow for cross-country comparison and identification of good practices (see Section 1.4 for more details on the methodology).

Table 1.2. Types of policies for FDI Qualities in the focus

<table>
<thead>
<tr>
<th>Policy type</th>
<th>Direct impact</th>
<th>Spillovers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>supply chain relationships</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Proactive policies and programmes</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>International agreements and standards</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Note: Some policy instruments can have an impact on multiple or all transmission channels.
1.4. Methodology

The policy toolkit offers a comprehensive framework for policymakers to assess and improve the performance of FDI transmission channels in four sustainability clusters. It is being developed based on four methodological steps: desk research, mapping of policies and institutions in selected countries, in-depth pilot country studies, and stakeholder consultations.

_Desk research_

First drafts of the key building blocks (see Section 1.3) for each of the clusters are developed through desk research and build on OECD expertise of the Investment Committee in the area of investment climate assessments based on the PFI (see Section 0) and on experience from across policy committees at the OECD (e.g. labour market and skills policy; gender policy; climate change mitigation policy; productivity enhancing and innovation policy, with particular focus on small and medium-sized enterprises; regional development policy; and development cooperation policy). With this interim report, the desk research is concluded for each of the four clusters covered (see Chapters 2-5). Chapters for international investment agreements and standards and development cooperation will be added in the final policy toolkit.

_Mapping of policies and institutions_

The policy toolkit will rely on existing OECD and non-OECD indicators and databases that allow for an assessment of economic and market conditions, FDI direct and spillover impacts on selected sustainability outcomes (i.e. FDI Qualities Indicators), as well as the broader regulatory framework. However, structured and comprehensive information on the availability, quality, and impact of policies and institutions at the intersection of investment and other policies that enable FDI transmission channels for sustainable development is currently limited.

The mapping is filling this gap and provides a typology to collect data on FDI transmission policies and institutions for the four selected SDG-based clusters. Identifying what institutions and policies act upon different FDI transmission channels is an important step towards better understanding the levers that can boost FDI impacts on sustainable development. The institutional setup and policy initiatives and how these policies are designed and implemented can vary considerably across countries, as do their respective governance frameworks (Meissner and Kergroach, 2019[20]). For example, some countries govern regional investment, innovation, SME, labour market, skills and green growth policies at the national level, while other countries apply a more decentralised approach. Some countries have a single agency in charge of the implementation of a large number of investment, innovation support programmes, whereas in others policy responsibilities are distributed across a large number of institutional actors.

_Purpose_

The purpose of the mapping tool and its typology contributes in three distinct ways to the policy toolkit. An initial mapping of ten OECD and developing countries will provide a good overview on how countries from different regions and different levels of development are designing and implementing their policies at the intersection of FDI and sustainable development (see section on ‘country scope’ below). It will also clarify varying approaches on policy coherence and coordination mechanisms across public institutions. Hence, the mapping will be an essential activity to inform and improve the draft policy toolkit chapters and develop an overarching chapter to provide guidance to policymakers on how to foster FDI impacts (see Section 1.3).

The second purpose of the mapping tool is to provide a practical and structured template for data collection to policymakers of any government interested to better understand its own policies and institutional setup for FDI transmission across channels and sustainable development objectives (e.g. as part of OECD
Investment Policy Reviews). The mapping is thus considered as a key ingredient and starting point to reflect on policy and institutional reforms.

The third purpose of the mapping tool is to start developing a database that allows making cross-country comparisons on policy design, implementation and coordination and can be used to derive good policy and institutional practices to improve the qualities of FDI. This compendium of country practices will be made publicly available to build a useful reference point on policies for FDI Qualities for the international policy community. Based on demand, the database will be expanded over time beyond the initial countries, while data on the first set of countries could be updated.

Country scope

The mapping will be implemented in ten countries in 2021, of which eight are developing countries and two are OECD Member Countries (Table 1.3). The list of ten countries is tentative. Government counterparts in currently selected countries have either proactively shown interest to participate in this exercise; or ongoing OECD Investment Committee projects with these countries allow to usefully expand and deepen the work.

In addition to the ten countries for which the mapping will be conducted across all four FDI Qualities clusters, the mapping is done for all 27 EU Member States for the SME productivity and innovation cluster in 2021, as part of a joint project of the OECD Investment Division and the OECD SME and Entrepreneurship Division, supported by the European Commission (DG Regio) (OECD, 2020[21]). Over 2021-22, the mapping across all four clusters will also be conducted for all eight countries included in the EU-OECD Programme on Promoting Investment in the Mediterranean (including Algeria, Egypt, Lebanon, Libya, the Palestinian Authority and Tunisia in addition to Jordan and Morocco). Based on demand, the database will be expanded over time beyond the initial countries, while data on the first set of countries could be updated.

Table 1.3. Tentative list of countries for the mapping of FDI Qualities policies and institutions

<table>
<thead>
<tr>
<th>Country</th>
<th>Region</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jordan</td>
<td>Mediterranean</td>
<td>Official request for FDI Qualities pilot study; part of OECD regional programme on investment in the Mediterranean</td>
</tr>
<tr>
<td>Morocco</td>
<td>Mediterranean</td>
<td>Part of OECD regional programme on investment in the Mediterranean (including OECD Investment Policy Review)</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Southeast Asia</td>
<td>OECD Investment Policy Review completed in 2020</td>
</tr>
<tr>
<td>Thailand</td>
<td>Southeast Asia</td>
<td>OECD Investment Policy Review completed in 2021</td>
</tr>
<tr>
<td>Rwanda</td>
<td>Sub-Saharan Africa</td>
<td>Official request for OECD Investment Policy Review made in 2021</td>
</tr>
<tr>
<td>Senegal</td>
<td>Sub-Saharan Africa</td>
<td>High-level support for the development of the FDI Qualities Policy Toolkit</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>Eurasia</td>
<td>Official request for OECD Investment Policy Review made in 2020</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>Latin America</td>
<td>Strong engagement on FDI Qualities as part of the OECD LAC initiative on investment</td>
</tr>
<tr>
<td>Sweden</td>
<td>OECD</td>
<td>Relevant for FDI Qualities gender equality cluster; engagement with government stakeholders initiated</td>
</tr>
<tr>
<td>Canada</td>
<td>OECD</td>
<td>Engagement on FDI Qualities in the OECD Investment Committee, particularity on gender equality</td>
</tr>
</tbody>
</table>

Note: In addition to the ten countries for which the mapping will be conducted across all four FDI Qualities clusters in 2021, the mapping is done for all 27 EU Member States for the productivity and innovation cluster (with a focus on SME productivity and innovation). Over 2021-22, the mapping across all four clusters will be conducted for the remaining six countries included in the OECD investment initiative on the Mediterranean (Algeria, Egypt, Lebanon, Libya, the Palestinian Authority, and Tunisia). The mapping for selected clusters could be covered in additional countries subject to available funding.

Scope of institutions and policies

The mapping exercise includes two main parts (Figure 1.2). The first part collects data on institutional frameworks and coordination mechanisms (i.e. governance arrangements) across policy domains (FDI/investment, innovation, SMEs, labour market and skills, gender equality, climate change mitigation, local development) and tiers of government (national and subnational) related to FDI transmission channels (Figure 1.2, 1. Institutions). Candidate institutions to be mapped include Ministries or Departments responsible for the relevant policy domains. Other institutions include (mostly) implementing agencies, such as Investment Promotion Agencies (IPAs), SME agencies, innovation agencies and local development agencies, if they exist in the country. With regards to IPAs, the project will partly rely on the OECD-IDB Survey of IPAs conducted since 2018, which covers Mediterranean, Eurasia, Latin America and the Caribbean and OECD countries. In some cases, the mapping may be extended to non-profit organisations (e.g. women entrepreneurs’ networks, associations), banks (e.g. microcredit banks), universities and training centres.

The second part includes data collection on major national policy initiatives at the intersection of FDI transmission channels for sustainable development, based on the policy section developed for each SDG-based cluster (Figure 1.2, 2. Policies). The data collection includes information on policy targeting (i.e. FDI Qualities clusters, FDI transmission channels and beneficiaries of the policies). Beneficiaries of policy initiatives will be mapped according to firm type (SMEs vs large firms), ownership (domestic vs foreign), geographic focus (place-based or national application); sector and function in value chain (e.g. pre-production services, low-medium- and high-technology manufacturing, and post-production services), and type of employment (employee or self-employed). This may involve specific policy targeting or, more simply, that the policy mostly reaches a type of company rather than another.

The data collection also includes information on design features of policy initiatives (e.g. policy/instrument types, policy scope, partner institutions involved and evaluation mechanisms). Policy types include thus outlined in Table 1.2 above: laws and regulations (regulatory framework), proactive policies and programmes, and international agreements and standards.

The mapping of institutions and policy initiatives will also cover whether strategic priorities, operational budgets and value chain focus have been adjusted with respect to FDI transmission activities as a response to the COVID-19 crisis.

**Implementation**

The mapping of policies and institutions in the initial ten countries is predominantly done through desk research (see tentative list of ten countries in Table 1.3). Desk research includes consultation of websites, laws and regulations, strategies and plans, as well as descriptions of policy initiatives associated with national institutions involved in FDI/investment, SME, innovation, labour market, gender equality and gender mainstreaming, skills, low carbon transition and local/regional development policy. Pre-filled mapping surveys are then shared with national institutions for validation and completion. This approach has proven effective in the ongoing mapping exercise conducted with the 27 EU Member States as part of

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For most policy initiatives, information on the targeting of transmission channels and beneficiaries (Figure 1.2, 2A) is likely to be available online and can be assessed through desk research. Similarly, in terms of policy design (2B), it will be possible to identify what instrument type is used through desk research. However, information on the scope, evaluation and impact as well as on how policies have been adjusted (if at all) in light of the COVID-19 outbreak (2C) may be questions which need to be answered by representatives of the relevant institutions.
focused work in the cluster on productivity and SMEs (OECD, 2020[21]); see section on ‘country scope’ above.

The rationale for prefilling the survey through desk research is twofold. Firstly, identifying the relevant national and subnational institutions (and collecting information on their characteristics and coordination mechanisms) allows understand quickly the complexity of the institutional framework around FDI transmission. Without this initial desk-based information collection, it would be difficult to map the institutional landscape. Secondly, prefilling information on both institutions and policy initiatives will allow for faster progress on the data collection and lower the burden for government institutions involved.

Concretely, the following approach to data collection is undertaken:

1. **Developing template/typology for data collection:** The scope of data described in the previous section will be translated into a survey questionnaire aimed at national institutions in the policy domains of this project. The questionnaire will include single and multiple choice questions as well as open questions requiring text or number inputting.

2. **Identifying institutions:** For all selected countries, relevant national institutions in the policy domains of this project will be identified through desk research.

3. **Prefilling information on national institutions:** For all identified national institutions (under 2), information on their characteristics, coordination with other institutions, and existence of Covid-19 response measures will be prefilled into the survey interface through desk research, as much as possible.

4. **Prefilling information on policy initiatives, designed and implemented by national institutions:** For all identified national-level institutions (under 2), information on their policy initiatives, including objectives, targeting, design and possible adjustments in response to the Covid-19 crisis will be prefilled into the survey interface through desk research.10

5. **Completing and validating information by representatives of national institutions:** The prefilled surveys for national institutions will be sent to respective representatives in order to complete missing data points and validate/adjust prefilled data.

6. **Synthesising and analysing collected information:** Once the collection of data on institutions and policy initiatives of a country is completed, the information will be synthesised and analysed.

In terms of sequencing, the data collection process is done country-by-country. Once the identification of institutions and the prefilling of institution- and policy information for a given country is completed (steps 2-4 above), the survey will be sent to representatives of relevant institutions for their completion and validation (step 5). This will allow to pilot the survey and adjust it if needed.

**Pilot country studies**

The current draft of the policy toolkit will be tested through a pilot country assessment of Jordan in 2021. Based on extensive exchanges between the OECD and the Jordan Investment Commission (JIC) in the context of the EU-OECD Programme on Promoting Investment in the Mediterranean11, JIC has requested this pilot FDI Qualities assessment.

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10 Note that national level institutions may implement place-based policies and coordinate with subnational level institutions. Accordingly, this prefilling exercise will provide some perspectives on FDI transmission policies with implications at the subnational level. A more detailed assessment at the subnational level is being conducted in the pilot country study.

The objective of the in-depth country study is twofold. On the one hand, it will provide tailored policy advice to the government of Jordan on how to strengthen the impact of FDI in the four sustainability dimensions covered in the policy toolkit. The study will take into account the COVID-19 crisis and formulate policy recommendations that support a resilient and inclusive recovery through investment. On the other hand, the pilot study will test the practicality and usefulness of the draft policy toolkit and help refine and improve the policy toolkit at a later stage in the process.

The study will examine to what extent public policies support the channels through which FDI affects the four sustainability dimensions. A key ingredient of the analysis is the mapping of policies and institutions described in the previous sub-section. The mapping will however go deeper than the desk research and includes virtual discussions with representatives from each of the agencies included in the mapping. The study will include the following main components:

- **Key indicators of FDI impacts on the four sustainability dimensions**, based on the sections on impacts in each of the cluster-specific chapters.
- **A mapping of the policies and institutions in place enabling FDI impact on the four sustainability dimensions**, including their coordination mechanisms and governance arrangements.
- **Policy recommendations to strengthen FDI impacts on the four sustainability dimensions**, during the recovery from the COVID-19 crisis and in the longer term.

Beyond the desk-based research, JIC and OECD have set up a taskforce, including institutions of the Investment Council that are relevant to the study, namely the Ministry of industry, trade and supply, the Ministry of planning and international cooperation, the Ministry of labour, and private sector representatives (e.g. chambers of industry and commerce and foreign chambers of commerce). It also includes lead ministries or agencies in the four sustainability dimensions of the study, such as:

- **Productivity and innovation (incl. SMEs)**: Ministry of digital economy and entrepreneurship, Ministry of higher-education and scientific research, Jordan Enterprise Development Corporation (JEDCO), Higher Council for Science and Technology (HCST), National Centre for Innovation (NCI), other?
- **Job creation, quality jobs, and skills development**: In addition to Ministry of Labour, Ministry of higher-education and scientific research, National Centre for Human Resources Development (NCHR), the Vocational Training Corporation (VTC), other?
- **Gender equality**: Ministry of social affairs, Jordanian National Commission for Women (JNCW), other?
- **Energy transition/green economy**: Ministry of environment, Ministry of energy, other?

The role of the taskforce is to provide strategic guidance and ensure that the information collected by the OECD, and included in the mapping of policies and institutions, is accurate and complete. The taskforce will meet in Q2/2021 to present the main objectives of the study and in Q3/2021 to present the first results of the study and get feedback on policy priorities. The Jordan Investment Commission (JIC) and the OECD act as the coordinators of the taskforce.

The joint project of the OECD Investment Division and the OECD SME and Entrepreneurship Division, supported by the European Commission (DG Regio), is an integral part of the FDI Qualities initiative and its ambition to develop a policy toolkit. In that context, in 2021, two similar pilot country assessments are conducted for the cluster on SME productivity and innovation in Portugal and the Slovak Republic.

In addition, three country assessments on all four clusters of FDI Qualities are planned as part of the EU-OECD Programme on Promoting Investment in the Mediterranean over 2022-24.
**Stakeholder consultations and political engagement**

The draft policy toolkit, just like the mapping exercise and pilot country studies, is presented to and discussed in several OECD networks/committees to validate and refine the guidance provided. As mentioned at the beginning (Section 1.1), these networks include primarily the Roundtable on Investment and Sustainable Development and the FDI Qualities Policy Network, led by the OECD Investment Committee.

The Roundtable is a high-level annual public event, involving policymakers from OECD and partner countries, international organisations, businesses, civil society and academia. The FDI Qualities Indicators report was launched by the OECD Secretary General at the 2019 Roundtable where the mandate for the policy toolkit was given by the Chairs of the Investment and Development Cooperation Committees. The call to deliver the FDI Qualities Policy Toolkit for the 2022 OECD Ministerial Council Meeting was reinforced at the 2020 Roundtable. An advanced draft of the policy toolkit will be discussed at the Roundtable in October 2021.

The OECD has established a dedicated multi-stakeholder policy network to support and provide guidance to the FDI Qualities initiative, through policy dialogue and technical discussions on project activities. The network includes government officials from investment, development and other related policy communities (from OECD and partner countries); representatives from the private sector and civil society; and experts from the OECD, other international organisations and academia. Stakeholders from Business at OECD (BIAC), the Trade Union Advisory Committee (TUAC) and OECD Watch are important partners in the network. The network is meeting for the fifth time in March 2021 to discuss this interim report of the policy toolkit. The format proved very useful to engage different stakeholder groups, receive constructive feedback, and generate support and ownership for the broader FDI Qualities initiative.

A small and informal group of Ambassadors to the OECD and high-level partners from developing countries provide the political backing of the FDI Qualities initiative and ensure its success to deliver a highly visible and practical policy toolkit. Ambassadors from Finland, the Netherlands and Switzerland form this group from OECD’s side and high-level partners from Jordan and Senegal represent developing countries.

Besides consultations and support through the above networks, the draft policy toolkit is developed in close cooperation with the OECD Development Assistance Committee. A dedicated policy toolkit chapter on how donors can support developing countries in their efforts to improve the impacts of FDI on sustainable development will be prepared (see Section 1.2). The chapter on SME productivity and innovation is developed in partnership with the Working Party on SMEs and Entrepreneurship with some involvement of the Regional Development Policy Committee due to its subnational dimension. The chapter on FDI in low-carbon activities includes inputs from colleagues from the Environment Directorate and its Working Party on Climate, Investment and Development as well as from the Centre for Tax Policy and Administration. The chapter on gender equality includes inputs and consultations from various directorates (including the Trade and Agriculture Directorate, the Development Centre and the Directorate for Employment, Labour and Social Affairs). It contributes to the OECD March on Gender 2021 and will be discussed by the Working Party on Gender Mainstreaming and Governance in 2022. The chapter on employment, job quality and skills will be reviewed by colleagues in the Directorate for Employment, Labour and Social Affairs and the Directorate for Education and Skills, while presentations to respective committees is planned.

The policy toolkit will also be brought to networks of other organisations, such as the United Nations, UNCTAD, the World Bank Group as well as stakeholder organisations such as Business at OECD (BIAC), the Trade Union Advisory Committee (TUAC) and OECD Watch. Consultations related to the policy toolkit with these groups were initiated in 2020 and will continue throughout the process of developing the policy toolkit.
1.5. Timeline

Table 1.4 provides a tentative list of the key moments in the process of developing the policy toolkit.

Table 1.4. Tentative timetable

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-2 Mar 2021</td>
<td>SDG Council</td>
<td>FDI Qualities part of discussion in Session 2: Leveraging private investment to foster progress towards the SDGs; informal group of OECD Ambassadors and partners from developing countries took part in discussion</td>
</tr>
<tr>
<td>31 Mar 2021</td>
<td>Fifth FDI Qualities Policy Network meeting</td>
<td>This interim report of the policy toolkit is discussed, including through break-out session on each of the four SDG-based clusters</td>
</tr>
<tr>
<td>April-May 2021</td>
<td>Council</td>
<td>OECD Secretariat reports on implementation of the 2015 update of the Policy Framework for Investment and will ask to get the mandate/buy-in from Council for the development of the FDI Qualities Policy Toolkit as deliverable for MCM 2022</td>
</tr>
<tr>
<td>Oct 2021 (tbc)</td>
<td>FDI Qualities Meeting with all ambassadors</td>
<td>Informal group of Ambassadors will co-chair the meeting; objective to inform all OECD ambassadors about the FDI Qualities work and engage in focused policy debate.</td>
</tr>
<tr>
<td>Oct 2021 (tbc)</td>
<td>High-level Roundtable on Investment and Sustainable Development</td>
<td>The Roundtable on Investment and Sustainable Development is the OECD Investment Committee’s platform to engage in high-level policy dialogue on investment and sustainable development in a public event. It will take place for the 4th in 2021 and will extensively discuss the draft FDI Qualities Policy Toolkit.</td>
</tr>
<tr>
<td>Oct 2021 – Jun 2022</td>
<td>Other ad hoc consultations</td>
<td>Contributions to sessions focused on FDI Qualities (e.g. events of OECD regional programmes on investment and external events of other organisations)</td>
</tr>
<tr>
<td>Jun 2022</td>
<td>MCM</td>
<td>Planned launch of the FDI Qualities Policy Toolkit</td>
</tr>
</tbody>
</table>

Note: These events are tentative; additional events could be added while some of the above mentioned events could be re-scheduled.

References


OECD (2020), “Enabling FDI diffusion channels to boost SME productivity and innovation in EU countries and regions: Towards a Policy Toolkit”.


Sauvant, K. (2021, forthcoming), *More attention to policies! Improving the distribution of FDI benefits: the need for policy-oriented research, advice and advocacy*.


This chapter presents a policy toolkit to help governments channel foreign direct investment (FDI) into productivity-enhancing activities and promote productivity and innovation spillovers on small and medium-sized enterprises (SMEs). The chapter describes the various transmission channels through which FDI impacts productivity and innovation as well as contextual factors determining the magnitude and direction of such impacts. It also provides a thorough overview of policies and institutions at the intersection of investment and complementary policies that can enhance the qualities of FDI in the area of productivity and innovation.
2.1. Global productivity slowdown amid rising inequalities

Productivity reflects a country's stage of economic development, and its resulting competitive edge and economic structure. As an economy develops, its structure typically shifts from agriculture, to light manufacturing, to heavier manufacturing, and eventually to high technology manufacturing and services, reflecting increasing levels of productivity and innovation capacity (OECD, 2014[1]). While productivity varies considerably across sectors, different value chain functions within sectors and the efficiency to conduct such activities involve varying levels of labour intensity and thus productivity levels (see Box 2.1. for definitions of productivity and innovation in this policy toolkit).

Productivity and innovation figure prominently in the Sustainable Development Goals (SDGs), particularly in SDG 8 (economic growth) and SDG 9 (industry and innovation). These goals encompass boosting overall competitiveness, reducing regional disparities, and raising productivity and innovation capacity of the typically more constrained small and medium-sized enterprises (SMEs). Enhanced productivity and innovation are closely tied to better-paid and more stable jobs and greater human capital and skills (Chapter 3). Productivity and innovation capacity is also closely tied with the transition towards a low-carbon economy (Chapter 4). Productivity and innovation may thus support progress across a broader set of sustainability objectives, although causality is likely to go in both directions (OECD, 2019[2]).

Yet, productivity growth has decelerated globally as shown in recent OECD work on ‘The Future of Productivity’ (OECD, 2015[3]). The main source of the productivity slowdown is not so much a decline in innovation, but rather a drop in the pace at which innovations spread throughout the economy. Productivity growth of the globally most productive and innovative firms has remained robust in recent years but the gap between these highly productive and innovative firms and the rest – mostly small and medium-sized enterprises (SMEs) – has widened.

SMEs are key actors for building more inclusive and sustainable growth, increasing economic resilience and improving social cohesion. Across the OECD, for instance, SMEs account for about 60% of employment and between 50% and 60% of value added and are the main drivers of productivity in many regions and cities where the global frontier innovators are absent (OECD, 2019[4]). Smaller firms face long-standing size-related barriers in dealing with stringent business conditions or accessing strategic resources. SMEs are a very heterogeneous population whose performance in terms of productivity, wages paid and international competitiveness, vary considerably across sectors, regions and firms. Enterprise creations in the OECD have picked up over last decade, especially in services, but newly created jobs are concentrated in low-productive and low-wage sectors. Productivity gaps between smaller and larger (particularly foreign-owned) firms are significant in both OECD and developing economies (Figure 2.1.) and have increased over time, even if SMEs outperform large enterprises in the services sector in many countries (OECD, 2019[5]; OECD, 2019[6]). More lower-productivity jobs have resulted in more lower-paid jobs. SMEs, even the larger ones, typically pay employees around 20% less than large firms and the gap with foreign firms is even larger.

Innovation is key to boost productivity, and digitalisation offers SMEs new opportunities to take part in the next production revolution. Emerging digital technologies, such as big data analytics, artificial intelligence and 3D printing, enable greater product differentiation and mass customisation, better integrated supply chain systems and, overall, new digital-enhanced business models that leverage shorter distance and time to markets (OECD, 2019[7]). This is likely to benefit smaller and more responsive businesses. Digitalisation also supports open sourcing and open innovation, with large – and foreign – firms contributing to the transformation of business ecosystems through business accelerators and innovation labs that provide start-ups and innovative SMEs with access to resources and markets. Digitalisation creates a range of innovative financial services for SMEs and also eases SME access to skills through better job recruitment sites, outsourcing and online task hiring, or by connecting them with knowledge partners.
Box 2.1. Defining productivity and innovation

This policy toolkit defines productivity in terms of value added per unit of labour (labour productivity), where labour is measured as total hours worked or number of employees (OECD, 2019[2]). It is important to stress that labour productivity is an incomplete gauge of efficiency. Labour productivity can rise due to increased capital spending (e.g. giving workers more machines), but does not mean all factors of production are being used more efficiently (e.g. using better machines). Labour productivity measures in services come with caveats as measures of output are often in terms of costs of labour and thus value added is difficult to measure (Triplett and Bosworth, 2008[6]). Total factor productivity or measures of return on capital (e.g. incremental capital-output ratios) would better capture efficiency improvements for capital-intensive industries like mining.

Innovation is defined as the implementation of a new or significantly improved product (good or service) or process, a new marketing method, or a new organisational method in business practices, workplace organisation, or external relations (OECD, 2005[7]). Patented intellectual property is sometimes used as an indicator for innovation output, although not all innovations are protected with patents. A broad set of tangible and intangible assets with embedded knowledge – ranging from human and organisational capital, existing technologies to R&D – need to be accumulated and combined to yield innovation outputs (Cirera and Maloney, 2017[8]). This policy toolkit makes predominantly reference to two measures of innovation: process innovation and R&D intensity, or R&D per unit of value added (OECD, 2019[2]).

Figure 2.1. Productivity premia of foreign firms in OECD and non-OECD economies

Average labour productivity premia of foreign relative to domestic firms, in %

Note: See methodology in OECD (2019); labour productivity = value added per employee

Digitalisation can also help SMEs integrate in global value chains (GVCs). Digitalisation has created effective mechanisms to reduce size disadvantages in international trade, such as by reducing the absolute costs associated with transport and border operations. In addition, the fragmentation of production worldwide has provided smaller businesses with significant scope for competing in specialised GVC
segments and scaling up activities abroad, while capturing international knowledge spill-overs and capitalising on more robust growth in emerging markets. As a matter of fact, wage gaps with large foreign firms are smaller for exporting SMEs and for highly productive SMEs, particularly those at the frontier of the digital revolution (OECD, 2019[4]).

2.2. FDI impacts on productivity and innovation

**FDI contributes directly to productivity enhancement**

Foreign direct investment (FDI) can directly affect productivity and innovation. Foreign firms’ direct impact relates to their own activities and how they contribute to aggregate and sectoral productivity and innovation (Cadestin et al., 2018[9]). FDI directly relates to improved productivity and innovation at the industry or aggregate level if foreign firm activity is concentrated in sectors that are typically more productive and innovative. The opposite holds if FDI is concentrated in low-value added, less innovative, sectors. Thus, FDI can shift the sectoral composition towards more or less productive or innovative activities. The OECD FDI Qualities Indicators suggest that, in OECD economies, sectors receiving more FDI tend to have higher labour productivity levels and R&D intensity and experience higher growth in labour productivity than other sectors (Figure 2.2.).

**Figure 2.2. Concentration of FDI based on sectoral productivity and R&D performance**

FDI is concentrated in relatively higher performing sectors if score > 0

![Figure 2.2](image_url)

Note: See OECD (2019) for a description of the methodology and data. Labour productivity = value added per employee; R&D intensity = R&D expenditures per unity of value added; wages = wage per employee

Source: OECD FDI Qualities Indicators (2020) based on Financial Times’ fDi Markets database, OECD National Accounts and OECD MSTI database

Besides the fact that foreign investors tend to invest in sectors that are typically more technology intensive, this is also the result of foreign firms being on average more productive than domestic firms (see Figure 2.1.), which is in turn linked to foreign affiliates having stronger access to technology, better managerial skills and more adequate resources for capital investment than domestic firms (Javorcik, 2020[10]). Size also matters, since foreign affiliates are larger than the average domestic enterprise and can therefore harness economies of scale – including through their relationship with the parent company – which are not available to domestic companies (Alfaro and Chen, 2012[11]; Desai, Foley and Forbes, 2008[12]).
FDI involves productivity spillovers on host economy SMEs

Due to foreign firms’ performance premium relative to domestic firms, policymakers often expect FDI to generate knowledge and technology spillovers that will also result in increased productivity of domestic enterprises, especially SMEs (Caves, 1996; Blomström and Kokko, 1998). SMEs can benefit from knowledge and technology spillovers through various transmission channels – such as value chain relationships, competition and imitation effects, and labour mobility – that are themselves enabled through specific contextual factors, notably the characteristics of FDI, capabilities of SMEs as well as broader policy and non-policy framework conditions (Görg and Strobl, 2001; Crespo and Fontoura, 2007; Smeets, 2008) (Figure 2.3).

Figure 2.3. FDI transmission to boost SME productivity and innovation

Value chain relationships

Value chain relationships include supply chain linkages both upstream and downstream that involve the spillover of knowledge from foreign affiliates of multinational enterprises (MNEs) to domestic suppliers and customers, and strategic partnerships, which involve formal collaborations beyond buyer-supplier relationships, for example in the area of R&D or workforce/managerial skills upgrading.

Backward linkages help domestic companies extend their market for selling (Figure 2.4) and raise the quality and competitiveness of their outputs. They generate knowledge spillovers when MNEs require better-quality inputs from local suppliers and are, therefore, willing to share knowledge and technology with them to encourage their adoption of better practices (OECD, 2020). A recent study of New Zealand, for example, found that small firms indeed benefit from economies of scale when they supply foreign MNEs and, thereby, also catch up technologically with foreign firms (Doan, D. and Iyer, 2015). For such technology spillovers to happen, SMEs require a certain level of absorptive capacity often defined in terms of technological proximity with foreign firms (see next sub-section).

FDI spillovers are more commonly found in these vertical supply relationships than in the relationship between foreign MNEs and potential local competitors (horizontal spillovers), as rivalry is more naturally embedded in the latter (Rojec and Knell, 2017; Javorcik, 2004; Blalock and J., 2008) - (see below.
discussion on competition and imitation effects). Finally, having strong linkages with domestic firms can 
embed foreign affiliates more deeply into the economy, making it less likely that they will move operations 
elsewhere (OECD, 2020[18]).

Figure 2.4. Sourcing structure of foreign affiliates, by supplier type/origin

![Figure 2.4. Sourcing structure of foreign affiliates, by supplier type/origin](source)

Affiliates of foreign MNEs operate in host countries not only as buyers of intermediate goods, but also as 
suppliers to domestic companies (forward linkages). Forward linkages between MNEs and local buyers 
have a positive impact on local enterprise productivity mostly through the acquisition of better quality inputs, 
which were not locally available before (C. and J., 2017[23]). In addition, many MNEs, especially in industrial 
sectors such as machinery, often offer training to their customers on the use of their products as well as 
information on international quality standards (Jindra, 2006[24]).

The emergence of GVCs has brought new types of MNE-SME partnerships, especially in high-technology 
and knowledge-intensive industries, which are based on the transfer of technology and the development 
of cross-border R&D projects. These partnerships can take many forms, including joint ventures, licensing 
agreements, research collaborations, globalised business networks (i.e. membership-based business 
organisations, trade associations, stakeholder networks), and R&D and technology alliances (Andrenelli 
et al., 2019[25]; OECD, 2008[26]).

Strategic partnerships are the result of a shift towards an open mode of innovation which, as noted above, 
has made innovation more accessible to SMEs (OECD, 2019[4]). Open innovation has increasingly been 
seen as a way for accelerating internal innovation and expanding the markets for external use of innovation 
(Chesbrough, 2003[27]). Large firms have increasingly taken part in the open innovation transformation by 
developing strategic partnerships with smaller enterprises or by setting up innovation labs and accelerators 
where start-ups and other small firms can nurture new business ideas and business models.

A recent study based on firm-level data of OECD and developing economies finds that productivity 
spillovers from strategic partnerships, such as manufacturing/marketing agreements and joint ventures, 
depend on firm-level characteristics, such as firm size, (foreign) ownership, internationally-recognised 
certifications and staff training (OECD-UNIDO, 2019[28]). Larger and foreign-owned firms as well as firms 
that have internationally-recognised certifications and engage in staff training are more likely to improve 
productivity when foreign MNEs engage in partnerships. This is consistent with studies showing that
knowledge and technology spillovers from foreign MNEs depend on SME absorptive capacities (see below).

Labour mobility

Labour mobility can be an important source of knowledge spillovers in the context of FDI, notably through the move of MNE workers to local SMEs – either through temporary arrangements such as detachments or long-term arrangements such as open-ended contracts – or through the creation by MNE workers of start-ups (i.e. corporate spin-offs).

Existing evidence suggests that firms established by MNE managers are more productive than other local firms (Görg and E., 2005[29]). Similarly, evidence from manufacturing in Norway suggests that workers who moved from foreign-owned to domestic firms retain part of their knowledge and contribute 20% more to the productivity of their firm than workers without foreign firm experience (Balsvik, 2011[30]). Recent OECD research on Ireland shows that over the period 2009-2015 more than one in four employees at foreign-owned companies either moved to a domestic firm or became self-employed. In addition, more than one in three start-up founders had previously worked at a foreign-owned company (OECD, 2020[31]). Labour mobility within Ireland is also very common among high-skilled researchers who have produced patents. One out of two patent inventors changed employer at least once during the period 2006-2016. As most inventors are based in foreign-owned companies, FDI spillovers related to inventor mobility play an important role in Ireland (OECD, 2020[31]).

On the other hand, research on Portugal provides a more sceptical perspective on potential productivity spillovers on domestic firms resulting from the mobility of workers from foreign to domestic firms (Martins, 2011[32]). Domestic firms in Portugal tend to hire ‘below-average’ workers from foreign firms who take, on average, pay cuts (which is consistent with involuntary mobility). It suggests that worker mobility is unlikely to be a major source of productivity spillovers from foreign to domestic firms. However, movements from domestic to foreign firms translate into considerable pay increases in Portugal but also in other European Union members (OECD, 2021, forthcoming[33]; Becker et al., 2020[34]). This pay increase is consistent with a generally greater ‘generosity’ in the remuneration practices of foreign firms vis-à-vis their domestic counterparts (see Chapter 3). As foreign firms attract some of the best workers in domestic firms where they experience a wage increase and acquire new knowledge, productivity spillovers from worker mobility may also (or rather) occur from domestic to foreign firms.

Competition and imitation effects

The entry of foreign-owned firms heightens the level of competition on domestic companies, putting pressure on them to become more innovative and productive – not least to retain skilled workers (Becker et al., 2020[35]). The new standards set by foreign-owned firms – in terms of product design, quality control or speed of delivery – can stimulate technical change, the introduction of new products, and the adoption of new management practices in local companies, all of which are possible sources of productivity growth. Foreign-owned firms can also become a source of emulation for local companies, for example by showing better ways to run a business. Imitation and tacit learning can, therefore, become a channel to strengthen enterprise productivity at the local level.

However, if local companies are not quick to adapt, competition from foreign-owned companies may also result in the exit of some domestically-owned firms. Increased competition for talent may also make it more difficult for local companies to recruit skilled workers (Lembcke and Wildnerova, 2020[36]). These effects are more likely to happen to local companies which operate in the same sector or value chain function of the foreign-owned company, which is the main reason why horizontal spillovers from FDI are so rare and, when they happen, they mostly involve larger domestic companies (Gorodnichenko, Svejnar and Terrell, 2014[37]; Farole and Winkler, 2014[38]; Crespo and Fontoura, 2007[16]).
Magnitude and direction of FDI transmission impacts depend on contextual factors

The magnitude and direction of FDI transmission impacts depend on contextual factors, including the type and characteristics of FDI that a country attracts, the capacity of local SMEs to absorb knowledge spillovers, and economic geography factors.

FDI characteristics

FDI characteristics include the sector and value chain functions in which the FDI takes place, the type of FDI (e.g. greenfield, M&A), FDI motives (e.g. access to market, access to low-cost labour or natural resources, access to knowledge and innovation assets, among others) and the country of origin of FDI (e.g. whether FDI is from a higher or lower-productivity economy). These characteristics will affect the extent to which FDI spillovers materialise. The MNE’s willingness to share knowledge and technology with local firms and set up market linkages with lower power asymmetry also affects the degree to which there will be productivity spillovers on the local economy.

With respect to value chain activities of foreign firms, there is emerging evidence that FDI concentration in high technology manufacturing is particularly beneficial for local SMEs. For example, in three Eastern European countries (i.e. Bulgaria, Poland and Romania), a recent study found that horizontal FDI spillovers (e.g. as a result of imitation and competition effects) are observed in labour-intensive sectors, while vertical FDI spillovers (e.g. related to buy and supply linkages) are mostly observed in high technology sectors (Nicolini and Resmini, 2010[39]). In the more advanced context of the United States, FDI spillovers are particularly strong in high technology sectors, while they are largely absent in low technology sectors (W. and S., 2009[40]). Furthermore, low-productivity small firms benefit more from FDI spillovers than high-productivity larger firms. 12 FDI can also be isolated from the rest of the economy in high technology manufacturing. For example, Israel has succeeded in attracting many ICT R&D labs from large US-based MNEs (e.g. Intel, IBM, etc.); however, these labs are often self-contained and have developed limited relationships with the rest of the economy (OECD, 2016[41]; OECD, 2019[42]).

The type of FDI – greenfield investment or mergers/acquisitions – that a country attracts has implications on the extent of FDI linkages with the local economy. A greenfield investment, for example, is more likely to involve the implementation of a new technology in the host country and is therefore accompanied by a direct transfer of knowledge and technology from the parent firm to the new affiliate (Farole and Winkler, 2014[38]). On the other hand, the acquisition of a domestic firm allows foreign investors to primarily access the host country’s technology as well as the already established informal business networks and knowledge sharing relationships possessed by the acquired firm. In this case, the deployment of the foreign investor’s technology would be implemented more gradually, thus making knowledge spillovers to domestic firms less likely in the short-term but may still occur in the longer term (Crespo and Fontoura, 2007[16]; Braconier, K. and Knarvik, 2001[42]; Branstetter, Fisman and Foley, 2006[43]).

Turning to the motives of investments, foreign investors may enter a country to expand sales in a new, often large, market (i.e. market-seeking); to tap into natural resources (resource-seeking), which is often the case in commodity sectors and agribusiness; or to achieve efficiency (efficiency-seeking), either by reducing costs (e.g. labour costs) or by seizing new local assets in the form of technology, innovation and related skills. In general, FDI motives are often interlinked, so that they cannot be fully separated but rather emerge in combination.

SME absorptive capacities

Global production networks and the presence of MNEs in particular provide local SMEs with an important opportunity to increase productivity and acquire knowledge. Technology transfers are more effective when

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12 This finding is contrary to some other findings in the literature (Lembcke and Wildnerova, 2020[36]).
firms possess previously accumulated knowledge and innovative capabilities. This set of knowledge and capabilities is generally identified by the literature as absorptive capacity (OECD, 2020[18]). More specifically, absorptive capacity is defined as the ability of the firm to utilise available information or knowledge that comes through the interaction with other firms (Cohen and Levinthal, 1990[44]). It involves the ability to acquire, assimilate and exploit the value of the information and knowledge (Todorova and Durisin, 2007[45]).

Empirical evidence shows that the absorptive capacity of domestic firms is an important determinant of knowledge transfer between foreign affiliates and domestic firms. In particular, domestic suppliers with better technical capabilities tend to develop more knowledge-intensive types of linkages with foreign firms (Saliola and Zanfei, 2009[46]). FDI is also found to have a positive effect on domestic productivity growth when the technology gap between domestic and foreign firms is not too large and domestic firms have enough absorptive capacity (Nicolini and Resmini, 2010[39]).

Absorptive capacity is typically measured in terms of performance gaps (e.g. productivity gaps) between foreign and domestic companies as illustrated in Figure 2.1. (OECD, 2019[2]; OECD-UNIDO, 2019[28]; Gal and Witheridge, 2019[47]; Farole and Winkler, 2014[38]). The absorptive capacity of SMEs largely depends on their financial, human and knowledge-based capital and their ability to access the strategic resources they need to adapt to market conditions and innovate (i.e. access to finance, skills and innovation assets, including technology, data, intellectual property rights and networks).

Economic geography factors

Economic geography factors generate spatial and agglomeration effects. The localised nature of FDI means that geographical proximity between foreign and domestic firms affects the likelihood of knowledge spillovers, which often involve tacit knowledge, and whose strength decays with distance (Audretsch and Feldman, 1996[48]). Recent work confirms that when there are productivity spillovers from FDI, these are concentrated in the same region of the investment (Lembcke and Wildnerova, 2020[36]; Girma, H. and M., 2008[49]).

Agglomeration effects, notably through the presence of local industrial clusters, have also been reported to affect FDI attraction and FDI spillovers. Clusters embed characteristics such as industrial specialisation (through specialised skilled workers and suppliers) and geographical proximity that make knowledge spillovers more likely to happen, including from MNE operations. For the same reasons, MNEs can also expect to benefit from investing in local clusters, notably through the sourcing of local knowledge and technology. Evidence from the United Kingdom, Italy, Poland and Romania shows that firms located in clusters benefit from FDI, both in the same sector of the foreign affiliate company and in other sectors. However, these benefits do not materialise for companies located outside the clusters (De-Propris and N., 2005[50]; Menghinello, De-Propris and Driffield, 2010[51]; Franco and Kozovska, 2008[52]).

Core questions to analyse impacts

This set of core questions provides the analytical framework for understanding the role and potential of FDI for productivity and innovation in host economies, including for the productivity and innovation of SMEs. Table 2.1. provides supplemental questions and suggestions for available cross-country data tools to investigate these questions. Available cross-country data are limited and may require additional information from national statistics. The aim of this exercise is also to identify potential data gaps in national statistics and to draw attention to the importance of collecting data.

- Economic context and structure of the economy: What is the economic context and structure of the economy? Which sectors and value chain functions are driving growth, productivity and innovation? What is the role of SMEs in the economy? How vulnerable is the economy to shocks?
- **GVC integration through trade and investment**: What is the level of GVC integration, particularly of SMEs? Which value chain functions and subnational regions are better integrated in GVCs? What is the role of FDI for GVC integration?

- **FDI characteristics**: To what extent sectoral concentration (concentration in value chain functions) of FDI is driving productivity and innovation? What types and motives of FDI are more conducive to support productivity and innovation growth? How concentrated is FDI geographically?

- **SME absorptive capacity**: Is there a productivity (technological) gap between SMEs and foreign firms and in which value chain functions and subnational regions are such gaps more prominent? Do SMEs have access to finance, innovation and digital assets and entrepreneurial, innovation and digital skills?

- **FDI transmission channels**: Is FDI directly affecting productivity and innovation growth in host economies? Are foreign affiliates generate positive or negative spillovers on domestic firms, particularly SMEs, such as through value chain linkages, including partnerships, labour mobility and competition and imitation effects?

### Table 2.1. Supplemental questions and data tools (preliminary)

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Questions</th>
<th>Sources of data</th>
</tr>
</thead>
</table>
| Economic context and structure of the economy | Which sectors and value chain functions* are driving growth, productivity and innovation? | OECD STAN Database for Structural Analysis  
World Bank Enterprise Surveys |
|                                  | What is the structure of the SME sector? What is the contribution of SMEs in terms of value added and employment for the economy as a whole? How innovative are SMEs? | OECD Structural and Demographic Business Statistics  
Eurostat Structural Business Statistics |
|                                  | How dynamic is the start-up entrepreneurship eco-system?                  | Global Entrepreneurship Report  
Flash Eurobarometer on Entrepreneurship  
Eurastat Community Innovation Survey |
|                                  | How vulnerable is the economy (and SMEs in particular) to economic shocks? | OECD Economic Outlook |
| GVC integration through trade and FDI | What is the level of GVC integration (both through backward and forward linkages)? | OECD Trade in Value Added Database |
|                                  | Which value chain functions are better integrated in global value chains? Which regions are better integrated in GVCs? | OECD Trade in Value Added Database  
World Bank Enterprise Surveys |
|                                  | To what extent are SMEs integrated in GVCs?                               | OECD Trade by Enterprise Characteristics  
World Bank Enterprise Surveys |
|                                  | What is the role of FDI in terms of value added and employment?           | OECD Analytical AMNE database  
World Bank Enterprise Surveys |
|                                  | To what extent does FDI drive integration in GVCs?                       | OECD Analytical AMNE database  
World Bank Enterprise Surveys |
| FDI characteristics              | In which value chain functions is FDI concentrated? Is FDI concentrated in relatively more productive/innovative sectors and value chain functions? | Refinitiv Database on cross-border M&A  
Financial Times’ fDi Markets Database (greenfield FDI)  
OECD FDI Statistics  
OECD FDI Qualities Indicators |
|                                  | Is the type of FDI (greenfield vs. M&A) supporting productivity and innovation growth, including of SMEs? | Refinitiv Database on cross-border M&A  
Financial Times’ fDi Markets Database (greenfield FDI)  
World Bank Enterprise Surveys |
<table>
<thead>
<tr>
<th>Source of data</th>
<th>Question(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Bank Enterprise Surveys</td>
<td>Are the motives of investment conducive with productivity and innovation growth aspirations and SME development?</td>
</tr>
<tr>
<td>Refinitiv Database on cross-border M&amp;A Financial Times’ FDI Markets Database (greenfield FDI) World Bank Enterprise Surveys</td>
<td>To what extent is FDI concentrated geographically?</td>
</tr>
<tr>
<td>OECD Analytical AMNE database World Bank Enterprise Surveys</td>
<td>To what extent is FDI responsible for the emergence of industrial clusters?</td>
</tr>
<tr>
<td>OECD FDI Qualities Indicators</td>
<td>Is there a productivity (technological) gap between SMEs and foreign firms?</td>
</tr>
<tr>
<td>OECD FDI Qualities Indicators</td>
<td>In which value chain functions are such productivity gaps higher?</td>
</tr>
<tr>
<td>OECD FDI Qualities Indicators</td>
<td>In which subnational regions are such productivity gaps higher?</td>
</tr>
<tr>
<td>OECD SME and Entrepreneurship Outlook</td>
<td>To what extent do SMEs have access to finance and funding?</td>
</tr>
<tr>
<td>OECD SME and Entrepreneurship Outlook</td>
<td>Do SMEs have access to innovation and digital assets?</td>
</tr>
<tr>
<td>OECD SME and Entrepreneurship Outlook</td>
<td>Do SMEs have access to entrepreneurial, innovation and digital skills?</td>
</tr>
<tr>
<td>OECD Analytical AMNE database</td>
<td>Are foreign affiliates sourcing from domestic firms (SMEs) and in which value chain functions?</td>
</tr>
<tr>
<td>OECD Analytical AMNE database</td>
<td>Are foreign affiliates selling to domestic firms (SMEs) and in which value chain functions?</td>
</tr>
<tr>
<td>OECD SME and Entrepreneurship Outlook Factset</td>
<td>Are SMEs engaging in partnerships (e.g. innovation networks, technology licencing) with foreign affiliates?</td>
</tr>
<tr>
<td>National statistics and empirical research</td>
<td>Is labour mobility between foreign and domestic firms happening and does it contribute to knowledge transfers and productivity growth?</td>
</tr>
<tr>
<td>National statistics and empirical research</td>
<td>Is FDI associated with positive/negative competition effects and imitation?</td>
</tr>
</tbody>
</table>

Note: The list of core questions is not exhaustive and will be extended further. Sources of data refer to databases that can be used to address questions and that include information across countries. These databases may not be suitable to answer all questions and data is typically available for a selected number of countries only. *Value chain functions may be split into pre-production services, low and medium technology manufacturing, high technology manufacturing and post-production services, Source: OECD elaboration.

### 2.3. Policies that influence FDI impacts on productivity and innovation

Productivity and innovation impacts of FDI may not materialise automatically. Besides contextual factors that relate to socio-economic development of host economies (Section 2.2), public policies and institutional arrangements play an important role in enabling FDI transmission channels and fostering positive FDI impacts (Figure 2.3). Policies and institutions are also essential to avoid negative implications that may result from the presence of foreign businesses, such as crowding out of local SMEs and jobs (also see Chapter 3). Most policies are not specifically targeted to foreign firms; they treat foreign and domestic investors alike. Yet, the extent to which policies affect the two groups, and with that their outcomes on sustainable development, can vary. Some regulations directly affect foreign firms’ choice of location, influence specific types of foreign firms to invest and keep away others.

Meanwhile, the institutional framework that governs policy formulation and implementation differs from country to country. The approach that governments adopt to organise the institutional framework reflects their strategic objectives and the priority they give to certain policy goals such as the internationalisation of the economy, the attraction of productivity-enhancing FDI and the competitiveness of the domestic SME...
population (Box 2.2). Different governance structures are feasible as long as appropriate reporting mechanisms and communication channels are in place to ensure policy alignment among different institutions and across national and subnational authorities. To this end, clear responsibility and accountability among government institutions is a pre-condition for designing and implementing effective policies that strengthen the impact of FDI on the productivity and innovation of domestic economies. It should be clear which institutions (e.g. investment promotion agencies, SME agencies, innovation agencies) are responsible for FDI-SME linkages and what roles and responsibilities they have.

Policies and institutions cannot be considered in silos but in the framework of an adequate and coherent policy mix – including not just investment policies but a variety of policy areas – and coordinated institutional governance that will help to best leverage FDI for productivity growth and innovation. Good governance will ensure that the design, implementation and evaluation of policies for FDI transmission are coordinated across public – and sometimes private – institutions at the international, national and regional levels. Identifying opportunities that enhance, and weaknesses that limit, the effectiveness of FDI transmission channels requires an assessment of the institutional coordination mechanisms.

The OECD Policy Framework for Investment (PFI) provides guidance on investment climate reforms that are concurrent with enabling investment for productivity enhancement. Yet, ensuring that FDI leads to higher productivity and benefits SME upgrading and integration in GVCs requires more tailored policy considerations and more focus on policies outside the PFI (e.g. SME, innovation and local development policies). A thorough overview of policies at the intersection of investment and complementary policies that will help policymakers enhance the qualities of FDI in the area of productivity and innovation is the core objective of this policy toolkit. The toolkit explains what regulatory conditions, proactive policies and programmes, international agreements and standards are important ingredients of a policy mix that enables FDI transmission on productivity and innovation – both directly and through spillovers (Table 2.2).

Table 2.2. Types of policies influencing FDI transmission on productivity and innovation

<table>
<thead>
<tr>
<th>Policy type</th>
<th>Instrument type</th>
<th>Direct impact</th>
<th>Spillovers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Supply chain relationships</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>Trade openness</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>FDI openness</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Competition policy</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>IP protection</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Labour market regulation</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Skills policies</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Public support for business innovation</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Access to finance</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Proactive policies and programmes*</td>
<td>Regulatory incentives (e.g. easing and concessions for FDI, Special Economic Zones, investor visas)</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Financial incentives (e.g. grants for SME technology acquisition, tax incentives for R&amp;D, payroll tax incentives)</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Technical assistance (e.g. supplier development programmes, matchmaking services)</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Business hubs and technology platforms (e.g. matchmaking platforms, industrial parks)</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>International investment agreements</td>
<td>SME provisions in RTAs and BITs</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Technology transfer, innovation and local sourcing provisions in RTAs and BITs</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>

Note: Some policy instruments can have an impact on multiple or all transmission channels. *Table 2.3 provides a more detailed overview of proactive policies and programmes.
Box 2.2 The institutional framework for FDI impacts on productivity and innovation in Portugal

Policies enabling FDI-SME productivity spillovers are designed and implemented in Portugal through a range of advisory bodies, Ministry departments and autonomous government agencies that are responsible for FDI promotion and facilitation, entrepreneurship, innovation and regional development. Advice to government on innovation and entrepreneurship is provided by the National Council on Entrepreneurship and Innovation (CNEI) and the National Council for Science and Technology (CNCT). Advice to government on foreign investment and international trade issues is provided by the Strategic Council for the Internationalisation of the Economy (CEIE), which includes representatives of Portuguese business associations alongside government ministers.

At the ministerial level, the Ministry of Foreign Affairs coordinates national investment promotion and trade policies in close collaboration with other ministries with competences in these policy areas. The primary responsibility for SME and business innovation policy lies with the Ministry of Economy and Digital Transition, which is also in charge of formulating and executing economic growth policies with the aim to foster the competitiveness of the Portuguese economy. Important prerogatives are also in the hands of the Ministry of Planning and Infrastructure, which plays a significant role in the implementation of regional programmes and territorial approaches, including in the formulation and implementation of Portugal’s national and regional smart specialisation strategies.

The implementation of policy initiatives in the areas of FDI promotion, SME internationalisation and innovation is entrusted to several implementing agencies, which operate either as part of the central government’s organisational structure (e.g. Ministry department), or autonomously under the direction of the Ministry to which they report. Portugal Global - Trade and Investment Agency (AICEP) is considered Portugal’s one-stop-shop for facilitation and aftercare services to foreign investors, while the SME Competitiveness and Innovation Agency (IAPMEI) is the implementing agency for the support of Portuguese SMEs. Public support programmes fostering business innovation are implemented by the National Innovation Agency (ANI). Finally, regional development policy is coordinated at the national level through the Agency for Development and Cohesion (AD&C), which ensures the overall coordination of the EU Structural and Investment Funds in Portugal. The EU’s cohesion policy is also administered through seven regional and four thematic operational programmes, which have their own national managing authorities (e.g. COMPETE 2020), consisting of a steering committee and a technical secretariat.

Note: In red frame are the main implementing agencies enabling FDI spillovers to Portuguese SMEs
Source: (OECD, 2021, forthcoming)
**Regulatory framework**

The quality of the broader regulatory environment can determine the magnitude of FDI spillovers. Host country factors such as well-functioning financial markets, intellectual property rights protection, a conducive labour market regime and competition rules that facilitate market entry and exit, need to be in place for countries to reap the benefits of FDI spillovers. These regulatory framework conditions can shape the type and motive of FDI, the characteristics and market behaviour of domestic SMEs, the degree of employee turnover between foreign and domestic firms and the overall structure of domestic supply chains.

Poorly designed or weakly applied regulations can undermine the performance of domestic firms, hamper the entry of foreign investors into domestic markets and discourage linkages with the local economy. The establishment of coordination mechanisms between national and subnational levels of government can reduce the likelihood of contradictory or duplicative regulation and ensure policy alignment between different agencies. For FDI to be embedded into the local economy, regulatory policy should therefore provide guidance and define clearly what investors can expect from government.

**Facilitating investment and business operations**

Firm size is a determinant of absorptive capacity and a critical factor shaping a firm’s ability to move towards high value added, knowledge-based production. As mentioned in Section 2.1, OECD and developing economies are often dominated by SMEs with low productivity, which may find it difficult to grow and obtain a critical scale that would allow them to join GVCs and become suppliers and partners of foreign firms. It is important that a proper business environment is created and regulatory hurdles removed to enable businesses to expand. These include areas such as ease of starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency, as covered in World Bank’s Doing Business Indicators (World Bank, 2020[53]).

Doing Business indicators have had unparalleled success in drawing attention to the regulatory burdens that businesses face in different countries, leading to hundreds of reforms worldwide to improve the business environment for foreign firms and SMEs. These burdens perpetuate informality, particularly of smaller and less productive firms, and can potentially dissuade foreign firms from investing when faced with more welcoming environments elsewhere. At the same time, the indicators have been criticised for the underlying assumption that less regulation is always better, thus ignoring the potential social benefits of regulation. An investment and business climate is a complex organism, requiring interventions in many areas to keep it in “good health”. For this reason, a holistic approach to investment climate reform, such as that provided by the OECD Policy Framework for Investment, is important. Reforming certain aspects of business regulation because of the worldwide visibility of Doing Business may not always be optimal (Thomsen, 2019[54]). Regulatory reforms should thus be informed by regulatory impact assessments rather than by international rankings.

**Enabling investment and trade policies**

Regarding the policy framework conditions, trade policy can influence the amount and spillover potential of FDI as well as the absorptive capacity of domestic firms. FDI spillovers tend to be larger in countries that are more open towards trade (Meyer and Sinani, 2009[55]; Harvanek and Irsova, 2011[56]; Du, Harrison and Jefferson, 2011[57]). A study on Thailand’s manufacturing sector, found that technology spillovers from FDI to the domestic economy happen predominantly in sectors with low trade restrictions, while evidence from China’s entry into the World Trade Organisation (WTO) suggests that vertical backward spillovers increased after its accession when tariffs were lowered and domestic content restrictions relaxed (Du, Harrison and Jefferson, 2011[57]). Trade openness can also shape the absorptive capacity of domestic firms, which are more exposed to international competition in an open trade regime, and therefore more
likely to access new markets, participate in GVCs, and produce intermediate goods required by foreign investors (Harvanek and Irsova, 2011[56]).

Liberalising the trade regime often goes hand in hand with less restrictive FDI regulations and competition rules that are conducive to market entry and exit. Openness to foreign equity investment, fewer incorporation procedural steps required to establish a foreign affiliate and fewer restrictions to FDI, are associated with higher FDI stocks (Mistura and Roulet, 2019[58]). Openness to FDI may not only affect productivity in industries that get market access, but also those in downstream sectors that benefit from potentially better access to high quality inputs and services domestically. Recent OECD work on Southeast Asia shows that liberalising FDI in services is positively associated with productivity in downstream manufacturing industries, where SMEs benefit in particular (Figure 2.5).

Figure 2.5. FDI openness in services and productivity in downstream manufacturing sectors

![Graph showing the relationship between FDI openness in services and productivity in downstream manufacturing sectors.](image)

Note: Analysis is based on firm-level data from 23 OECD and developing countries; see methodology in OECD (2019). Services restrictions are based on the OECD FDI Regulatory Restrictiveness Index.

Source: (OECD, 2019[59])

Positive linkages between foreign MNEs and domestic firms may not automatically materialise just because a country is able to attract FDI (Alfaro, 2017[60]). Competition rules that ensure a level playing field for foreign and domestic firms can facilitate the entry of foreign investors and, at the same time, incentivise domestic firms to become more productive, innovate and improve the quality of their products (Lembcke and Wildnerova, 2020[36]). Firms exposed to stronger competition might also be better prepared to imitate good practices from foreign firms. As described in Section 2.2, competition and imitation are an important channel through which knowledge and technology diffusion from FDI takes place in the host economy. In this context, it is important to assess the degree to which laws and policies promote or inhibit competition in areas of the product and service markets where competition is viable.

Protecting intellectual property

Policies that ensure intellectual property rights (IPR) protection are also important as they guarantee the appropriability of knowledge and innovation benefits, and determine the qualities of FDI that can be attracted. Empirical evidence suggests that where rights are strong, foreign firms are not only more likely to invest but are also more likely to engage in local R&D and more willing to share new technologies with local partners through joint ventures and licensing agreements (OECD, 2015[61]). Branstetter et al. (2006[43]) find that US MNEs respond to changes in IPR regimes abroad by increasing technology transfer to their affiliates in countries that undertake reforms to strengthen IPRs. Similarly, Javorcik (2004[62]) finds
that, in Central and Eastern Europe, the strength of patent laws as well as the overall level of IPR protection increases the likelihood of attracting FDI in several high technology sectors where IPRs play an important role. Foreign investors are also found to be more likely to engage in local production, as opposed to focusing solely on setting up distribution networks, in countries with stronger IPR regimes, increasing therefore the potential for more linkages with the local economy.

**Supportive labour market policies**

Labour market regulations and standards can also influence the effect of FDI on domestic SMEs through various channels, including the amount and qualities of FDI that a country attracts, the skills that the local labour force acquires, as well as the ability of domestic workers to move between different employers and different sectors (see Chapter 4). While labour market regulations are typically designed to protect jobs, excessive constraints such as strict rules on hiring and firing workers, restrictions in fixed-term contracts, and high obligatory contributions to non-wage labour costs, can deter foreign firms from investing in the first place.

Evidence from Western and Eastern European countries shows that greater flexibility in the host country’s labour market relative to that in the investor’s home country is associated with larger FDI inflows (Javorcik and Spatareanu, 2005[63]). In highly rigid labour markets, employee turnover can also be limited, therefore further reducing the knowledge spillovers that could occur through the move of MNE workers to local SMEs. However, evidence on the relation between labour market regulations and human capital formation, shows that the rigidity of employment can have a positive effect on domestic firms’ willingness to invest in job training, which is an important component of a firm’s absorptive capacity. Using firm-level data across developing countries, (Almeida and Aterido, 2011[64]) find that a stricter enforcement of labour regulations is strongly associated with a higher investment by firms in the human capital of their employees.

Recent evidence from EU countries shows that the benefits for a local economy from FDI are lowest where there exist a combination of stringent employment protection legislation and low absorptive capacity of domestic firms (Becker et al., 2020[35]). This is because foreign firms seek to attract local talent by offering higher wages that domestic firms with low absorptive capacity are unable to match. Increased wage disparities coupled with rigid labour market conditions limit the ability of domestic firms to retain and attract skilled workers, leading to a significant crowding out effect that holds back labour mobility towards domestic firms. In contrast, in EU countries with greater labour market flexibility, it was found that FDI inflows do not exacerbate wage disparities or reduce employment in domestic firms because the local labour market is able to adapt to the increased demand for labour following the entry of FDI. These findings highlight the need to examine labour market regulations and their role in FDI transmission by looking at how they relate with other drivers of labour mobility, including the absorptive capacity of domestic firms and the availability (or lack) of skills in the local labour force.

**Strengthening business innovation and skills**

FDI spillovers to domestic firms are influenced strongly by the local innovation infrastructure, which may include innovative firms, technological research institutes, higher and vocational education institutions and other public and private sector entities that contribute to the creation and diffusion of knowledge (Farole and Winkler, 2014[38]). These “systems of innovation” are often part of broader public support frameworks, which play a key role in shaping the extent, nature and direction of business innovation. Government support can take many forms (e.g. subsidies, grants, loans, tax relief, infrastructures, training programmes) and target various actors (e.g. companies, universities, research institutions, technology transfer offices). A thriving local innovation ecosystem that is supported by a conducive policy environment will naturally be better positioned to exploit the knowledge coming from foreign firms, and develop knowledge-intensive linkages.
The literature also points to the important role of education and skills policies in helping domestic firms meet the requirements of foreign investors. Skill shortages and mismatches undermine the ability of the economy to increase productivity and upgrade into knowledge-intensive sectors. The skills of the local labour force are an important determinant of firms’ absorptive capacity and can significantly influence the potential for knowledge spillovers to domestic firms (Farole and Winkler, 2014[38]). Empirical evidence from the manufacturing sector in Romania shows that FDI productivity spillovers are lower in regions with a low share of education (Tytell and Yudaeva, 2007[65]). Vocational education training (VET), lifelong learning activities and skills upgrading programmes with a focus on technical education should be not only available but also in line with the requirements of new emerging fields and tailored to the needs of foreign and domestic firms (Gereffi, Fernandez-Stark and Psilos, 2011[66]). Addressing skill shortages in the workforce is of paramount importance to ensure that all reap the benefits of FDI-driven knowledge diffusion.

**Ensuring well-functioning financial markets**

Well-functioning financial markets can facilitate FDI spillovers by enabling SMEs to access supply chain finance and secure investments for entrepreneurial activity. Studies find that well-developed financial markets can strengthen the absorptive capacity of domestic firms and provide the liquidity that SMEs need to export, develop new products and invest in technology upgrading (Farole and Winkler, 2014[38]). For many SMEs, the high fixed costs of establishing a distribution network and adjusting their products for overseas standards, often require external finance. Governments can play an important role in improving access to credit by creating a regulatory environment that provides flexible collateral options and transparent legal recourse in cases of default, and by establishing support schemes to support SME access to finance (OECD, 2019[4]). Similarly, removing regulatory hurdles and raising awareness about alternative forms of financing such as crowdfunding, venture capital and business angels is necessary to stimulate innovative entrepreneurship.

**Proactive policies and programmes**

While the broader regulatory framework described above is a key determinant, a number of more targeted policy initiatives at the intersection of FDI, SME, innovation and regional development policy can further boost FDI-driven knowledge transmission and its impact on SME productivity and innovation. This system of policies aims to support the channels through which FDI spillovers occur (i.e. value chain relationships, labour mobility, competition and imitation) or the enabling factors that affect their magnitude (i.e. FDI characteristics, SME absorptive capacity, agglomeration economies and clustering). A policy initiative can, however, act upon several channels and enabling factors and make use of various policy instruments, reflecting the plethora of policy goals it may seek to achieve as well as the many pathways to achieving FDI transmission. The main challenge for governments is establishing the right policy mix that is aligned with the country’s economic structure, policy priorities and economic geography (Meissner and Kergroach, 2019[67]). For illustration purposes, Table 2.3 provides an overview of the policy mix for FDI transmission on productivity and innovation in Portugal, based on the OECD FDI Qualities Mapping.

Many of the policies discussed are implemented by multiple institutions and belong to different policy domains (e.g. innovation, investment, entrepreneurship, science and technology, regional development). An analysis of the policy mix for FDI-driven knowledge transmission goes beyond the characteristics of policy formulation and implementation, and focuses more on the areas where the different policy mix components are used in complementary and mutually reinforcing ways to achieve desired outcomes. It places emphasis on questions of completeness, balance and interaction among strategic objectives, policy goals, instruments, sectors and populations targeted, and institutional actors involved. Ideally, the policy mix will take into account interactions among these elements and ensure balanced support to enhance the contribution of FDI to the productivity and innovation of the host economy. Based on the type of instrument
used, such policies can be classified into targeted regulatory incentives, financial incentives, technical assistance programmes, and business hubs and technology platforms.13

Table 2.3. Illustration of proactive policies having an impact on productivity and innovation

<table>
<thead>
<tr>
<th>Instrument type</th>
<th>Policy option</th>
<th>Direct impact</th>
<th>Spillovers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory incentives</td>
<td>Special investment status                                         ✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Regulatory easing and concessions for FDI                        ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Investor / entrepreneur visas                                    ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Special Economic Zones                                           ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Local content requirements                                       ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Financial incentives</td>
<td>Grants/loans for SME innovation &amp; internationalisation activities ✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Grants/loans for SME technology acquisition                      ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax incentives for productivity-enhancing FDI                    ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax incentives for R&amp;D and innovation activities                 ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Payroll tax incentives / wage subsidies for skilled workers      ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Financial incentives for B2B collaboration                        ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Technical assistance</td>
<td>Supplier development programmes                                   ✓</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>SME performance diagnostic tools                                 ✓</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Matchmaking services                                             ✓</td>
<td></td>
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<tr>
<td></td>
<td>Networking and demonstration events                              ✓</td>
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<tr>
<td></td>
<td>Work placement / employee exchange programmes                    ✓</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Cluster policies                                                 ✓</td>
<td></td>
<td></td>
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<tr>
<td>Business hubs and technology platforms</td>
<td>Business support centres                                         ✓</td>
<td></td>
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<tr>
<td></td>
<td>Matchmaking platforms                                            ✓</td>
<td></td>
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<tr>
<td></td>
<td>Local supplier databases                                         ✓</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Technology centres and science parks                             ✓</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>FDI site selection platforms                                     ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Industrial parks                                                 ✓</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: This table serves as a starting point for the mapping of policies and institutions that will inform the policy toolkit for FDI, productivity and innovation. It is not intended to be exhaustive and will be further updated as the policy toolkit is developed.

Targeted regulatory incentives

Regulatory instruments define the framework within which market actors operate and often use legal rules to shape market conditions. They generally include laws and binding regulations that seek to provide “the rules of the game” for foreign and domestic firms alike. The broader regulatory framework at the intersection of FDI and productivity spillovers is discussed in the previous section. This section focuses on those regulatory aspects that provide more targeted incentives for investors to engage in productivity-enhancing activities and knowledge transfers.

Such targeted regulatory incentives include lighter administrative and licensing regimes for certain types of investment activities, local content requirements for foreign firms and labour mobility incentives. National strategies and action plans on policy areas relevant to FDI transmission such as investment, entrepreneurship and innovation policy are also important in defining regulatory and policy priorities and actions.

Regulatory measures for the attraction of productivity-enhancing FDI usually come in the form of special investment regimes granted to FDI projects that are deemed to be of strategic importance for the host

13 This classification is inspired by Meissner and Kergroach (2019) but uses an adapted terminology.
economy, giving access to regulatory incentives such as eased administrative and licensing procedures. These special regimes are usually predicated on certain conditions such as creating a number of jobs, targeting knowledge-intensive and productivity-enhancing sectors, or benefitting specific geographic areas. Falling under the same category of regulatory incentives, special economic zones (SEZs) are also used as a tool to attract FDI that creates linkages with the local economy by cutting red tape and simplifying administrative procedures for companies located inside the zones.

Several countries have chosen to introduce local content requirements (LCRs) to induce foreign firms to use domestically-manufactured goods or domestically-supplied services. Despite the long-standing and predominately negative evidence of the impact of LCRs on economic development, there has been a substantial increase in the use of these measures in recent years, as governments try to achieve a variety of policy objectives that target industrial, employment, productivity and technological development goals. Recent OECD work shows that, while LCRs may help governments achieve certain short-term objectives, they undermine long-term competitiveness (Stone, Messent and Flaig, 2015[68]).

Linked to FDI attraction and facilitation efforts is the increasing number of policies to facilitate immigration of business talent as a way to help domestic economies become more innovative and create linkages with international markets. In recent years, there has been an increase of investor and entrepreneur visa programmes (e.g. Startup Visa, Tech Visa), which seek to attract innovative entrepreneurs by allowing them to obtain residence rights after setting up or transferring their business. For the visa to be granted, entrepreneurs usually have to demonstrate solid business and financial plans and undertake innovative activities in knowledge-intensive sectors. The impact of these schemes on the productivity and innovation of domestic economies is not clear yet, but other factors such as labour market conditions, the presence of a thriving startup ecosystem, and the quality of the business environment are thought to be key determinants.

**Financial instruments**

Financial instruments provide financial support to market actors in direct (e.g. grants, loans) or indirect form (e.g. tax relief) to encourage or discourage certain types of business activities. Direct financial support consists of out-of-hand public spending to attract foreign firms or induce them to invest. They are often used to compensate foreign investors for the perceived disadvantages of a particular location or subsidise the actual costs of relocating corporate units such as job training costs, expatriation support and temporary wage subsidies.

Fiscal incentives, on the other hand, consist of an easing of the tax burden on the investing companies. They normally take the form of reduced corporate tax rates or tax holidays; encouragement of capital formation such as investment tax credits and accelerated depreciation allowances; and preferential treatment of foreign operators (e.g. lower tax on remittances). Fiscal incentives can have the potential to attract investment with positive spillovers on productivity and innovation, but are not always aligned with the objective to enhance domestic resource mobilisation for sustainable development. If poorly designed they may also have limited effectiveness in attracting new investment and often come at a substantial cost to a country. For instance, they may result in windfall gains for projects that would already have taken place in absence of the incentive. In addition, competition to attract investment through fiscal incentives may increase the complexity of the tax system and may even incentivise businesses to engage in profit shifting (OECD, 2019[59]).

Financial and fiscal incentives may also be used to strengthen the absorptive capacity of local SMEs. Many countries have taken policy action to support SMEs and entrepreneurs to access the finance they need for their creation and growth. Direct lending as well as grants and subsidies are provided to SMEs to help them invest in R&D, acquire new technology, adopt digital solutions, and engage in innovation and internationalisation activities. Various tax relief measures are also granted to support subgroups of the SME population such as innovative firms and startups to expand their business and join GVCs. Many of
these financial support schemes also include additional financial incentives for the development of products and services through science-to-business (S2B) and business-to-business (B2B) collaboration, including with foreign firms, reflecting the importance of networks and strategic partnerships for FDI-driven knowledge transmission.

**Technical assistance**

Technical assistance includes mainly voluntary and non-coercive policy measures that encourage the uptake and diffusion of knowledge between foreign and domestic firms and rely on less hierarchical forms of cooperation. The extensive use of these instruments is due to the evolving role of the government which is increasingly seen not only as regulator but also as provider, coordinator and facilitator. Many investment promotion agencies (IPAs) provide matchmaking services and organise B2B meetings where representatives of foreign and domestic firms are brought to get to know each other. In addition, many IPAs organise demonstration and networking events which include moments of knowledge exchange and information sharing. The policy goal here is to bring down information barriers and allow foreign firms to identify local suppliers for future collaboration.

Supplier development programmes are also increasingly part of government support to improve the absorptive capacity of local SMEs and increase their chances of becoming partners and suppliers of foreign firms. These programmes usually assess the need for upgrading SME capabilities in various aspects of their performance – management, production, sales and commercialisation, innovation, human resources and overall productivity – and provide coaching and training in quality control, management strategy, financial planning, as well as product certification and foreign market standards. As part of these programmes, many government agencies also organise seminars and courses for SMEs (e.g. SME Academies), and provide a range of business diagnostic tools to help them assess their innovation and technological capabilities.

As a way to increase labour mobility between domestic and foreign firms, many governments have also put in place work placement and employee exchange programmes. For instance, the Portuguese IPA manages the INOV Contacto programme, which gives the opportunity to highly-skilled graduates to conduct a short-term internship in a Portuguese company, followed by a long-term internship in a multinational company abroad. Although these policies do not affect the overall labour market conditions, which play a crucial role in strengthening labour mobility, they can provide a more targeted approach to facilitating the transfer of knowledge and skills to the local labour market.

**Business hubs and technology platforms**

Business hubs and technology platforms refer to interfaces, platforms, infrastructures and other networking facilities that enable and strengthen interactions and knowledge flows between foreign and domestic firms. For instance, as part of the FDI facilitation and aftercare services, many IPAs use local supplier databases to help foreign firms find information on domestically-manufactured goods and domestically-supplied services. Matchmaking platforms can also serve as a single access point for B2B technology offers and requests, allowing companies to receive information on collaborative R&D projects and identify opportunities for business partnerships.

There has been also a rapid increase of intermediary technology institutes (ITIs) and technology transfer offices (TTOs) in recent years. These infrastructures seek to address the market failure which exists in taking innovative ideas forward to commercial application by providing resources, competences and expertise that SMEs often lack. Their role is to provide from the earliest possible moment hands-on support in innovation processes and help SMEs undertake foresight exercises, focused technology development, and manage intellectual assets. In many cases, particular emphasis is placed on collaborative projects between companies and between companies and research institutions. Hence, they also play the role of
an innovation broker creating “communities of innovators” and allowing foreign and domestic firms to work together on specific topics.

Industrial parks have also acted as a catalyst to facilitate investment and industrial development and create agglomeration economies. They are location-specific and can target both foreign firms and local SMEs, providing them with land and office space to set up their business activities. Apart from providing basic infrastructure, many industrial parks are often associated with the provision of other services such as incentives for entrepreneurs to grow, business diagnostic tools, and programmes involving public-private partnerships. They are often able to host any kind of business activity, but depending on their location they tend to attract companies undertaking specific types of activities in line with the sectoral make-up of the local economy where the park is located. The co-location of companies facilitates the development of networks and information sharing among firms and can be an important source of knowledge and technology spillovers for local economies.

International investment agreements

International agreements that address investment (IIAs) – including bilateral investment treaties (BITs) and trade agreements with investment chapters – may play an important role in efforts to maximise the contribution of FDI to the productivity and innovation of host economies.

Most investment treaties in force today do not contain provisions that seek expressly to promote productivity and innovation. Rather, they have tended to focus almost exclusively on providing legal protections to investors that qualify for such protection. These treaties commonly apply to a broad range of assets that are defined as “investments”, including in many cases intellectual property rights. Treaty protections for IPRs may serve to strengthen domestic frameworks for recognising and enforcing IPRs but it is difficult to assess the tangible effects of such treaty coverage for promoting FDI in innovation activities. More importantly, however, broad protections for covered investors in these treaties may significantly restrict governments’ policy space to regulate in support of innovation and productivity if such regulation would detrimentally affect investments by treaty-covered investors. Recent treaty practices clarifying and narrowing the scope of treaty protections may improve the balance between investor protection and governments’ ability to regulate for new treaty relationships but reduced regulatory policy space remains a critical issue under many older treaties in force today.

More recent IIAs concluded in the past decade, especially trade agreements that address investment issues, have covered broader policy areas beyond investment protection that relate more directly to productivity and innovation. Some recent IIAs address policies affecting SMEs by envisaging international cooperation and dialogue to promote and facilitate investment opportunities for SMEs in the economies of the treaty parties. These initiatives may ultimately help SMEs to overcome a lack of familiarity with foreign markets as well as logistical, managerial and other challenges when investing abroad. They may also help SMEs in the host country trying to form business relationships with incoming foreign investors. Similar initiatives in IIAs focussed on strengthening domestic laws and international cooperation on IPRs and regulations affecting the digital economy – such as data protection, cybersecurity, data localisation and online consumer protection rules – may also support innovation in the treaty party economies to the extent that they lead to improvements in domestic laws in these areas.

Some recent IIAs also contain government commitments on market access, investment facilitation and promoting fair competition that may generate tangible impacts for productivity and innovation. Through the elimination of regulatory barriers to investment based on nationality, IIAs can stimulate more potential FDI primarily based on market considerations, which in turn can generate many benefits for host economies as described above. Greater openness to foreign competition can lead to new competition for local SMEs, which may stimulate greater productivity or lead to crowding-out effects depending on the maturity of the relevant domestic market. In addition to market access barriers, businesses can face a myriad of other obstacles to effective entry and success of FDI in foreign markets. Recent IIAs have sought to alleviate
Box 2.3. The policy mix for FDI impacts on productivity and innovation: the case of Portugal

FDI-driven knowledge diffusion is supported in Portugal by a wide range of policy initiatives that are designed and implemented by the main public agencies as well as Ministry departments, inter-institutional committees and other administrative structures responsible for the coordination of national strategies and action plans. The policy mix relies mainly on policies and programmes that aim to strengthen the broader enabling environment rather than the direct channels through which productivity spillovers occur. More than 60% of the assessed policy initiatives aim to support the absorptive capacity of local SMEs by upgrading their skills, facilitating their digital transformation and the acquisition of modern technologies, and supporting their involvement in R&D and innovation activities. A number of policy programmes (33%) also target the attraction and facilitation of FDI in productivity-enhancing activities, while a few initiatives (14%) are in place to promote agglomeration economies and industrial clustering.

Targeted public action is also undertaken to strengthen FDI transmission channels, albeit not all channels are supported to the same extent. Value chain linkages (29%) and strategic partnerships (39%) are supported through financial incentives for R&D and technology collaboration, matchmaking services bringing together foreign investors with domestic firms, as well as supplier development programmes aimed at supporting the internationalisation of small firms. In contrast, a small number of policy programmes (15%) is in place to promote competition and knowledge exchange, and little is done to facilitate the mobility of skilled workers in local labour markets.

The main implementing agencies are responsible for the bulk of policies that support FDI-driven knowledge diffusion. Given its dual mandate to attract FDI into Portugal and support the internationalisation of the Portuguese economy, AICEP implements the majority of policies supporting value chain linkages and strategic partnerships between foreign and domestic firms. ANI, Portugal’s innovation agency, also implements a few programmes aimed at promoting R&D and technology collaboration between companies and between companies and research institutions, but these do not necessarily always involve foreign firms and their scope can be limited to collaborations between domestic firms only. On the other hand, the Portuguese SME agency, IAPMEI, focuses on improving the competitiveness and innovation of domestic firms and therefore implements most of the policies related to the absorptive capacity of SMEs. Aside from the main implementing agencies, other public institutions are involved in the implementation of FDI diffusion policies. Their involvement is, however, more prominent in supporting the broader enabling environment, namely the attraction of knowledge-intensive FDI, the support of Portuguese SMEs and the creation of agglomeration economies, rather than the FDI diffusion channels.

Portuguese policies and the FDI transmission channels and enabling factors they act upon

Source: (OECD, 2021, forthcoming[33])
these barriers through rules to address problems such as transfers and visas for personnel, clarity on
different environmental and technical standards, a lack of transparency in regulatory procedures, or
logistics issues. Similarly, recent IIAs have sought to strengthen competition on a level playing field for
incoming foreign investors, including through rules for greater transparency of subsidies for SOEs and
administrative decision-making processes.

Another feature of some recent IIAs that can affect productivity and innovation is disciplines on
performance requirements. These provisions, inspired by the WTO TRIMs Agreement, prohibit treaty
parties from imposing mandatory performance requirements on incoming foreign investors such as forced
technology transfers, local content or R&D quotas. Outright prohibitions on these types of regulation may
have an impact on policy space to achieve development goals, including by restricting the conditions for
spillover effects for the local economy when local SMEs make linkages with foreign MNEs. Some IIAs
adopt a more nuanced approach by creating express exceptions or reservations in some areas (e.g.
allowing governments to impose technology transfers on foreign investors as part of investment screening
review processes) or allowing governments to attach certain conditions to non-mandatory advantages
offered under domestic law (e.g. tax breaks, subsidies, etc) that would require foreign investors to perform
in some way to benefit the domestic economy (e.g. locate production, train or employ workers, carry out
R&D locally, etc). The impacts of such policies need to be carefully weighed and examined alongside other
factors that drive FDI spillovers such as SME absorptive capacities and the availability (or lack) of skills in
the local labour market.

Core questions to assess policies and institutions

This set of core questions provides guidance on how to assess policies and institutions that enhance the
impact of FDI on productivity and innovation, including on SMEs. These questions are structured around
specific aspects of the institutional setting, the broader policy framework, proactive policies and
programmes and international agreements and standards that matter for FDI transmission. Table 2.4
provides supplemental questions and suggestions for available tools to investigate these questions.
Available policy data are limited. Additional data collection, particularly using the OECD FDI Qualities
Mapping, developed for this policy toolkit (see methodology in Chapter 1), is required. The aim of this
exercise is also to identify potential data gaps and to draw attention to the importance of collecting data.

- **Institutional setting:** What is the quality of the broader institutional framework that affects the
  impact of FDI on domestic productivity and innovation? Do relevant institutions (i.e. investment
  promotion agencies, SME agencies, innovation agencies, regional development agencies) have
  enough decisional power and financial resources? Do these institutions coordinate their policies,
  activities and strategic priorities?

- **Regulatory framework:** Is the regulatory framework conducive for FDI to support productivity and
  innovation, particularly of SMEs? Are sectors that drive productivity and innovation growth open
to trade and FDI? Do competition rules ensure a level playing field for foreign and domestic firms
(particularly SMEs)? Do rules on intellectual property and labour market regulations support
productivity and innovation growth?

- **Targeted regulatory incentives:** Are regulatory incentives (e.g. eased administrative and
  licensing procedures) granted to investors that fulfil certain performance criteria? Does the
government impose local content requirements on foreign (and domestic) investors? Does the
government provide specific visas for investors and entrepreneurs?

- **Financial incentives:** Does the government provide direct financial support (e.g. grants, loans,
  wage subsidies) or tax incentives to attract investments into specific productivity-enhancing
  activities?

- **Technical assistance:** Does the investment promotion agency (or other government agencies)
  provide matchmaking services, organise demonstration and/or networking events involving foreign
and domestic firms, and engage in supplier development programmes or work placement and employee exchange programmes?

- **Business hubs and technology platforms**: Does the government sustain a local supplier database? Does the government have an online matchmaking platform? Do intermediary technology institutes and technology transfer offices exist? Do industrial parks exist?

- **International agreements and standards**: Is the country party of regional trade agreements or bilateral investment treaties, which incorporate provisions on fostering government cooperation on SMEs? Is the country party of regional trade agreements or bilateral investment treaties, which incorporate provisions on fostering technology transfer and local sourcing? Is this done through mandatory requirements or voluntary principles?

### Table 2.4. Supplemental questions and tools (preliminary)

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Policy questions</th>
<th>Indicator/Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Institutional setting</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Are there high-level cross-ministerial coordination mechanisms in the policy areas of investment promotion, entrepreneurship and innovation?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>Do investment promotion agencies, SME agencies and innovation agencies coordinate their policies, activities and strategic priorities to ensure that FDI creates linkages with the domestic economy?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>Do national institutions also operate at the subnational level? If not, do they coordinate with subnational authorities to ensure that local economy characteristics are taken into account when designing and implementing FDI transmission policies?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>Have relevant institutions set up mechanisms to consult with the private sector –foreign investors and local SMEs alike-- to receive feedback on the relevance of their policy programmes?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>Do relevant institutions monitor and evaluate the impact of their FDI diffusion policies to ensure that productivity and innovation spillovers actually occur?</td>
<td>OECD FDI Qualities Mapping</td>
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<tr>
<td><strong>Regulatory framework</strong></td>
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<tr>
<td>Openness to FDI and trade</td>
<td>Are sectors – in which productivity and innovation growth is targeted – open to trade (e.g. low import tariffs) and FDI? Are activities/sectors (e.g. services) that enable productivity growth in downstream sectors (e.g. manufacturing) open to FDI?</td>
<td>OECD FDI Regulatory Restrictiveness Index OECD Services Trade Restrictiveness Index</td>
</tr>
<tr>
<td>Complementary policies</td>
<td>Do competition rules ensure a level playing field for foreign and domestic firms (particularly SMEs)?</td>
<td>OECD Product Market Regulations Indicators</td>
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<tr>
<td></td>
<td>Are intellectual property rights (IPR) protected by adequate laws and regulations? Is IPR legislation well implemented?</td>
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<tr>
<td></td>
<td>Do labour market regulations strike a good balance between protecting labour and ensuring flexibility? Are these regulations adapted to the labour market and business reality on the ground (e.g. availability of skilled workers, absorptive capacities of SMEs) (see more specific questions in Chapter 4)</td>
<td>OECD Employment Protection Legislation Indicators</td>
</tr>
<tr>
<td></td>
<td>Are skills policies coherent with requirements of skills to implement policy objectives related to FDI, productivity and innovation? (see more specific questions in Chapter 4)</td>
<td>OECD SME and Entrepreneurship Outlook</td>
</tr>
<tr>
<td></td>
<td>Are financial market regulations ensuring that large and small firms can fulfil their financing needs?</td>
<td>OECD SME and Entrepreneurship Outlook</td>
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<tr>
<td><strong>Proactive policies and programmes</strong></td>
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<tr>
<td>Targeted regulatory incentives</td>
<td>Are regulatory incentives (e.g. eased administrative and licensing procedures) granted to investors that fulfil certain requirements (e.g. investments in productivity-enhancing activities, investments in specific geographic locations such Special Economic Zones, investments generating specific types of jobs)?</td>
<td>OECD FDI Qualities Mapping</td>
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<tr>
<td></td>
<td>Does the government impose local content requirements on foreign (and domestic) investors?</td>
<td>OECD FDI Qualities Mapping</td>
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<tr>
<td><strong>Financial incentives</strong></td>
<td>Does the government provide specific visas for investors and entrepreneurs (e.g. eased access to visas; eased procedures to apply for visas)?</td>
<td>OECD FDI Qualities Mapping</td>
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<td></td>
<td>Does the government provide direct financial support (e.g. grants, loans, wage subsidies) to attract investments into specific activities (e.g. value chain functions, job training, relocation to specific geographic areas)?</td>
<td>OECD Database on investment incentives</td>
</tr>
<tr>
<td></td>
<td>Does the government provide fiscal incentives? Which types of instruments are used (e.g. tax holidays, tax credits, tax allowances)? What eligibility criteria and performance requirements are applied (e.g. R&amp;D, supplier linkages, skills development, size)?</td>
<td>OECD Database on investment incentives</td>
</tr>
<tr>
<td><strong>Technical assistance</strong></td>
<td>Does the investment promotion agency (or other government agencies) provide matchmaking services (e.g. B2B meetings between foreign and domestic firms)?</td>
<td>OECD FDI Qualities Mapping</td>
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<td>Does the government organise demonstration and/or networking events involving foreign and domestic firms?</td>
<td>OECD FDI Qualities Mapping</td>
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<td></td>
<td>Does the government engage in supplier development programmes? What types of suppliers are they promoting? What is the technical and financial assistance suppliers are receiving? What is the scale of these programmes (i.e. how many firms are benefiting)?</td>
<td>OECD FDI Qualities Mapping</td>
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<tr>
<td></td>
<td>Does the government engage in work placement and employee exchange programmes to give workers the opportunity to improve their skills and get practical experience?</td>
<td>OECD FDI Qualities Mapping</td>
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<tr>
<td><strong>Business hubs and technology platforms</strong></td>
<td>Does the government sustain a local supplier database? If so, is it regularly updated? Is it easy to access (online) for interested firms and investors? Does the government have an online matchmaking platform serving as a single access point for B2B technology offers and requests?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>Do intermediary technology institutes and technology transfer offices exist? What services do they provide (e.g. foresight exercises, technology development, management of intellectual assets)?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>Do industrial parks exist? Are they accessible to both foreign and domestic firms? What services do they offer?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
</tbody>
</table>

**International investment agreements**

| Does the country party of regional trade agreements or bilateral investment treaties, which incorporate provisions on fostering government cooperation on SMEs and facilitating their internationalisation? | OECD FDI Qualities Mapping |
| Does the country party of regional trade agreements or bilateral investment treaties, which incorporate provisions on fostering technology transfer and local sourcing? Is this done through mandatory requirements or voluntary principles? | OECD FDI Qualities Mapping |

Note: The list of core questions is not exhaustive and will be extended further.

Source: OECD elaboration.


OECD (2020), “Enabling FDI diffusion channels to boost SME productivity and innovation in EU countries and regions: Towards a Policy Toolkit”.


https://doi.org/10.1787/9789264248533-en. [3]

https://doi.org/10.1787/9789264208667-en. [61]

https://dx.doi.org/10.1787/9789264208667-en. [84]

https://dx.doi.org/10.1787/empl_outlook-2014-en. [80]


OECD (2021, forthcoming), *FDI Qualities Assessment of Portugal: Enabling FDI diffusion for SME productivity and innovation*. [33]


This chapter provides an overview of policies that can boost FDI impacts on job quality and skills. It describes the main transmission channels of FDI impacts on labour market outcomes and related policies and institutions that can act upon these channels. The draft policy toolkit provided in this chapter builds and expands on Chapter eight “Developing human resources for investment” of the OECD Policy Framework for Investment. The policy toolkit aims to be aligned with other OECD instruments and strategies such as the Guidelines for Multinational Enterprises and the 2018 Jobs Strategy.
3.1. Building more resilient and inclusive labour markets

Achieving more resilient and more inclusive labour markets are more than ever key priorities for all governments – in developed and developing countries alike. While the global economy has been recovering from the global financial crisis for several years now, employment and wage growth remain sluggish, and levels of income inequality are unprecedentedly high in most countries. The COVID-19 pandemic has taken an additional toll on labour market resilience by causing activity to collapse and unemployment to soar. Poverty will rise for the first time since 1998, with hundreds of millions of jobs lost, and wage disparities will widen as labour income losses have been uneven across workers (ILO, 2021).

Policies in favour of job quality and skills development can play a significant role in building forward more resilient and inclusive labour markets. They can help improve individuals’ well-being as well as support labour force participation, productivity and economic growth. Creating better jobs and developing skills figure prominently in the Sustainable Development Goals (SDGs), particularly SDG4 (education) and SDG8 (economic growth). These goals aim to increase the number of people with relevant skills for employment and ensure that all can work productively and receive fair wages. Creating good jobs is also at the core of the OECD 2018 Jobs Strategy, which goes beyond job quantity and considers job quality, in terms of both wage and non-wage working conditions, as a key policy priority (OECD, 2018a). The Strategy also insists on the need to equip people with the right skills in a context of rapidly changing skills demands.

Yet governments still lack a comprehensive policy framework that can help them think about how investment – a key driver of labour market outcomes – influences job creation and skill upgrading. Private investment, and particularly foreign direct investment (FDI), together with international trade, technological change and digitalisation, have been shaping the world of work, with both positive and adverse impacts on host countries’ labour markets (OECD, 2019a). The COVID-19 crisis is the most recent illustration of that, with the fall in global FDI adversely affecting job creation (Figure 3.1). Many of the jobs affected by the pandemic depend on the operations of multinational enterprises (MNEs) and their suppliers in global value chains (GVCs). The pandemic has revealed how MNEs adapt faster to new forms of work by ramping up remote working more rapidly than domestic firms and, in turn, reducing health risks (OECD, 2020).

Figure 3.1. The impact of the COVID-19 crisis on jobs created through greenfield FDI

Jobs created in 1,000 (estimates)

Source: Author’s calculation from Financial Times fDi Markets, as of 10 September 2020.
3.2. FDI impacts on job quality and skills

FDI can have varying effects on host country labour market outcomes (Figure 3.2, right box). The establishment of a greenfield investment or a change in the nationality of a firm’s ownership affects the demand for skilled and unskilled labour, with concomitant effects on employment and wages. Evidence shows that FDI has broadly positive impacts on job creation and earnings, but not all countries and all segments of the population benefit equally (OECD, 2019a). More FDI often leads to wage dispersions across firms and workers, mostly due to an increase in the skill premium. FDI can also affect other working conditions, including job security, occupational health and safety at work and core labour rights. Whether FDI improves or undermines working conditions depends on the type of activity of foreign firms and the extent to which they export home country practices and norms or adopt instead those of the host country.

FDI effects on labour market outcomes involve several transmission channels (Figure 3.2, middle box). Outcomes can result from foreign firms’ direct operations in the host country, such as hiring new workers or firing incumbents following a foreign takeover or offering better or worse working conditions than domestic firms. Foreign firms’ direct operations have also spillover effects arising from: (1) their value chain relationships with domestic firms, whether buyers or suppliers; (2) market interactions through competition and imitation (or learning) effects; (3) and labour mobility of workers between foreign and domestic firms.

Figure 3.2. Factors influencing FDI impacts on job quality and skills

The premise underlying the existence of FDI spillovers is that foreign firms are technologically superior and more skill-intensive and, in turn, benefits might spill over to domestic firms. Value chain relationships or movement of workers between foreign and domestic firms can lead to knowledge spillovers, and in turn raise productivity, wages and employment levels. The same spillovers occur when domestic firms imitate foreign competitors. FDI spillovers on labour market outcomes are often specific to certain segments of the workforce, industries, or locations. They are also not always positive if, for instance, foreign firms have irresponsible labour practices with their suppliers or if competition for talent leads to lower quality of skilled labour in domestic firms. The intensity of such adverse impacts often depends on how fast the labour market adjusts to external shocks. For instance, FDI does not lead to an increase in the share of skilled workers and worsens wage disparities when skills shortages are severe and labour mobility is constrained.
The direction and magnitude of the combined direct and spillover effects of FDI on labour market outcomes ultimately depends on the economic structure of the host country and domestic firms’ characteristics (size, productivity level, skill-intensity, business and labour practices), labour market characteristics (employment levels, share of skilled labour, unionisation rates, etc.) and the policies and institutions in place (Figure 3.2, left box). While the next section focuses on the policies, the following sub-sections describe how FDI affects specific labour market outcomes, namely employment, wages, non-wage working conditions, and skills development. The last sub-section develops a list of questions and indicators that can guide governments in their efforts to better understand the conditions that influence FDI impacts on the labour market.

**Employment**

FDI can affect employment growth or contraction through changes in labour demand. Effects differ by investors’ entry mode (greenfield project versus M&A) and vary by workforce type (skilled vs. unskilled). Greenfield FDI projects have a positive and direct effect on the demand for labour, leading to job creation, at least in the short-term. A foreign takeover of a domestic firm could either have a positive or negative direct effect on jobs, but evidence shows that it often boosts employment growth as acquired firms’ productivity and market share grow (Coniglio et al., 2015; Ragoussis, 2020). In contrast, a divestment by a foreign firm is followed by a drop in employment (Borga et al., 2019; Javorcik and Poelhekke, 2017). Irrespective of their entry mode, foreign firms tend to have a higher demand for skilled workers than domestic firms due to technology advantages (Bandick and Karpaty, 2011; Hijzen et al., 2013).

Whether there will be net employment growth will also depend on FDI spillovers on domestic firms operating in the same supply chain, industry or geographical area. Empirical evidence is inconclusive. Foreign firms could introduce labour-saving techniques that are then adopted by domestic firms through imitation effects, leading to a transitory decline in labour demand, but the progressive integration of foreign firms into the local economy can create a positive effect on jobs in the long-run (Karlsson et al., 2009; Jude et al., 2016; Lee and Park, 2018). Nonetheless, FDI spillovers on employment growth are found to be negative if domestic firms are geographically far from foreign firms as imitation effects are less likely to occur while market competition effects are less sensitive to distance (Lembcke and Wildnerova, 2020).

The FDI Qualities Indicators confirm that FDI generates jobs, but unevenly across countries. The extent of job creation varies with the level of development and economic structure. FDI projects in mining or biotechnology (capital-intensive) generate fewer direct jobs per dollar invested than those in garment manufacturing or healthcare (labour-intensive), for instance. Accordingly, greenfield FDI in Costa Rica or in the Czech Republic create around 6 jobs per million dollars invested, three times more than in Kazakhstan or Luxembourg. The behaviour of foreign and domestic firms is similar in terms of labour adjustments due to business fluctuations. Over longer time spans, and when taking into account the possibility of spillovers, greenfield FDI relates positively to employment growth; but this does not apply to all countries. In the OECD, the positive FDI-employment growth relationship is more pronounced in countries where medium-tech industrialisation processes are, or have been, stronger and more sustained.

The COVID-19 pandemic, and the resulting decline in FDI as well as crippled MNEs operations adversely affected job creation. The decline in greenfield FDI reduced potential job creation by half in the first five months of 2020 (OECD, 2020). Furthermore, many businesses have had to lay off workers or reduce working hours. Nonetheless, preliminary numbers suggest that foreign businesses have cut jobs less than domestic firms. Perhaps some MNEs are more resilient to disruptions by relying on a larger set of suppliers and buyers. In addition, foreign firms have managed better than their domestic peers to adapt their modus operandi to the new work realities by ramping up remote working (Box 3.1).
Box 3.1. Foreign direct investment during the pandemic: A buffer for quality jobs?

The COVID-19 pandemic has caused foreign investors to curtail their operations in host countries, with knock-on effects on jobs, incomes and livelihoods. Some foreign firms have been able to shield their workforce from such impacts and are choosing to keep and pay employees during the suspension of their activities, but many businesses have had to lay off workers or reduce working hours of their staff.

A priority for companies operating during the pandemic is to protect the health and safety of workers, and to reduce their exposure to COVID-19 in the workplace. This can be particularly challenging in sectors such as garments, construction or healthcare. Foreign firms have managed relatively better than their domestic peers to adapt their modus operandi to the new business and work realities created by the crisis: 30% of foreign firms surveyed by the World Bank in 2020 started or increased their online activities, compared to only 25% of their domestic competitors. Similarly, almost 50% of foreign businesses had either begun or ramped up remote working; while only 27% of local firms did so.

Differences in the ability to perform jobs remotely have affected the impact of confinement and other social distancing measures on individuals’ employment outcomes. The impact is probably larger in poorer economies, where only few workers can telework (more skilled workers have higher odds to work remotely). MNEs can promote new forms of work in host countries, either through imitation effects or through business relationships with their suppliers. But not all tasks can be performed from home. FDI in business and digital services typically creates a high number of jobs, many of which can be done from home. FDI in other sectors, such as in manufacturing or healthcare, also create many jobs but which for the most part do not lend themselves to teleworking.

Source: OECD (2020)

Wages

In a competitive labour market, there is no reason why comparable foreign and domestic firms should pay different wages to workers with similar skills. Wage differences between the two groups arise, however, often because of other firm- and industry-specific features (Hijzen et al., 2013). These include firms’ size, productivity level, workforce skill intensity, product market power, and working conditions, such as job insecurity. Foreign firms may still pay higher wages to workers with similar skills and tasks, for example, to reduce turnover and lower the risk of technology transfer to competing firms through labour mobility.

The FDI Qualities Indicators and wider evidence confirm the role of productivity, technology and skills as engines to enhance living standards: foreign firms pay higher wages than domestic firms. This is true only to some extent, however. Foreign firms are on average twice as productive as domestic firms, but they pay only 50% higher wages (Figure 3.3). This means that performance premia of foreign firms are not fully translated into wage benefits for workers, possibly because MNEs are more active in highly-concentrated markets -- which in turn can generate rents. Such rents, and how they are shared with workers, can be due to policy pitfalls, such as barriers to competition (Criscuolo et al., 2020).

Foreign companies do not necessarily lift wages in all sectors and for all workers. The largest wage gains benefit skilled workers and, in the case of a foreign takeover, those moving from domestic to foreign firms, rather than incumbents, revealing the importance of labour mobility as a crucial transmission channel of FDI impact on wages (Hijzen et al., 2013). But foreign firms in low-paid activities do not always pay higher

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14 Hijzen et al. (2013) argue that one would expect the positive wage effects of foreign ownership to new hires to trickle down to the rest of the workforce with time.
salaries than their domestic peers. This is the case in Indonesia or Nigeria, among others (OECD, 2019a). Foreign firms also do not necessarily improve earning conditions of all workers within the firm. For instance, following a foreign takeover, workers at the bottom-end of the wage distribution may not experience as much wage growth as they would have, had their firm not been taken over by a foreign firm (OECD, 2008).

Figure 3.3. Foreign firms’ wage and productivity premia in OECD and emerging countries

Do foreign firms pay higher wages and are they more productive than their domestic peers? (yes if score > 0; no if score < 0)

Source: OECD FDI Qualities Indicators (OECD, 2019a).

Foreign entrants’ competition for talent with domestic firms drives up wages, but potentially reduces the ability of the latter to hire or retain more skilled workers (Lu et al., 2017). This effect is stronger, and lasts longer, in industries facing skills shortage and in locations with limited labour mobility. Beyond raising the demand for labour, especially of skilled workers, FDI affects competitors’ wages through skill-biased technological transfer (imitation effects). Empirical studies point to increased wages in domestic firms as a result of FDI in the same industry or location, particularly in developing countries where skilled labour is scarcer and the technology gap more substantial (Hale and Xu, 2016). FDI effects on wages can also occur in upstream or downstream firms having value chain relationships with foreign firms, but empirical studies are inclusive on the direction of these effects. The FDI Qualities Indicators show, to some extent, that local sourcing by foreign firms amplifies positive spillovers of FDI on wages (OECD, 2019a).

If FDI can enhance living standards, it may nonetheless raise income disparities through higher wage dispersion within the foreign firm and between foreign and domestic firms. In general, inequality between firms accounts for a sizeable share of the levels in overall wage inequality. Recent research shows that wage premia due to productivity-related rents is an increasingly important driver of between-firm inequality, even more than differences in workers’ characteristics, such as skills or gender (Criscuolo et al., 2020). This is relevant in a context where some MNEs are viewed as “superstar” or “winner-takes-most” firms with large market rents. Overall, FDI is likely to have a smaller impact on wage inequality in countries or regions with better absorptive capacity, including more adequate skills (Wu and Hsu, 2012; Lin et al., 2013).

Non-wage working conditions

Job quality also covers non-wage working conditions, including job security, occupational health and safety at work and core labour standards. Foreign and domestic firms may have differentiated impacts on these working conditions but, as for the foreign wage premium, differences often reflect firm- or industry-specific characteristics and are not specific to the ownership status. Foreign and domestic firms could be active in
different sectors where companies have different survival rates, worker turnover rates, or propensities to use temporary contracts, the latter providing less protection to workers. Yet, other working conditions are shaped by foreign firms’ intrinsic characteristics, such as more advanced management practices than in domestic firms, and good management can be a critical component of a good job, in turn leading to higher job satisfaction and better health (Bloom et al., 2016). FDI effects on non-wage working conditions might also be contingent on foreign firms exporting their home country labour practices, and diffusing them to domestic firms, or responding instead to the host country’s labour standards. Overall, there is little evidence to suggest that MNEs export their working conditions abroad (Almond and Ferner, 2006; OECD, 2009).

The empirical evidence on foreign firms’ impacts on job security is mixed. The FDI Qualities Indicators provide some evidence that FDI is associated with lower job security. This could be due to the fact that MNEs can rapidly move activities across borders in response to wage movements or changes in labour markets regulations (Cunat and Melitz, 2007; Feenstra, 2008). The observed relationship could also reflect foreign firms’ concentration in sectors with more exposure to global trade fluctuations, or in areas under special regulatory regimes with more flexible labour rules, such as in some special economic zones. Empirical literature examining these aspects does not provide a clear-cut response, however (Bernard and Sjöholm, 2003; Bernard and Jensen, 2007; Hijzen et al., 2013; Javorcik, 2014). There is also no evidence that foreign firms compensate workers for increased job insecurity or more difficult working conditions by paying higher wages (Hijzen et al., 2013; OECD, 2017).

There is a dearth of evidence relating FDI to occupational health and safety at work. Some studies suggest a positive correlation between fewer job accidents rates and FDI (Alsan et al., 2006; Flanagan, 2006). Herzer and Nunnenkamp (2012) find a negative effect of FDI on population health. The FDI Qualities Indicators show that greenfield FDI tends to be concentrated in activities with higher risks of occupational injury, including in OECD countries, such as in manufacturing or infrastructure. During the COVID-19 pandemic, foreign firms have managed better than domestic business to adapt their modus operandi to the new work realities by ramping-up teleworking, potentially reducing workers’ exposure to Covid-19 in the workplace (Box 3.1). MNEs could accelerate the adoption of new forms of work in host countries through competition and imitation effects, labour mobility, or relationships with their suppliers or buyers.

Evidence indicates that inward FDI and core labour standards, which cover the freedom of association, the abolition of forced and child labour and the eliminations of discriminations at work, are positively correlated (Kucera, 2002; OECD, 2009). MNEs may shy away from investing in countries with low labour standards because of reputational risks and to fulfil international standards on responsible business conduct or core labour rights, sometimes adopted in home country regulations. This however does not say whether, once they are operating, foreign firms would help improve working conditions, including in their relationships with local suppliers and buyers.

FDI impacts on non-wage working conditions may also be increasingly affected by trends in digitalisation, which are themselves accelerated by cross-border investment. New business models are emerging, including the platform economy, in which self-employed workers provide services through online platforms often owned by foreign firms. These flexible working arrangements have created new jobs but also raised concerns about job security, poor working conditions and a weak bargaining position vis-à-vis platform firms (OECD, 2019b). Work through platforms is still a limited phenomenon in both developed and developing countries, and the exact impact of FDI on related working conditions is yet to be explored.

Skills development

The previous sections have described how FDI affects employment and wages by raising the demand for skilled labour. FDI – especially from more advanced economies – often brings new technologies that

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15 There is also no evidence that wage gains from foreign ownership come at the expense of job-security (Hijzen et al., 2013), consistent with theories which stress the role of higher wages in preventing worker movement.
require complementary skills. If, as a result, skilled employment increases more than unskilled employment, the share of skilled workers in the host country will also grow. A plethora of studies have shown that FDI raises the demand for skilled workers. The most typical and salient example is Mexico's maquiladoras where FDI has accounted for over 50% of the increase in the skilled labour wage share that occurred in the late 1980s (Feenstra and Hanson, 1997). Other studies have confirmed since then that FDI has led to an increase in the demand for skilled labour (Bandick and Hansson, 2009; Bandick and Karpaty, 2011; Peluffo, 2015).

That foreign firms raise the demand for skilled-labour in a specific industry does not necessarily imply they operate in high-skilled sectors of the host economy. The FDI Qualities Indicators show that FDI tends to be concentrated in sectors with lower shares of skilled workers in countries with competitive wages and labour-intensive manufacturing activities (OECD, 2019a). FDI could also affect the demand for specific tasks that parent companies want to offshore (Autor et al., 2003; and Levy and Murmane, 2004). For instance, routine tasks can be more easily offshored, thus explaining why foreign affiliates in developing countries may be less skill-intensive than their parent company (but not necessarily less than domestic firms in the same industry).

Foreign investors can also increase the supply of skills by providing training to their employees or to those of domestic companies as part of support activities (Crespo and Fontoura, 2007; Paus and Gallagher, 2008; Tong 2018). They may also induce local firms to invest in human capital in response to rising competitive pressure from their presence in the market (competition effects) or to imitate more profitable foreign firms’ practices (imitation effects), including by training workers (Blomström and Kokko, 2003). Contrary to existing findings, the FDI Qualities Indicators show that foreign and domestic firms have similar on-the-job training practices. The indicators also show that, at least in the majority of OECD countries, FDI is concentrated in sectors with lower shares of trained workers (OECD, 2019a).

Through impact on both the demand and supply of skilled labour, FDI can enlarge the share of skilled workers in the host country, which, in turn, creates a virtuous circle as new investors will select the location for their knowledge-intensive projects. Ultimately, FDI impacts on skill development will depend on how fast the supply side can respond to increased demand for skilled labour. When skill shortages exist in a region or industry, labour market adjustments from an unskilled to a skilled labour force can be lengthy and costly (Hale and Xu, 2016). In that case, foreign entrants will offer much higher wages to attract available talent, thus exacerbating wage disparities and crowding out employment in domestic firms, without raising the share of skilled workers in the host economy, at least in the short-term. This illustrates the importance of addressing skill shortages and promoting labour mobility across regions and industries as ways to reap the benefits of FDI for skills while mitigating adverse distributional impacts (Becker et al., 2020).

Core questions to analyse impacts

The set of core questions in Table 3.1 provides the analytical framework for understanding the role and potential of FDI for job quality and skills development in host economies. The aim of this exercise is also to identify potential data gaps in national statistics and to draw attention to the importance of collecting data. The set of questions is structured around the following areas:

- **Structure of the economy**: FDI is expected to have different impacts on labour market outcomes depending on the sector (e.g. labour- or skill-intensive sector) or region of investment. The sectoral composition varies according to the structural characteristics of the host country, such as its level of development, comparative advantage, integration and position in GVCs. Domestic firms’ characteristics such as their size, productivity level, skill-intensity, or business practices also shape FDI direct (in case of a foreign takeover) and spillovers impacts on labour market outcomes. For instance, domestic firms with higher absorptive capacities will benefit more from foreign firms’ skill-biased technological transfers.
- **Labour market characteristics**: A plethora of labour market features shape how the demand and supply of labour adjust to foreign firms’ entry and operation and, in turn, their impacts on labour market outcomes. These include, inter alia, the level of employment rates, the extent of skills shortages, workers’ bargaining power, trade union density, the degree of labour mobility, and the labour practices of domestic firms.

- **FDI characteristics**: Different types of FDI may have different impacts on the labour market. For example, efficiency-seeking FDI is likely to create less stable jobs than FDI driven by the search market-seeking FDI. Similarly, greenfield FDI projects are expected to have a greater impact on employment than M&A deals, at least in the short term. The country of origin of FDI is also relevant, as firms from countries with higher labour standards may transfer their practices to domestic firms.

- **FDI transmission channels**: FDI may affect labour market outcomes both directly, through the foreign firm activities, or through spillovers via value chain linkages, competition and imitation effects and labour mobility. While direct impacts involve workers of foreign firms, spillovers affect the wider labour market within an industry, subnational region or country.

### Table 3.1. Core questions and data tools (preliminary)

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Questions</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Structure of the economy</td>
<td>Which sectors and activities drive most labour market outcomes?</td>
<td>OECD and ILO statistics</td>
</tr>
<tr>
<td></td>
<td>Does the country have a comparative advantage in labour-intensive sectors?</td>
<td>UN Comtrade Database</td>
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<tr>
<td></td>
<td>Is there a productivity/skills gap between domestic and foreign firms?</td>
<td>OECD FDI Qualities Indicators</td>
</tr>
<tr>
<td></td>
<td>Are observed regional disparities high in comparison with other countries?</td>
<td>OECD Regional Database</td>
</tr>
<tr>
<td>Labour market characteristics</td>
<td>What are the the rates of employment and unemployment in the economy?</td>
<td>OECD and ILO statistics</td>
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<tr>
<td></td>
<td>What is the percentage of skilled workers in the economy?</td>
<td>OECD and ILO statistics</td>
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<td></td>
<td>What is the extent of labour mobility in the economy?</td>
<td>National statistics and empirical research</td>
</tr>
<tr>
<td></td>
<td>What is the extent of skills shortages in the economy?</td>
<td>National statistics and empirical research</td>
</tr>
<tr>
<td></td>
<td>What is the percentage of workers with the right to bargain? What is the</td>
<td>OECD and ILO statistics</td>
</tr>
<tr>
<td></td>
<td>trade union density?</td>
<td></td>
</tr>
<tr>
<td>FDI characteristics</td>
<td>What types (greenfield vs. M&amp;A) and motives of FDI are more conducive to</td>
<td>Refinitiv; Financial Times’ fDi Markets; World Bank Enterprise Surveys</td>
</tr>
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<td></td>
<td>positive labour outcomes in the economy?</td>
<td></td>
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<tr>
<td></td>
<td>Is FDI concentrated in sectors with higher labour- or skill-intensity?</td>
<td>OECD FDI Qualities Indicators</td>
</tr>
<tr>
<td></td>
<td>Is FDI concentrated in sectors with lower occupational injuries?</td>
<td>OECD FDI Qualities Indicators</td>
</tr>
<tr>
<td></td>
<td>What is the share of FDI from countries with higher labour standards?</td>
<td>National statistics and empirical research</td>
</tr>
<tr>
<td>FDI transmission</td>
<td>Are average wages higher in foreign firms relative to domestic firms?</td>
<td>OECD FDI Qualities Indicators</td>
</tr>
<tr>
<td>channels</td>
<td>Do foreign firms train more theirs workers than domestic firms do? To which</td>
<td>OECD FDI Qualities Indicators; National statistics and empirical research</td>
</tr>
<tr>
<td></td>
<td>extent foreign they also train workers of their suppliers?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Is job security higher in foreign firms relative to domestic firms?</td>
<td>OECD FDI Qualities Indicators</td>
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<tr>
<td></td>
<td>Is labour mobility between foreign and domestic firms happening and does it</td>
<td>National statistics and empirical research</td>
</tr>
<tr>
<td></td>
<td>contribute to skills transfers and wage growth?</td>
<td></td>
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<tr>
<td></td>
<td>Is FDI associated with positive/negative competition effects and imitation?</td>
<td>National statistics and empirical research</td>
</tr>
</tbody>
</table>

Note: The list of core questions is not exhaustive and will be extended further.

Source: OECD elaboration.
3.3. Policies that influence FDI impacts on job quality and skills

Policies that are conducive to investment in general influence the FDI entering the host country and its labour market implications (OECD, 2015). But they are not sufficient to act on desired transmission channels of FDI impacts on job quality and skills development. Beyond a conducive investment climate, policymakers must ensure that product and labour market regulations can positively influence FDI impacts on workers while still protecting the most vulnerable. Flexibility in product and labour markets is, however, not enough to deliver quality jobs. It should be combined with proactive measures that address specific market failures resulting from information imperfections or externalities resulting from FDI. Such government intervention can cushion or amplify FDI spillover effects on the labour market, including distributional effects. Beyond policies and measures implemented at national level, policymakers need to promote internationally-agreed principles that can help ensure, inter alia, high labour standards in the operations of foreign firms (Table 1.2).

Table 3.2. Examples of policy instruments influencing FDI’s impacts on job quality and skills

<table>
<thead>
<tr>
<th>Policy type</th>
<th>Policy instrument</th>
<th>Direct impact</th>
<th>Spillovers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>supply chain</td>
<td>competition</td>
</tr>
<tr>
<td></td>
<td></td>
<td>relationships</td>
<td>&amp; imitation</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>Openness to foreign investment</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Pro-competition regulations</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Employment protection legislation</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Collective bargaining rights</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Other labour regulations and standards</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Proactive policies and programmes</td>
<td>Incentives to stimulate labour demand</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Information &amp; matchmaking services</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Training &amp; skills development programmes</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Skills anticipation systems</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>International agreements and standards</td>
<td>Ratification of ILO’s core labour conventions</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Trade and investment agreements</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Multilateral initiatives involving labour standards</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Agreements between MNEs and global unions</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Note: This table serves as a starting point for the mapping of policies and institutions that will inform the policy toolkit. It is not intended to be exhaustive and will be further updated as the Toolkit is developed. Some policy instruments can have an impact on multiple transmission channels. For simplicity, only the most important ones are selected here.

The majority of policies in Table 1.2 do not explicitly target foreign firms, but they are particularly relevant to ensure that FDI has positive impacts on labour market outcomes. Indeed, the contribution of foreign firms to job quality and skills development is often linked to their performance, an aspect that does not justify developing specific policies for them. Nonetheless, the extent to which foreign and domestic firms react to the same policy setting can vary, together with their respective labour market outcomes. For instance, MNEs can choose to move production across subsidiaries following a policy change in one host country. An option that domestic firms do not have. Policymaking should take into consideration these differentiated impacts on foreign and domestic business, including through policy co-ordination. Several institutions are involved in the design and delivery of policies in Table 1.2, including ministries in charge of investment, labour and skills development policies, specialised agencies such as investment promotion agencies or public employment services, subnational bodies, labour unions, and the MNEs themselves.
**Regulatory framework**

Product and labour market regulations influence foreign firms’ direct impacts on job quality and skills as well as the transmission channels of FDI spillovers on the labour market. Most regulations treat foreign and domestic investors alike, but the extent to which they affect the two groups of firms, and influence their respective impacts on labour market outcomes, can vary. Some regulations directly affect foreign business location choice, characteristics and, in turn, labour market impacts. Product and labour market policies also affect how labour markets adjust in response to FDI entry and spillovers. Impacts on jobs, wages and skills is likely to be greater in settings with efficient resource reallocation. Solid collective bargaining institutions and high labour standards are however fundamental to ensure that FDI also benefits the most vulnerable such as low-skilled workers, and limits potential adverse impacts on increased wage disparity.

**Openness to foreign investment**

Discriminatory measures on foreign investors’ entry and operations deters FDI and, in turn, potential labour market gains from higher investment. Forgone FDI benefits hinge on the labour or skill-intensity of restricted sectors as well as their propensity to increase labour supply – increased investment in higher education could support the growth of a skilled workforce. The type of discriminatory measure also matters. Joint venture requirements may push foreign investors to limit skills transfers while restrictions on the employment of foreign personnel in key management positions may limit the diffusion of managerial expertise (Moran, Graham and Blomström, 2005).

Governments often introduce FDI restrictions to protect domestic firms (and their workers) from foreign competition or to ensure that FDI generates high development benefits, for instance when investor entry is conditional on mandatory job creation requirements. But these policies may not be optimal for tackling such concerns as they create uncertainty and negatively influence foreign investors’ decisions (Mistura and Roulet, 2019). By limiting competitive pressures, FDI restrictions also deter innovation and potential learning opportunities by domestic competitors, and related productivity spillovers that can help them retain their workers in better jobs (see Chapter 2).

Whether openness to foreign investment leads to positive impacts of FDI on labour market outcomes also depends on the time horizon. For instance, removing restrictions on foreign equity in the services sector can crowd out domestic firms in the short-term as most of them operate exclusively within the domestic market. Indeed, FDI in services is often associated with the largest increases in wage inequality because lower-skilled workers are displaced in favour of higher-skilled workers. But in the longer-term services liberalisation improves productivity in other sectors (Chapter 2) and can therefore assist indirectly in creating more and better-paid jobs. Governments could prioritise promoting service sectors that are export-oriented to limit the potential increase in wage inequality from services FDI in the short run (Steenbergen and Tran, 2020).

**Pro-competition regulations**

Together with FDI restrictions, other regulations affect the degree of product market competition, including barriers to international trade, barriers to entrepreneurship and state control of business enterprises. Product market competition can reduce foreign firms’ entry and operation costs, increase their productivity and, in turn, job-creating potential (Fiori et al. 2012; Gal and Theising, 2015). Enhanced competition can also help contain rents of large foreign firms active in highly-concentrated markets. More generally, strengthened competition could contain rents that are unrelated to innovation in “superstar” firms operating in global markets with high mark-ups and low labour shares as a result of high product market concentration (Criscuolo et al., 2020; Autor et al., 2020). Such rents of foreign firms could also be contained by levelling the playing field in terms of tax policies, as MNEs are often better able to reduce their tax burden through tax optimisation measures than domestic firms (Johansson et al., 2017).
The impact of product market reforms on FDI and related labour market outcomes also depends on host country labour market regulations. For instance, when workers’ bargaining power is high, possibly because of more stringent employment protection legislation, and the economy is far from full employment, a decline in firms’ mark-up due to product market reforms can lead to larger employment increases than in a context with more flexible labour markets (Fiori et al., 2012). The basic intuition behind is that, with less flexible labour markets, employment will be further away from its full employment level. This example shows that institutions should take into consideration product and labour policy interactions when collectively thinking about ways to boost FDI impact on job creation.

Employment protection legislation

Stringent employment protection legislation can increase firms’ labour adjustment costs but also improves job security. Evidence indicates that greater flexibility of the host country’s labour market matters for the location choice of foreign investors and affects FDI volumes – and thus potential job creation – as well as their knowledge intensity. For instance, stringent legislation can deter FDI in the services sector more than in manufacturing (Javorcik and Spatareneau, 2005). It may also dissuade R&D firms from locating their radical innovation activities as these need drastic employment adjustment because workers with new skills are needed to implement the innovation (Griffith and Macartney, 2014). There is also some evidence that it is the stringent legislation on regular contracts that can adversely affect FDI-related employment size, and less the legislation on temporary work (Gross and Ryan, 2008). But job security also protects workers from being fired in response to small fluctuations, which can encourage them to invest in long-term training.

Employment protection legislation may matter less for foreign firms that can move production across subsidiaries or that are attracted by markets with low production costs (Leibrecht and Scharler, 2009; Cuñat and Melitz, 2012). These firms be able to bargain from a privileged position with host governments and unions, thus obtaining exceptions on hiring and firing practices (Navaretti et al., 2003). Notwithstanding the additional leeway foreign firms may have over domestic companies, their divestment decisions might still be affected by regulations such as those on collective dismissals – which often cover large firms – particularly footloose large foreign firms.

Employment protection legislation also affects how the labour market adjusts in response to FDI entry and spillovers. For instance, stricter employment protection can deter or delay labour mobility from domestic to foreign firms while it is typically via this channel that FDI enhances wages in host countries (Hijzen et al., 2013). But it may also protect vulnerable workers that otherwise would have been displaced and losing out via long unemployment spells or lower wages in post-displacement jobs. When local absorptive capacities are sufficiently high, more flexible labour markets can host FDI without necessarily reducing employment or increasing wage disparities between foreign and domestic firms (Becker et al., 2020).

Collective bargaining and workers’ voice

FDI, together with innovation, trade and migration transform the world of work. Collective bargaining and workers’ voice can ensure that all workers and companies benefit from current transformations by helping formulate solutions to emerging issues (e.g. robotisation), and complement policies to anticipate skills needs, or support displaced workers in new forms of work (OECD, 2019b). Indeed, sector-level collective bargaining is associated with lower wage inequality while wages and other working conditions tend to be higher in firms with a workers’ representation (OECD, 2019b; Freeman et al. 2020).¹⁶

Effective systems of collective bargaining can be particularly important in the context of large and profitable foreign firms: The FDI Qualities Indicators suggest that foreign firms’ productivity-related rents do poorly

¹⁶ OECD (2019b) finds that there is a wage premium for workers who are covered by firm-level bargaining compared with those not covered or those covered only by sectoral bargaining while wage dispersion is smallest among workers who are covered by sector-level bargaining compared with systems based on firm-level bargaining only.
translate into wage benefits, particularly in less skill-intensive foreign firms. Sharing productivity-related rents is observed less among firms with lower-skilled workers because of workers' lower bargaining power. Collective bargaining could help achieve better rent-sharing (Criscuolo et al., 2020).

In practice, even when there is a right to collectively bargain in the host country, foreign firms' negotiation power may still differ from that of domestic firms, possibly reflecting union fears that wage demands (or negative shocks) may lead to the relocation of production to other countries (OECD, 2008). One consequence of this bargaining imbalance has been the development of transnational workers' representations to better coordinate workers' bargaining policies. For instance, in the EU, European Works Councils are consulted by MNE management on decisions at European level that affect workers' employment or working conditions (see also section on international agreements and standards).

Other labour regulations and standards

Minimum labour standards ensure that those practiced by foreign firms are not less favourable than those by domestic firms. This helps ensuring that FDI is not worsening working conditions in host country. Labour standards can be established through legislation, collective agreements or both. Core labour standards identified by the ILO aim to: 1) eliminate all forms of forced or compulsory labour; 2) effectively abolish child labour; 3) eliminate discrimination in respect of employment and occupation; and 4) ensure the freedom of association and the right to collective bargaining. Other labour regulations and standards relate to working-time arrangements, minimum wages, health and safety at work, or legislation on foreign workers (see section on international agreements and standards).

Countries may not want to raise or enforce labour standards because they fear this will deter foreign investors. But empirical evidence suggests that lowering labour standards does not facilitate, and may even discourage, FDI and might also change its composition and related societal benefits (Kucera, 2002; OECD, 2008). This equally holds in special economic zones, where governments should further harmonise labour standards, in particular minimum wages or restrictions to freedom of association, with those in the wider economy. Evidence shows that there is no strong link between higher formal labour standards and better actual labour practices, indicating that labour standards are not always properly enforced (OECD, 2009). This is likely to reflect institutional weaknesses and insufficient resources.

When foreign firms export their home country labour standards practices, and these are higher than those of the host country, then FDI may even improve working conditions, including through imitation effects or through relationships with local suppliers. There is, however, limited evidence that foreign firms export their home country labour standards. But this depends on the type of labour practice. For instance management practices are more advanced in foreign firms than in domestic firms, and good management can be a critical component of a good job. Foreign firms have also relied significantly more than domestic firms on teleworking arrangements during the COVID-19 pandemic (OECD, 2020). With support from labour unions, they could play a leading role in adapting themselves to new work realities, and their good practices could serve as a basis for domestic reforms that can improve labour standards.

Proactive policies and programmes

Proactive policies and programmes can help governments act on desired labour market outcomes of FDI, including by influencing specific transmission channels of FDI spillovers. Some policies aim at stimulating labour demand by attracting investment in specific occupations, sectors or locations. Other policies aim at increasing the supply of adequate skills – and strengthening domestic absorptive capacities – or mitigate potential adverse effects of FDI by supporting displaced or vulnerable workers.

Such mutually-reinforcing policy interventions are warranted as FDI spillovers effects on the labour market are externalities that can be both positive and negative. They are also crucial to meet the challenges that automation, digitalisation or trade – all accelerated by FDI – impose on the labour market. But policies
must be carefully designed to ensure the right mix. Co-ordination efforts across investment, employment and skills development institutions are crucial as some policies target firms and others target individuals, and could be equally viewed as active labour market policies, place-based development policies or investment promotion policies.

**Tax and financial incentives to stimulate labour demand**

Governments use a wide range of tax and financial incentives that may induce directly or indirectly firms to create jobs, raise wages and train workers. They usually do not differentiate between foreign and domestic investors but in practice some incentives tend to target foreign investors – for instance through criteria on investment size – as labour market gains from FDI can be high. There is a variety of incentives, each potentially targeting a specific labour market outcome and influencing a specific transmission channel of FDI impacts. But incentives also distort competition and are not always cost-effective in inducing firms to create quality jobs, although this depends on the instrument and the targeting strategy. Governments that make use of such incentives need to periodically evaluate their appropriateness and relevance.

Tax holidays are a typical instrument governments use to attract investors with the hope to stimulate labour demand. They can target projects in labour or skill-intensive sectors or in regions with low employment shares. Tax credits and subsidies are another instrument that can be directly tied to the performance of firms in terms of jobs created, the wage bill, or trained workers. They can target specific groups such as R&D workers, youth or women (see Chapter 4). But evidence on their effectiveness in increasing employment or earnings is mixed in both developed and developing countries (McKinsey, 2017; Bown and Freund, 2019). When they are not well targeted, incentives might benefit firms that did not need support to hire or train workers in the first place. Tax credits can also influence a specific transmission channel of FDI spillovers, such as support to firms that train workers of their domestic suppliers. Likewise, tax credits may induce domestic firms to upgrade their workers' skills in response to foreign competitive pressure.

Some governments make special deals with large firms operating in attractive sectors, typically foreign firms, and offer them upfront discretionary incentives packages for commitments to create a certain number of jobs. Such packages are often not very cost effective and they do not necessarily increase broader economic growth according to empirical evidence from the United States (Bartik, 2018; Slattery and Zidar, 2020). Furthermore, large firms receiving upfront tax incentives could fail to fulfil employment requirements predicated on ex-ante contractibility because of rapidly changing environments (Rodrik and Sabel, 2019).

Incentives aiming to mitigate the adverse effects of downturns on labour markets could particularly help foreign businesses. For instance, during the COVID-19 pandemic, many governments provided wage subsidies to employers to prevent layoffs and compensate for wage reductions. Foreign firms relied more than other firms on these subsidies, possibly because they tend to adjust labour by decreasing the number of hours worked, and thus lowering wages, more than through layoffs (Figure 3.4). Perhaps foreign firms find it costly to reduce their workforce during a crisis: higher skilled staff are typically harder to find and firms will face substantial competition to attract them once the recovery occurs (OECD, 2020). They may also be more resilient to crises due to their ability to shift temporarily production to other subsidiaries.
Figure 3.4. COVID-19 pandemic: foreign firms relied more on active labour market policies

![Diagram showing wages and workforce levels](image)

Note: Each indicator is an average of the 19 countries covered by the World Bank Enterprise Survey “Covid-19: Impacts on Firms”. The countries are: Albania, Chad, Cyprus, El Salvador, Georgia, Greece, Guatemala, Guinea, Honduras, Italy, Jordan, Moldova, Nicaragua, Niger, Russian Federation, Slovenia, Togo, Zambia, and Zimbabwe.

Source: Author’s calculations based on the World Bank Enterprise Surveys “Covid-19: Impacts on Firms”.

**Information programmes and matchmaking services**

Proactive policies such as active jobs information programmes or matchmaking services can lower search costs and reduce information gaps in the labour and product markets. These policies can be particularly helpful for job seekers or workers in vulnerable communities such as lower-skilled workers, youth and women (Steenbergen and Tran, 2020). Some displaced workers can lose out following FDI entry and spillovers via long unemployment durations or activity in lower-paid jobs. Supporting job seekers with active jobs information programmes and workers in low-paid jobs with matchmaking services, MNEs secondment programmes and FDI-supplier linkages programmes can help them adjust to changes in the marketplace and find better job opportunities.

Information programmes to stimulate internal labour mobility could particularly help job seekers from areas with lower employment rates. The largest market failures in labour markets occur geographically, with very different employment opportunities for the same skills depending on where individuals are located (Mckenzie, 2017). As FDI often creates more jobs in urban areas, governments could help nearby communities by lowering search costs and offering public information about available jobs (Steenbergen and Tran, 2020). Programmes providing information about job opportunities in a different location or subsidising job search in different parts of the city has been found to be effective (Jensen, 2012; Franklin, 2015; Abebe et al. 2016).

**Training and skills development programmes**

Training and skills development policies features prominently among the various policies affecting a country’s enabling environment for investment and economic development (OECD, 2015). They must be developed in line with the country’s development and investment strategies, and in consultation with workers and the private sector. By reducing skills mismatch and shortages, training and skills development programmes can help increase the share of skilled workers following FDI entry or expansion, including in domestic firms that will be more able to absorb potential spillover benefits (Becker et al. 2020). The FDI
Qualities cluster on “productivity and innovation” provides further insights on policies that can strengthen the absorptive capacity of domestic firms (see Chapter 2).

Training programmes by government agencies, albeit costly, have shown some success when well-designed and targeting the right beneficiaries (Bown and Freund, 2019). For instance, sectoral training or re-training programmes in transferable certifiable skills can facilitate labour mobility and help workers move to better-paid jobs (Kratz et al. 2020). These programmes could be particularly helpful for vulnerable workers affected by rapidly changing labour markets due to, inter alia, evolving needs of multinationals. Pre-employment training programmes can help host countries quickly respond to the needs of foreign firms considering to invest. One example is Assured Skills, a state programme in Northern Ireland that prepares and trains workers for guaranteed jobs in new foreign firms.

Governments can also partner with the private sector in skill provision by inducing companies to train their workers. For instance, on-the-job training programmes contribute to a more flexible workforce and, in turn, to higher wages; and foreign firms tend to rely on them at least as much as domestic firms do (Almeida and Faria, 2014; Konings and Vanormelingen, 2015). Providing all firms with financial support to run such programmes is, however, not always a cost-effective solution. Companies that compete in high-productivity environments, such as foreign firms, need to provide on-the-job training in any case because it is critical to their productivity and survival. Policies to increase on-the-job training demand need to consider other policy aspects, such as encouraging product market reforms to increase competition (Sara, 2018).

**Skill needs assessment and anticipation systems**

Multinationals are key drivers of megatrends such as technological change and trade which influence the kind of jobs that are available and the skills needed to perform them. Collecting information on foreign firms’ skills needs will help governments developing adequate policies, such as training programmes, that can prevent skills mismatches and shortages as well as to reduce retraining costs. Many countries have put in place systems and tools for assessing and anticipating skills needs, but limited co-ordination between stakeholders is often a barrier preventing the information from being used further in policy making (OECD, 2016). Ministries of Labour and Education, the statistical offices and employer organisations are the actors most frequently involved in skills assessment and foresight exercises. Involving investment promotion agencies in such exercises could help reduce the gap between the information produced and the needs of multinationals. Investment promotion agencies have access to unique information on foreign firms’ operations, and often run surveys to identify their current challenges (OECD, 2018b).

**International agreements and standards**

Policies to boost FDI impacts on job quality and skills development can go beyond unilateral measures and also include internationally-agreed principles that can help ensure, inter alia, minimum labour practices in the foreign operations of MNEs. Those principles can be instigated and implemented by national governments, such as ratifying ILO’s international labour conventions or including labour provisions in International Investment Agreements. They can also consist of non-binding recommendations addressed directly to MNEs, such as the OECD’s Guidelines for Multinational Enterprises, or agreements negotiated between MNEs and global union federations that can help commit the MNE to apply common labour standards across its global operations.

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17 For instance, ILO’s “Skills for Trade and Economic Diversification” guide recommends to disaggregate data between foreign and domestic businesses when FDI accounts for a significant part of a sector. The guide helps governments design skills policies that can anticipate and prepare for new employment opportunities.
Ratification of ILO’s international labour conventions

International labour standards are an essential component in the international framework for ensuring that the global economy, including FDI, provides benefits to all. The ILO Declaration on Fundamental Principles and Rights at Work (1998) represents the most widely accepted effort to define a set of core labour standards that may be considered universal. It refers to four areas of labour rights – mentioned above under “other labour regulations and standards” – and covers eight fundamental conventions, namely the: Freedom of Association and Protection of the Right to Organise Convention; Right to Organise and Collective Bargaining Convention; Forced Labour Convention; Abolition of Forced Labour Convention; Minimum Age Convention; Worst Forms of Child Labour Convention; Equal Remuneration Convention; and Discrimination (Employment and Occupation) Convention.

The large majority of countries has formally subscribed to some or all parts of the ILO Declaration, with important implications at the national level as the ratification of ILO conventions is strongly correlated with changes in national labour laws. Indeed, many developing countries where poor labour practices in the operations of foreign firms have been a concern tend to have reasonable de jure labour standards, in some cases comparable to those in developed countries. But poor labour practices in the operations of foreign firms, and businesses more generally, reflect weak public enforcement of national and international labour provisions. Indeed, non-compliance with international labour provisions by foreign firms and their suppliers continues to be a pressing concern in many countries with weak rule of law.

International investment agreements

International investment agreements (IIAs), including bilateral investment treaties (BITs) or arrangements on investment and labour that are included in a larger economic agreement, like a free trade agreement (FTA), can influence FDI direct impacts and spillovers on labour market outcomes, including on working conditions. The nature of governments’ obligations and the scope of commitments undertaken can significantly differ across IIAs (Table 3.3). The majority of investment treaties in force today contain no provisions that directly address labour issues but instead focus on post-entry protections for covered investors. More recent treaties that expressly address labour issues – predominantly trade agreements that also address investment – do so in a variety of ways. IIAs can prompt governments to strengthen domestic regulation or cooperate with respect to labour regulations and standards. IIAs can also set rules for businesses that invest abroad and influence investor conduct in relation to working conditions.

Table 3.3. Illustration of how IIAs explicitly address labour regulations and standards

<table>
<thead>
<tr>
<th>Policy objective</th>
<th>Type of reference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Encourage international cooperation</strong></td>
<td>General promotion of progress in labour standards and cooperation</td>
</tr>
<tr>
<td></td>
<td>Commitment to cooperate on labour matters</td>
</tr>
<tr>
<td><strong>Reinforce domestic law</strong></td>
<td>Explicit safeguards or enhancements of labour standards</td>
</tr>
<tr>
<td></td>
<td>Non-lowering of labour standards for the purpose of attracting investment</td>
</tr>
<tr>
<td><strong>Preserve domestic policy space</strong></td>
<td>Explicit affirmation of labour regulatory power of host state</td>
</tr>
<tr>
<td></td>
<td>Carve-out clauses for labour measures with respect to certain treaty provisions</td>
</tr>
<tr>
<td></td>
<td>Exclusion of non-discriminatory labour measures from ISDS</td>
</tr>
<tr>
<td><strong>Influence investor conduct</strong></td>
<td>Investor obligations related to labour standards</td>
</tr>
</tbody>
</table>

Note: This table will be updated as the Toolkit is developed. It will include a list of examples of IIAs that fall into the categories identified.

International agreements addressing investment can promote better labour practices by strengthening the incentives of governments to transpose international labour standards into national law and strengthen
Some labour provisions in IIAs aim at preserving domestic policy space for governments to enact and update labour laws. They expressly affirm governments’ right to regulate to achieve legitimate policy objectives including in relation to labour standards. Treaty-based litigation between investors and governments can raise questions about the appropriate balance between protecting investments by covered investors and preserving the policy space of the host country. Careful drafting of exceptions to treaty protections in IIAs that give more room for governments to enact labour measures is one way for treaty parties to preserve their right to regulate. Many IIAs exclude government measures in specific sectors and subject matters from the scope of protection provided to investors in order to allow the state to meet public policy goals, which may include the protection and promotion of workers’ rights (ILO, 2016).

IIAs may also directly influence investors’ conduct and their business impacts on labour market outcomes. Most IIAs containing provisions on labour standards target government commitments to better practices. While this may help to strengthen incentives to protect basic labour rights and reduce the temptation of poor labour practices in order to gain a competitive advantage, they are likely to be less effective when poor practices reflect institutional weaknesses (OECD, 2009). A few IIAs include provisions that encourage or require investors to observe RBC standards, contribute to skills development, or commit to pay a certain minimum wage. For example, the Brazil-Malawi BIT (2015) requires investors to make best efforts to strengthen local capacities, especially by creating employment opportunities and facilitating access of workers to training. IIAs can also prompt workplace placement and skills development exchange programmes in parallel to the primary agreement, such as with the Australia-Indonesia CEPA (2019). More recently, the USMCA includes a provision in its dedicated chapter on labour issues requiring that a certain percentage of a car manufactured in North America be built by workers earning at least $16 per hour in order to qualify for the preferential market access treatment.

In terms of enforcement and implementation, some treaties follow a sanction-based approach to promote compliance with labour standards. For example, some trade and investment agreements condition trade benefits such as market access on commitments relating to labour standards, allowing a treaty party to deny market access to products from a country where labour standards are routinely violated. More commonly, however, state-to-state dispute settlement or softer forms of implementation mechanisms like government consultations or third-party expert procedures are available for disputes about implementation.

By contrast, some trade agreements seek to use positive incentives. For example, the Cambodia-US Bilateral Textile Agreement (CUSBTA) that was concluded in 1999 made the extension of quota limits conditional on the level of compliance with international and national labour laws. This induced the Cambodian Government to accept the involvement of the ILO in an initiative to enhance compliance, leading, inter-alia, to significant increase in the possibility of forming trade unions. It is not clear whether such initiatives go against the principles of the WTO (OECD, 2009).
of government commitments. Trade unions often express concerns that workers and unions do not have direct access to dispute settlement under IIAs containing labour commitments, unlike covered investors. Some recent IIAs commit the treaty parties to establish inter-governmental committees or other bodies tasked with cooperation, dialogue and monitoring implementation of labour commitments; some envisage greater roles for NGOs and other stakeholders in these processes. Such frameworks could help address implementation gaps for institutions at the domestic level (ILO, 2016). Other approaches, such as the new EU Chief Trade Enforcement Officer, seek to rely on institutions beyond the treaty to ensure effective enforcement of treaty commitments on workers’ rights. Overall, however, there is mixed evidence on the effectiveness of these features of IIAs leading to a tangible improvement of working conditions in the domestic economies of the treaty parties.

Multilateral initiatives to promote core labour standards

Multilateral initiatives such as the OECD’s Guidelines for Multinational Enterprises and the ILO’s Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy can help raise awareness about responsible business conduct (RBC), including on labour practices. They are non-binding recommendations by adhering governments, supported by employer and worker organisations, which are directly addressed to MNEs. They recommend MNEs to observe standards of employment no worse than those observed by employers in the host country and are intended to encourage the positive contribution of MNEs on the labour market (Box 3.2). They also recommend MNEs to carry out due diligence through their value chain relationships to address existing or potential adverse risks on job quality. Recommendations are rooted in the ILO Declaration on Fundamental Principles and Rights at Work. ILO’s MNE declaration is addressed to all MNEs, while the OECD Guidelines only relate to MNEs that operate in and from adhering countries. The OECD Guidelines allow for active mediation in specific instances through the system of National Contact Points (NCPs).

Agreements between multinationals and transnational unions

MNEs’ bargaining power with labour actors may differ from that of domestic firms, possibly reflecting their ability to relocate business across subsidiaries. Their higher propensity to bypass collective employee representation when going abroad could adversely affect rent-sharing with workers. It may also weaken MNEs’ compliance with labour standards in global value chains. Responding to these concerns, innovative cross-border mechanisms such as Global Framework Agreements (GFAs) have emerged to spread workers’ rights, including the right to unionise and bargain collectively, within MNEs (Helfen et al., 2016). GFAs are non-binding agreements negotiated between a MNE and global union federations. They are instruments for regulating labour conditions and employment relations within MNEs and throughout their global value chains. As such, they can help protect the interests of workers and support transnational coordination of collective bargaining. More than 300 GFAs have been signed by 2019, according to a database maintained by ILO and the European Commission. The majority make reference to ILO Conventions, and an increasing number are also referring to the OECD MNE Guidelines and the ILO MNE Declaration. Most of GFAs also make reference to the supply chain, even if supplier companies are not parties to them. Evidence suggests that GFAs do have the capacity to improve fundamental rights at work such as freedom of association and the rights to organise and bargain collectively, although this also depend on the MNE home country labour practices (Bourque, 2008; Papadakis, 2011; Helfen et al., 2016).

GFAs can also benefit MNEs by helping them standardise their behaviour across the operations of subsidiaries and raise levels of trust in labour–management relations. Unlike domestic firms, MNEs must consider how different approaches to industrial relations can be implemented in the various countries in which they operate. This can be challenging for MNEs that wish to implement uniform global practices and standards, but that may be prevented from doing so due to varying policies across countries. With the
engagement of global union federations, GFAs could address this challenge by serving as a basis for MNEs to promote global standards across their subsidiaries.

**Box 3.2. OECD Guidelines for Multinational Enterprises: Employment and Industrial Relations**

The Employment and Industrial Relations chapter of the OECD Guidelines for Multinational Enterprises include several clauses calling multinationals to promote quality jobs and better working environment. According to the Guidelines, multinationals should:

- Respect the right of workers employed by the multinational enterprise to establish or join trade unions and representative organisations of their own choosing.
- Observe standards of employment and industrial relations not less favourable than those observed by comparable employers in the host country.
- When multinational enterprises operate in developing countries, where comparable employers may not exist, provide the best possible wages, benefits and conditions of work, within the framework of government policies.
- In their operations, to the greatest extent practicable, employ local workers and provide training with a view to improving skill levels, in co-operation with worker representatives and, where appropriate, relevant governmental authorities.
- Take adequate steps to ensure occupational health and safety in their operations.
- In considering changes in their operations which would have major employment effects, in particular in the case of the closure of an entity involving collective lay-offs or dismissals, provide reasonable notice of such changes to representatives of the workers in their employment and their organisations, and, where appropriate, to the relevant governmental authorities, and co-operate with the worker representatives and appropriate governmental authorities so as to mitigate to the maximum extent practicable adverse effects.
- In the context of bona fide negotiations with workers’ representatives on conditions of employment, or while workers are exercising a right to organise, not threaten to transfer the whole or part of an operating unit from the country concerned nor transfer workers from the enterprises’ component entities in other countries in order to influence unfairly those negotiations or to hinder the exercise of a right to organise.


**Core policy questions**

Table 3.4 offers an initial list of core principles and policy questions to guide policymakers in their assessment of the policies and institutions that influence FDI impacts on job quality and skills. The questions focus on the three policy areas of Table 1.2, namely the regulatory framework, proactive policies and programmes and international agreements and standards. Together with Table 3.1 on the actual relationship between FDI and labour market outcomes, the questions aim at identifying gaps and weaknesses that limit the positive contribution of FDI and provide a solid basis for the design and implementation of policy and institutional reforms. Combined, Tables 3.1, 3.2 and 3.4 form the basis of the FDI Qualities Policy Toolkit for job quality and skills. It is fundamental for users to think about the different elements of the policy toolkit not in isolation from each other. Strong institutional co-ordination will be central for an optimal use of the toolkit, and for the resulting policy actions to achieve expected impacts.
Core principles

- What are the country’s priorities in terms of labour market outcomes (e.g. create more jobs, increase the share of skilled workers, etc.)? Are these priorities aligned with broader development objectives?
- What is the country’s FDI attraction strategy? Are specific labour market objectives incorporated in the strategy?
- What is the quality of the broader institutional framework that affects FDI impacts on labour market outcomes? Do relevant institutions have enough decisional power and financial resources?
- Do different institutions coordinate their policies, activities and strategic priorities? Are these coordination mechanisms formal?
- Do national and subnational institutions regularly collect labour market statistics by firm ownership (foreign vs. domestic)?

Table 3.4. Core policy questions (preliminary)

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Policy questions</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory framework</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Openness to FDI</td>
<td>Are there restrictions on FDI in labour or skill-intensive sectors? Do laws and regulations allow the deployment of foreign workers from a firm investing in the host country? Are investment liberalisation reforms developed in co-operation with government bodies in charge of labour issues?</td>
<td>OECD FDI Regulatory Restrictiveness Index; OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Pro-competition regulations</td>
<td>To what extent do existing regulations impede effective and fair competition? Do governments take into account how such regulations affect foreign firms’ entry, operations and mark-up?</td>
<td>OECD Product Market Regulations Indicators;</td>
</tr>
<tr>
<td>Employment protection legislation</td>
<td>How does the government ensure an adequate employment protection framework, while allowing sufficient flexibility (e.g. labour mobility)? Do governments take into account how labour market regulations affect foreign firms’ entry and operations? To what extent are reforms discussed with bodies in charge of investment policy?</td>
<td>OECD Employment Protection Legislation Index; OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Collective bargaining rights</td>
<td>What measures has the government taken to ensure the right to collective bargaining and to support workers’ voice arrangements? To what extent bargaining systems are adapted to a changing world of work? Do governments take into account how collective bargaining rights and workers’ voice arrangements affect negotiations in foreign firms?</td>
<td>OECD indicators on collective bargaining coverage and trade union density; OECD/AIAS database</td>
</tr>
<tr>
<td>Other labour regulations and standards</td>
<td>What mechanisms are being put in place to promote and enforce core labour standards? How does the government ensure nation-wide implementation of these standards, including in SEZs?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Proactive policies and programmes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incentives to stimulate labour demand</td>
<td>Are there tax or financial incentives for businesses that support job creation, better work conditions or training of workers, including those of local suppliers? To what extent do these incentives affect specific transmission channel of FDI impacts? Do governments periodically evaluate their relevance? What mechanisms exist to support policy coordination across relevant agencies?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Information &amp; matchmaking services</td>
<td>To what extent do information programmes support job seekers or workers in vulnerable communities such as lower-skilled workers, youth and women? Are there information programmes to stimulate labour mobility, particularly job seekers from areas close to foreign firms’ activity? What mechanisms exist to support coordination between investment and public employment services?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Training &amp; skills development programmes</td>
<td>Are programmes developed in line with the country’s development and investment strategies, and in consultation with workers and business? Are there sectoral training programmes in transferable certifiable skills? What role do foreign firms play in ensuring the programmes fit their needs (e.g. on-the-job training)?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Skills anticipation systems</td>
<td>How does the government measure and assess the skills level in the economy? Do skills anticipation systems (if they exist) take into account FDI trends? Are investment promotion agencies involved in skills anticipation exercises? How are the results of these exercises used to address skills shortages?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
</tbody>
</table>
### International agreements and standards

<table>
<thead>
<tr>
<th>Area</th>
<th>Question</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ratification of ILO's core labour conventions</td>
<td>Has the government signed and ratified the fundamental ILO conventions related to core labour standards? Does the government comply with these conventions in practice, regardless of whether they have been ratified? What measures are in place to ensure and promote the effective implementation of these conventions?</td>
<td>ILO</td>
</tr>
<tr>
<td>International Investment Treaties</td>
<td>Are labour provisions included in IIAs? To what extent do they aim at promoting better labour practices? Are there provisions to preserve domestic policy space, directly influence investors' conduct and commit the parties to establish institutional mechanisms to monitor implementation of labour commitments?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Multilateral initiatives involving labour standards</td>
<td>Has the country adhered to the OECD Guidelines for Multinational Enterprises? To what extent do governments align their laws, regulations and labour relations with the Employment and Industrial Relations chapter of the Guidelines?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Agreements between MNEs and global unions</td>
<td>To what extent does the government promote agreements between MNEs and global unions? Does the government support capacity-building of labour unions?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
</tbody>
</table>

Note: The list of core policy questions is not exhaustive and will be revised in future iterations.

Source: OECD elaboration based on section 3.3 of this chapter and OECD Policy Framework for Investment.

### References

Abebe, Girum, Stefano Caria, Marcel Fafchamps, Paolo Falco, Simon Franklin, and Simon Quinn (2016), “Anonymity or Distance? Experimental Evidence on Obstacles to Youth Employment Opportunities.” Unpublished research study, Stanford University, Stanford, CA


multinational companies, *Just Labour.*


OECD (2020), Investment and sustainable development: Between risk of collapse and opportunity to build back better, Discussion paper for the joint IC-DAC session at the 2020 Roundtable on Investment and Sustainable Development


This chapter presents an overview of policies that influence the impact of FDI on gender equality. It describes the main channels through which FDI can affect gender equality outcomes and the relevant policies and institutions that act on these channels. This draft policy toolkit builds on and expands upon Chapters seven "Policies to Enable Responsible Business Conduct" and eight "Human Resource Development for Investment" of the OECD's Policy Framework for Investment. The policy toolkit is in line with other OECD tools such as the Guidelines for Multinational Enterprises and the OECD Recommendation on Gender Equality in Public Life.
4.1. Continued pressures on gender equality at the workplace

Achieving gender equality in the labour market can provide considerable benefits to countries (Box 4.1 provides key gender terms and concepts). Greater inclusion and empowerment of women in the labour market can bring significant benefits in terms of reduced income inequality and greater economic diversification. These, in turn, are linked to more resilient economies (OECD, 2017).

OECD estimates, for example, suggest that reducing the gender gap in labour force participation by 25% by 2025 could increase GDP per capita growth by 24% in Mexico, 23% in Turkey, 19% in South Korea and 10% in the United States (OECD, 2017). An OECD study shows that economic growth in the Nordic countries in recent decades has benefited significantly from increased participation of women in the labour market. Increases in women's employment accounted for between 3 and 20% of total GDP per capita growth over the past 50 years or so, depending on the country (OECD, 2018).

Yet, worldwide, women's participation in the labour market remains low, at less than 50% in 2019, compared to 75% for men (ILO, 2019). In some regions such as the Middle East and North Africa and Central and South Asia, women's participation rates are even lower, at below 30%. In OECD countries, female labour force participation is higher, at around 65%, but the gap with men is still significant (OECD, 2019a). Women are also more likely to work part-time, in lower paid jobs and in the informal sector. Gender inequalities also persist with regard to wages. Globally, women earn, on average, 20% less than men (ILO, 2018). A lower gender wage gap is observed in the OECD area, at around 13%, but with a large variation between countries (OECD, 2019a).

Women are also less likely to reach the highest levels of management, in both the private and public sectors. In OECD countries, only about one third of managers are women. Women are also much less likely than men to become CEOs, sit on the boards of private companies or hold public leadership positions (OECD, 2020a). Similarly, in developing countries few women reach high-level, well-paid positions such as legislators, senior officials and managers (ILO, 2016). In both developed and developing countries, women are also underrepresented as entrepreneurs. Women-owned businesses are generally smaller, tend to operate in low-productivity sectors and, especially in developing countries, in the informal economy (OECD, 2017; UNCTAD, 2014).

Persistent gender inequalities in the labour market are likely to make women more vulnerable than men during periods of economic turbulence, such as those caused by the COVID-19 pandemic. A recent OECD analysis (OECD, 2020b) indicates that the impact of the COVID-19 outbreak has been particularly hard on women. This is because women are over-represented in the healthcare system, do most of the unpaid care work in households, face high risks of economic insecurity and are more at risk of being victims of violence, abuse or harassment during quarantine periods. The OECD analysis also shows that, so far, the economic crisis linked to the COVID-19 pandemic has hit hardest the sectors of the economy that are the main employers of women. These include many service sectors such as air travel, tourism, retail, accommodation services (e.g. hotels), but also manufacturing industries such as clothing (Box 4.2).
The relationship between FDI and gender equality

The transmission of FDI impacts on gender equality in the labour market

Direct investment by foreign MNEs generates multiple gender-specific effects in the labour market of host countries. FDI influences the relative demand and prices of factors of production, including labour. Since men and women have different preferences and skill sets due to policy and non-policy factors (taxation, social and cultural norms, etc.), and different industries employ different intensities of male and female labour, FDI generates shifts in the relative demand for labour by gender and changes the employment and wages of men and women differently. FDI can also influence other dimensions of gender equality and women’s empowerment in the labour market, such as women’s non-wage working conditions (job security, occupational health, etc.) and prospects for skills development and career advancement (training, promotion, etc.) (also see Chapter 3). The operations of affiliates of foreign MNEs (hereafter referred to as ‘foreign MNEs’ or ‘foreign firms’) can also have significant implications for local women entrepreneurs (the green box in Figure 4.1 shows the gender-equality outcomes that are the focus of this chapter).
FDI can influence the above gender outcomes through the direct operations of foreign MNEs or indirectly through trade linkages and other market interactions with domestic firms. An extensive review of the literature, presented in the background paper Montinari and Wermelinger (2020), identifies four main channels of FDI diffusion with gender-specific impacts (yellow box). These are:

- **MNE direct activities.** FDI affects women in host countries mainly through the direct employment activities and practices of foreign MNEs (recruitment, remuneration, training, promotion, benefits, security, etc.). The direct impact of FDI on women's employment, wage and non-wage working conditions, and skills development varies depending on several factors, including the types of FDI (e.g. efficiency research, market research), the sector of investment (e.g. whether it is dominated by women or men) and the framework conditions of the host country (e.g. level of socio-economic development, industrial structure, social and cultural norms in relation to gender).

- **Value chain relationships.** FDI can create jobs for local women not only in affiliates of foreign MNEs, but also in domestic companies through business opportunities generated with local suppliers (i.e. vertical linkages) or through global value chains (e.g. through subcontracting or outsourcing). Value chain relationships can also be a channel for the transfer of gender practices and values from foreign MNEs to domestic companies (UNCTAD, 2021). Through value chain relationships, FDI can also generate new business prospects for local women entrepreneurs.

- **Competition and imitation effects.** Foreign MNEs compete with local firms both in product markets (crowding-out) and in labour markets for local talent. Especially in female-dominated sectors, competitive pressures from foreign MNEs can lead to job losses for women if domestic firms downsize or close down. As women-owned firms are generally smaller and less productive than those owned by men (OECD, 2017), they are also more likely to be negatively affected by foreign competition. At the same time, higher wages and better job opportunities brought by foreign firms may force local competition to react by improving women's wages and working conditions (Aguayo-Tellez, 2012). Imitation effects occur when domestic firms imitate the business practices
of the MNE, including gender-related practices. Through imitation effects, foreign MNEs can have an impact on women in domestic firms or on domestic firms owned by women.

- **Labour mobility.** This channel involves movements of women workers from foreign MNEs to domestic enterprises or the start-up of enterprises by women previously employed by foreign MNEs. In both cases, labour mobility can have an impact on gender equality and women's empowerment in the host economy. For example, previous work experience with the MNE may help women obtain better job opportunities in domestic enterprises. While working for the MNE, women can acquire new skills through training and on-the-job learning, which can enable them to have better prospects for career development in future jobs. Labour mobility can also contribute to the transfer of information on gender practices from foreign to domestic companies (UNCTAD, 2021; Davis and Poole, 2020). Women could also use the knowledge gained at the foreign MNE to set up their own company.

As discussed in the background paper for this report, the direction and magnitude of gender-specific FDI impacts depend on several factors, including the types of FDI (e.g. FDI motive, entry mode), the sector in which the investment takes place (e.g. female-dominated vs male-dominated), and the policy and non-policy framework conditions of the host country (blue box, Figure 4.1) (Montinari and Wermelinger, 2020). Non-policy framework conditions refer to the level of socio-economic development of the host country, including prevailing gender norms and values. Policy framework conditions include a broad set of policies that will be discussed further in the second part of the chapter.

**FDI impacts on gender equality are not always positive**

Evidence from a variety of studies points to a trade-off in the way FDI affects the employment and wage dimensions of gender equality (Montinari and Wermelinger, 2020). Especially in developing countries with large female-dominated industries (e.g. garment, electronics, toys), FDI contributes to create jobs for women, but these jobs are often low-skilled (and low paid) and with limited career prospects (UNCTAD, 2014; Carr and Chen, 2004). In countries with a more advanced industrial structure, the inverse relationship tends to be observed: FDI in those countries is directed towards more productive and technology-intensive sectors (Benfratello and Sembrenelli, 2006; Criscuolo and Martin, 2001), which on average employ lower shares of women and are characterised by a lower gender wage gap. The OECD FDI Qualities Indicators confirm the existence of this trade-off, as shown by the negative relationship observed between the employment and wage dimensions (OECD, 2019b) (Figure 4.1).

There is limited evidence on the contribution of FDI to women's non-wage working conditions due to the lack of comparable data on issues such as job security, safety, and benefits. Some studies suggest that the working conditions offered by foreign MNEs tend to be better than the alternatives available in the domestic economy because MNEs are more resilient to adverse economic cycles, offer better job security and greater protection of labour rights (Davin, 2001; Ver Beek, 2001). At the same time, other studies suggest that women working for MNEs are more likely to have precarious contracts than their male co-workers (Carr and Chen, 2004; Ghosh, 2002).

Regarding women's empowerment practices in the workplace, such as those that provide opportunities for skills development and career progression, studies for some countries indicate that foreign MNEs perform better than domestic firms, as evidenced by their higher shares of women in top-management positions (Kodama et al., 2018; Olcott and Oliver, 2014; Ono and Odaki, 2004). Nevertheless, women remain largely underrepresented in the top management and boards of multinational enterprises (UNCTAD, 2020).
Recent studies highlight the importance of corporate culture, which appears to be a key factor governing the gender-related employment practices of MNEs. Corporate culture, in turn, is strongly influenced by the values and norms accepted in the country of origin. These studies show that affiliates of MNEs from more gender-equal countries are more gender inclusive than domestic firms: they have higher female employment shares, show a smaller gender pay gap and are more likely to offer family-friendly working arrangements (Kodama et al., 2018; Tang and Zhang, 2017).

The impact of FDI on women entrepreneurship remains largely under-explored. Some evidence points to a negative effect of foreign ventures on women-owned business, possibly due to their lower ability to compete: women-owned businesses tend to be smaller and less productive than men-owned businesses (OECD, 2017). At the same time, the FDI Qualities Indicators (OECD, 2019b) show that, in countries with a less developed industrial structure, FDI tends to prevail in sectors with larger shares of business owned by women. These are typically female-dominated industries, which are labour-intensive and low-skilled (e.g. food, garment).

The relationship between FDI and the above gender equality dimensions has become yet more complex during the COVID-19 pandemic. Measures introduced by governments to contain the epidemic have generated significant disruptions in MNE activities and their value chains. This, in turn, puts women's employment at risk, particularly in sectors where women are over-represented such as healthcare, tourism, accommodation, but also manufacturing sectors like apparel and food. Longer-term changes in MNE investment decisions and business strategies in response to the crisis are likely to have important implications for women workers, especially in female-dominated sectors and in low cost countries (Box 4.2).
Core questions and indicators

A list of core questions are guiding governments in their efforts to better understand the conditions that govern the relationship between FDI and gender equality in their country. The core questions cover four main areas:

- **Gender equality in the labour market:** evidence show that, globally, gender gaps and gender-based discrimination in the labour market penalise women in participation, pay, career progression and entrepreneurship. Assessing how their country performs across different labour market dimensions of gender equality allows governments to prioritise areas where policy action is most needed.

- **Structure of the economy:** FDI is expected to have more significant gender-specific impacts in sectors dominated by women. These sectors vary according to the structural characteristics of the host country, such as its level of development, comparative advantage, integration and position in GVCs. For example, in developing countries with a comparative advantage in low-cost production,
many women work in export-oriented industries (e.g. clothing, toys, electronics), while in more advanced countries they are prevalent in service sectors (e.g. health, education, tourism).

- **FDI characteristics**: Different types of FDI may have different impacts on gender equality in the labour market. For example, especially in female-dominated sectors, FDI driven by the search for low-cost labour (efficiency-seeking FDI) is likely to create more job opportunities for women than FDI driven by the search for new markets (market-seeking FDI). Similarly, greenfield FDI projects are expected to have a greater impact on employment than M&A deals, at least in the short term. The country of origin of FDI is also important, as foreign MNEs from more gender-equal countries are generally more gender inclusive and can transfer gender values and practices to domestic firms.

- **FDI transmission channels**: FDI may affect gender equality in the labour market both directly, through the MNE employment activities (e.g. hiring, remuneration, promotion), or indirectly via supply chain linkages, competition/imitation effects and labour mobility. While direct impacts involve women directly hired by foreign affiliates, indirect impacts affect women working in domestic firms or women-owned businesses.

Table 3.1 provides an initial list of core questions for each of the four dimensions described above. The table also offers examples of indicators that governments can use to conduct an assessment in each area. Where available, the source of the data is indicated. The aim of this exercise is also to identify potential data gaps in national statistics and to draw attention to the importance of collecting data disaggregated by sex.

**Table 4.1. Core questions and indicators (preliminary)**

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Policy questions</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender equality in the labour market</td>
<td>What is the gender employment gap in the country? How does it vary across sectors?</td>
<td>ILO’s databases on labour market statistics</td>
</tr>
<tr>
<td></td>
<td>What is the gender wage gap in the country? How does it vary across sectors?</td>
<td>OECD’s Employment Outlook</td>
</tr>
<tr>
<td></td>
<td>How many women reach the top levels of management in private and public companies?</td>
<td>OECD’s Employment Outlook</td>
</tr>
<tr>
<td>Structure of the economy</td>
<td>In which sectors and value chains do women work?</td>
<td>ILO’s databases on labour market statistics</td>
</tr>
<tr>
<td></td>
<td>In which sectors and value chains are women-owned businesses concentrated?</td>
<td>OECD’s Employment Outlook/WB’s Doing Business</td>
</tr>
<tr>
<td></td>
<td>Does the country have a comparative advantage in female-dominated sectors?</td>
<td>UN Comtrade Database</td>
</tr>
<tr>
<td>FDI characteristics</td>
<td>Does FDI go to sectors that employ many women?</td>
<td>OECD FDI Qualities Indicators</td>
</tr>
<tr>
<td></td>
<td>What is the employment impact of FDI in female-dominated sectors?</td>
<td>OECD FDI Qualities Indicators</td>
</tr>
<tr>
<td></td>
<td>What is the share of FDI coming from more gender-equal countries?</td>
<td>OECD FDI statistics</td>
</tr>
<tr>
<td></td>
<td>What is the share of women employed by affiliates of foreign MNEs?</td>
<td>OECD FDI Qualities Indicators*</td>
</tr>
<tr>
<td></td>
<td>Is the gender wage gap higher in foreign firms relative to domestic firms?</td>
<td>OECD FDI Qualities Indicators*</td>
</tr>
<tr>
<td></td>
<td>What is the share of women in top levels of management/boards in foreign and domestic firms?</td>
<td>OECD FDI Qualities Indicators*</td>
</tr>
<tr>
<td></td>
<td>What is the extent of linkages between foreign and domestic firms in female dominated sectors?</td>
<td>OECD extended TiVA database (based on AMNE data)</td>
</tr>
<tr>
<td></td>
<td>To what extent female workers move from foreign to domestic firms?</td>
<td>National Sources*</td>
</tr>
</tbody>
</table>

Note: The list of core questions is not exhaustive and will be extended further. *Data may not exists and should be collected. Source: OECD elaboration
4.3. Policies that influence FDI impacts on gender equality

As explained above, FDI does not always improve gender equality in host countries. The impact of FDI is the result of an interaction of policy and non-policy factors. Non-policy factors include the types of FDI a country attracts, the sector in which the investment takes place and the economic and social characteristics of the host country. Policy factors also matter. Policies can play a key role in sustaining the positive impacts of FDI and minimising potential negative effects. Some policies, however, can have a negative effect on gender equality and FDI flows, affecting the performance of transmission channels and the potential positive impact of FDI on gender equality.

Policies that influence the impacts of FDI on gender equality involve not only investment policies in the narrow sense – or the broader investment climate reforms covered in the OECD Investment Policy Framework (PFI) (OECD, 2015) – but also policies that specifically target outcomes of women in the labour market (i.e. the policy framework for gender equality in the workplace) (see above Figure 4.1 blue box). The latter cover policies ranging from education and training, health and social protection (e.g. childcare), reproductive rights (e.g. maternity leave), labour market regulations, entrepreneurship, and transport.

Policies at the intersection of creating a favourable investment climate and promoting better labour market outcomes for women is the focus of this policy toolkit. This policy toolkit analyses which regulatory conditions, proactive policies and programmes, international agreements and standards influence the transmission of FDI on gender equality, both directly and indirectly (Table 4.2). Annex 4.A provides first insights from a mapping of policies and institutions in Jordan, based on this classification of policy instruments.

Regulatory framework

National strategies and plans

Countries increasingly use national gender equality strategies to set overarching objectives in the area of gender equality. These strategies are important to ensure the coherence of all gender initiatives and linkages between stakeholders. According to the OECD Recommendation on Gender Equality in Public Life (2016), an effective gender equality strategy should (i) set goals, priorities, timelines, expected outcomes and action plans; (ii) involve all governmental and non-governmental stakeholders to ensure inclusive and comprehensive coverage of gender equality issues; and (iii) take a dual approach to reducing equality gaps both through specific targeted actions to promote gender equality and by mainstreaming gender into institutions and their policies, services and budgets. Gender equality objectives can vary according to specific national contexts and development priorities. They may refer to specific groups of women, for example women working in specific sectors or geographical areas. They are generally based on principles of gender equality affirmed in international agreements (e.g. CEDAW Convention, ILO Conventions) or in national constitutions. In addition to having a gender equality strategy, countries are increasingly incorporating gender equality objectives into national development strategies to ensure that gender goals are integrated and in line with other national objectives.

Labour market regulations

Labour market regulations and laws influence critical aspects of women's working lives, such as their participation in the labour market, their pay, their decision to return to work after having children, and starting and running a business. Labour market regulations can help reduce gender inequalities in the labour market. For example, evidence shows that paid maternity and parental leave schemes reduce employment and wage gaps (Farré, 2016). These measures appear to be particularly impactful in developed and some developing countries (IMF, 2018). Similarly, legislation that promotes equal rights for women in areas such as the workplace, pay and entrepreneurship can stimulate female labour force
participation. This refers, for example, to laws requiring equal pay for work of equal value between women and men or to laws prohibiting discrimination and sexual harassment in the workplace. Studies find that countries that have revised their legal frameworks to reduce gender discrimination have experienced substantial increases in female labour force participation rates (Gonzales et al., 2015b). Developing countries can benefit the most from these policies, as the principles of gender equality may not be reflected in ordinary laws (IMF, 2018). Some labour market regulations may, however, perpetuate patterns of gender inequality. For example, regulations that prevent women from working in certain sectors and occupations, which are not imposed on men, may result in higher gender employment inequality. A gender-inclusive labour market framework is especially important in female-dominated sectors. In developed countries, these are mainly the service sectors. In developing countries, these include also low-cost, export-oriented manufacturing where women are generally more vulnerable due to the highly competitive nature of these sectors (Carr and Chen 2002).

### Table 4.2. Policy instruments influencing FDI impacts on gender equality

<table>
<thead>
<tr>
<th>Policy type</th>
<th>Policy instrument</th>
<th>Direct impact</th>
<th>Spillovers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Supply chain relationships</td>
<td>Competition &amp; imitation effects</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>National strategies and plans</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>National gender equality strategy</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Gender equality objectives in national development strategies</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Labour market regulations:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Equal pay legislation</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Restrictions for women to work in specific sectors and/or occupations</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Legislation on discrimination and sexual harassment</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Maternity and parental leave schemes</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Restrictions for women-owned businesses</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>FDI regulatory restrictions</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Proactive policies and programmes</td>
<td>Investment incentives</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax incentives for hiring women</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Tax incentives for training female employees/ Training subsidies</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Tax incentives for offering family-friendly policies (e.g. childcare)</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Wage subsidies for female employees</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Tax incentives/subsidies for women-owned businesses</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td></td>
<td>Training and skill development programmes</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Skill development programs</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Certification and qualification programmes</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td></td>
<td>Information and facilitation services</td>
<td></td>
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<tr>
<td></td>
<td>Matchmaking/supplier diversity programmes</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Information services to reduce gender bias</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Safe public transport</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Public childcare services</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>International agreements and</td>
<td>Gender provisions in RTAs and BITs</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>standards</td>
<td>Ratification of key women’s human rights instruments</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Adherence to the OECD Guidelines</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Note: The table provides an initial list of policy instruments, which will be further extended. Source: OECD elaboration
FDI regulatory restrictions

Restrictions on FDI inflows can take different forms, from limits on foreign ownership, to the screening and approval process, to constraints on foreign personnel. All these barriers undermine the potential benefits associated with foreign investment, such as job creation, productivity spillovers, and the transfer of skills and technology (see Chapters 2 and 3). These restrictions have further implications in terms of gender equality when targeting female-dominated sectors. FDI restrictions tend to be highest in services, which are globally dominated by women. In developing countries, various types of FDI restrictions are also found in manufacturing industries where many women work. FDI restrictions are often justified by the need to protect domestic firms and workers from foreign competition. These policies, however, increase uncertainty for investors and can divert investment to less risky locations. Countries that impose restrictions on FDI in female-dominated sectors reduce the potential benefits that FDI can bring in terms of increased employment, wages, better or new learning opportunities for domestic women; this potential is of course subject to other policies and corporate practices of the MNE. They also hinder the potential positive spillovers that FDI could have on women working in domestic firms through supply chain linkages, competition/imitation effects and labour mobility.

Proactive policies and programmes

Investment incentives

Policy makers use incentives to influence the behaviour of firms. From a gender perspective, incentives can be used to attract FDI in female-dominated sectors, encourage gender-inclusive employment practices or to support women-owned/managed enterprises. There are two main types of incentives: tax incentives and financial incentives. Tax incentives are preferential tax treatments that are provided to a selected group of enterprises in the form of a tax deduction, tax credit, or tax exclusion. Financial incentives are financial contributions provided by the government to firms, such as grants, subsidies (e.g. wage subsidies, job training subsidies) and credits (e.g. soft loans). Incentives are used by countries to attract FDI in specific sectors or geographical areas. When used in female dominated sectors, they have the potential to boost the impact of FDI on women's employment and wages. Evidence shows, however, that in countries with a comparative advantage in female dominated low-cost productions the use of incentives has in some cases led to a race to the bottom, where the goal of attracting FDI has forced countries to maintain low labour standards (Braunstein, 2008). Both types of incentives can also be designed to encourage gender-inclusive business practices (Kronfol et al. 2019). For example, tax incentives can be offered to companies that hire or promote women or that provide services such as childcare, parental leave, flexible work arrangements (e.g. teleworking) and training. Similarly, subsidies and grants may be used to help offset the higher costs that firms may face in hiring, promoting and training female employees. Several types of incentives can also be used to support women-owned businesses, including start-up companies (e.g. tax credit, subsidised loans). In practice, gender-specific incentives are rarely used (Kronfol et al. 2019).

Training and skills development programmes

Raising women's skills is important to increase the potential benefits of FDI on gender equality, particularly in countries that attract significant FDI in low-value added labour-intensive industries. Although a large pool of low-cost, low-skilled labour is attractive for a certain type of investment, in the long run potential development benefits are larger if countries shift to higher value-added types of activities (UNCTAD, 2014). Thus, investing in women's skills can help them attract higher-skilled investment, while minimising the risk

Both tax incentives and financial incentives have distortionary effects, as they may divert resources from more efficient to less efficient activities. They also carry an economic cost, either in terms of expenditure on financial incentives or in terms of lost revenue from tax incentives (OECD, forthcoming).
of women remaining in low-skilled jobs or moving to informal employment when industrial upgrading occurs and productivity improves (Braunstein, 2008). Governments can support the upgrading of women's skills through skills development programmes. These programmes can target both women who already have jobs and those who are seeking employment. They can be organised in collaboration with companies, training centres and universities. Specific programmes can also be designed to help women start, grow and expand their businesses. Alternatively, governments can also provide incentives to companies to train their female employees, for example through training subsidies or other tax incentives. Offering incentives to companies may be preferable when companies have a better understanding of the skills that are lacking in the local labour market. In addition, foreign multinationals may be in a better position to provide training because of their access to better skills and technology. Along with training programmes, governments can also offer certification and qualification programmes to help women leverage standardised accreditation to signal their skills to companies (Kronfol et al. 2019).

Information and facilitation services

Women may have limited access to information due to a lack of time, resources and their smaller professional networks (OECD, 2017). In addition, gender stereotypes and norms can influence the perception of employers and investors. These information asymmetries penalise women when looking for a job, negotiating contracts and trying to access capital, skills and networks (Kronfol et al. 2019). In sectors with a large presence of foreign firms, these information asymmetries reduce the potential benefit that foreign investment can bring to women in terms of better jobs and opportunities for skills development and career advancement. The provision of facilitation and information services can help overcome these information barriers. For example, supplier development and matchmaking programmes (e.g. supplier diversity programme, women supplier database, matchmaking and networking events) can help women entrepreneurs connect with foreign buyers and investors. Information services (e.g. information and awareness-raising campaigns, mentoring programmes) can address gender stereotypes and norms that limit women in choosing certain professional opportunities and reduce misconceptions among companies and investors about women's skills and abilities.

Other services and programmes

The opportunity cost of entering the labour market is higher for women than for men. This is explained by an unequal distribution of unpaid care responsibilities (i.e. cooking, cleaning and caring for children, the sick and the elderly) between men and women. Women spend disproportionately more time on unpaid work than men (OECD, 2017). This is because in most cultures and societies unpaid care work is seen as a female prerogative. The disproportionate share of care work for which women are responsible has a negative impact on women's labour force participation and affects the types of employment opportunities available to them (e.g. many women self-select into part-time jobs) (OECD, 2019d; 2014). The provision of public childcare services is key to increasing women's labour market participation and maximising the impact of investments on women. Some countries also offer tax incentives to companies that provide childcare for their employees (Kronfol et al. 2019). The possibility for women to travel to work by safe and accessible means of transport is also an important factor influencing their decision to work (UNACTD, 2014). Studies for several developing countries have reported an increase in sexual violence and crime around foreign factories, partly related to the lack of safe transport (Livingston, 2004).

International agreements and standards

Regional trade agreements

The inclusion of gender provisions in regional trade agreements (RTAs) is not a recent phenomenon. The first gender-related article is found in the 1957 Treaty of Rome establishing the European Economic
Community (EEC), which requires each member state to apply the principle of equal pay for men and women. In recent years, however, both the number and share of RTAs with gender provisions, as well as the average number of gender provisions in an RTA, have increased significantly. Today, about 13% of all RTAs currently in force and notified to the WTO contain specific gender provisions (Monteiro, 2018). Gender provisions vary widely in structure (e.g. specific article or chapter) and location in RTAs (e.g. main text or side agreement), but also in terms of language, scope and enforceability (i.e. whether they are applicable under the dispute settlement mechanism). The mechanisms for implementing these provisions are also important (e.g. budgetary commitments for implementation, mechanisms to support women’s participation in monitoring implementation, provisions regarding the consequences of non-compliance with gender-related provisions). Cooperation on gender issues remains the most widely used type of gender-related provisions in RTAs. In general, the enforceability of gender provisions is weak, as they are rarely covered by the dispute settlement procedure, especially when they are in the cooperation chapter. Currently, the most detailed and comprehensive gender chapters and provisions are those included in the RTAs to which Chile is a party with Argentina and Uruguay and the amended RTAs negotiated by Canada with Chile and Israel (Monteiro, 2018). An interesting case is also the modernised Canada-EU RTA for which organisations representing women entrepreneurs were consulted and engaged both in the design phase of the agreement and during implementation and monitoring (Korinek, 2020).

**Bilateral investment treaties**

Gender provisions in bilateral investment treaties (BITs) are scarce and rarely impose concrete obligations on investors (Dubin, 2018). A notable exception is provided by the Netherlands’ 2019 model BIT, which contains several explicit and implicit references to gender equality and establishes the potential for claims against investors due to non-compliance with gender-related obligations. Several articles of the Dutch model BIT explicitly refer to gender equality. Article 6(3) states that the contracting parties have an active duty to promote equal opportunities for women and men in the economy, including in international investment. In addition, discrimination on the basis of gender is expressly qualified as an ‘unlawful ground’ which constitutes a violation of fair and equitable treatment under Article 9 (2). Other articles implicitly refer to gender issues by incorporating references to international human rights instruments and international standards on CBR. The potential for complaints has important implications for the employment practices of foreign MNEs in host countries. It minimises the risk of potential negative impacts on women directly employed by foreign affiliates, while also providing the basis for improving their status in the labour market. It can also have positive spillover effects on women employed by domestic companies, for example if foreign MNEs require compliance with gender obligations from their domestic suppliers or buyers.

**International principles and standards**

Gender equality principles are found in various multilateral instruments promoting responsible business practices by MNEs, such as the OECD Guidelines for Multinational Enterprises (see Box 4.3), the ILO Tripartite Declaration of Principles concerning Multinational Enterprises, and the United Nations Norms on the Responsibilities of Transnational Corporations. Key principles include (1) equality of opportunity and treatment between women and men in employment and pay; (2) non-discrimination on the basis of sex; (3) protection of women’s human rights; and (4) elimination of violence against women. Compliance with these principles and other core labour standards (see Chapter 3) requires multinational companies to identify and address potential negative impacts on women in their companies, but also throughout their operations. These principles are generally not legally binding on companies, but signatory governments have an obligation to ensure that companies operating in their country comply with them.

Equality between women and men and non-discrimination on the basis of sex are also fundamental human rights affirmed in numerous international instruments. These instruments can be of various types (conventions, declarations, etc.) and may or may not be legally binding on the signatory countries. Even
when they are not binding, they play an important role in the dissemination of gender equality principles in national legal systems. Important international instruments for the protection of women's rights include the 1979 Convention on the Elimination of All Forms of Discrimination against Women (CEDAW), the 1995 Beijing Declaration and Platform for Action, and several ILO conventions dealing with gender-specific issues such as the Equal Remuneration Convention (No. 100, 1951), the Discrimination (Employment and Occupation) Convention (No. 111, 1958), the Convention on Workers with Family Responsibilities (No. 156, 1981) and the Maternity Protection Convention (No. 183, 2000). Women's equality and empowerment is also one of the 17 Sustainable Development Goals (SDGs) and is reflected in many other dimensions of inclusive and sustainable development (e.g. good health and well-being, quality education, quality jobs).

Box 4.3. Principles on gender equality and non-discrimination in the OECD Guidelines

The OECD Guidelines for Multinational Enterprises (2011) are a key international instrument for promoting RBC practices by foreign MNEs, including in relation to gender issues. The Guidelines are recommendations made by governments to MNEs to prevent and address the negative impacts of business operations on the economy, society and the environment. Although they are not legally binding on companies, they are binding on signatory governments, which are required to ensure that the guidelines are implemented and observed.

While gender issues concern all aspects of business activity, two chapters of the guidelines are more closely related to women: Chapter IV on ‘Human Rights’ and Chapter V on “Employment and Industrial Relationships”. Commentary 40 of Chapter IV on ‘Human Rights’ states that enterprises should pay particular attention to the human rights of individuals belonging to vulnerable groups such as women. Chapter V on “Employment and Industrial Relationships” refers to principles of equal treatment in employment and non-discrimination on grounds of sex. Commentary 54 of Chapter V further stresses the importance of equal criteria for selection, pay and promotion and of preventing discrimination or dismissals based on marriage, pregnancy and maternity, whereas Commentary 58 states that equal opportunities should also be ensured in training.

Practical guidance for companies on how to identify and address potential negative impacts on women in their own operations and value chains is further provided in the OECD Due Diligence Guidance for Responsible Business Conduct (OECD, 2018b). The OECD Due Diligence Guidance helps companies to become aware of actual and potential risks in situations where women may be disproportionately impacted, for instance in certain sectors or geographical areas. It also provides guidance on how to ensure that actions taken to prevent and mitigate negative impacts are effective and appropriate.

In addition to the OECD’s general guidance on due diligence, other OECD sectoral guidance instruments help companies operating in specific sectors to identify how their actions may disproportionately affect women. For example, the OECD Due Diligence Guidance for “Responsible Supply Chains in the Apparel and Footwear Sector” explains how companies along these value chains can identify and address gender-specific risks, such as sexual harassment and discrimination.

Core questions and principles

This section offers a list of core principles and questions that will guide policymakers in assessing policies and institutions that influence the impact of FDI on gender equality. It enables the identification of structural gaps and weaknesses in the policy framework that limit the positive contribution of FDI and provides a sound basis for the design and implementation of policy and institutional reforms. Several indicators are available to examine the policy and institutional frameworks that influence the impact of FDI on gender equality. In addition to these indicators, a mapping of policies and institutions, described in Chapter 1, gathers evidence on the extent to which specific policies and institutional practices are in place. The core principles concern the country’s strategic priorities and institutional framework, while the core questions focus on specific policy instruments in three main areas (see Table 4.3 for detailed questions):
• **Regulatory framework**: Restrictions on FDI, particularly in sectors dominated by women, can hinder positive impacts of FDI on gender equality. Moreover, discriminatory practices in the labour market can limit the ability of women to fully participate in and benefit from the employment opportunities offered by foreign multinationals. Discriminatory practices are influenced by labour market regulations and laws in areas such as pay, jobs, parenthood and entrepreneurship. These regulations and laws, in turn, can change in response to priorities and objectives set out in national strategies and plans.

• **Proactive policies and programmes**: Governments have a wide range of policy instruments at their disposal to influence the behaviour of firms and individuals. These policy instruments can have gender equality implications when they target companies in female-dominated sectors or when they are used to achieve specific gender equality goals. They include tax and financial incentives to attract foreign MNEs in female-dominated sectors, to encourage gender-inclusive business practices or to support women-owned enterprises; training and skills development programmes for female employees or women entrepreneurs; information and facilitation services to help women connect with foreign employers and investors; and other services and programme such as affordable childcare and the provision of safe transport.

• **International agreements and standards**: Gender provisions have increasingly been incorporated into regional trade agreements and bilateral investment treaties. Although these provisions are generally non-binding, they are important for mainstreaming gender into trade and investment policies. Gender equality values and standards are also affirmed in numerous international human rights agreements and multilateral instruments that encourage responsible business practices by multinational corporations. While these agreements are not always legally binding on signatory countries, they are important for disseminating gender principles in national legal frameworks.

**Core principles**

• What are the country’s priorities in terms of gender equality and women empowerment in the labour market? Are these priorities aligned with broader development objectives?

• What is the country’s FDI attraction strategy? Are gender equality objectives and gender considerations incorporated in the strategy?

• What is the quality of the broader institutional framework that affects gender-specific impacts of FDI? Do relevant institutions have enough decisional power and financial resources?

• Do different institutions coordinate their policies, activities and strategic priorities? Are these coordination mechanisms formal?

• Do national and subnational institutions regularly collect gender-disaggregated data in areas such as investment/FDI, labour market and SMEs/entrepreneurship?
**Table 4.3. Core questions (preliminary)**

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Policy questions</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Regulatory framework</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FDI restrictions</td>
<td>Are there restrictions on FDI in female-dominated sectors? (e.g. services sectors)?</td>
<td>OECD FDI Regulatory Restrictiveness Index</td>
</tr>
<tr>
<td>Labour market regulations</td>
<td>Does the country have a law demanding equal pay between women and men? Are there restrictions for women to work in certain jobs and/or sectors?</td>
<td>WB’s Women, Business and the Law</td>
</tr>
<tr>
<td></td>
<td>Does the law prohibit discrimination in employment based on gender? Is there a legislation on sexual harassment in employment?</td>
<td>WB’s Women, Business and the Law</td>
</tr>
<tr>
<td></td>
<td>Is paid leave of at least 14 weeks* available to mothers? Are maternity leave benefits paid entirely by the Government? Is there paid leave available to fathers? Is there parental leave available to families?</td>
<td>WB’s Women, Business and the Law</td>
</tr>
<tr>
<td></td>
<td>Does the law prohibit discrimination in access to credit based on gender? Can a woman sign a contract in the same way as a man? Can a women register a business in the same way as a man?</td>
<td>WB’s Women, Business and the Law</td>
</tr>
<tr>
<td>National strategies and plans</td>
<td>Does the country has a recent strategy on gender equality?</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td><strong>Active policies and programmes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incentives</td>
<td>Are there incentives to attract FDI in female-dominated sectors?</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td></td>
<td>Are there incentives for foreign MNEs that promote gender-inclusive business practices? (e.g. wage/training subsidies for female employees, tax incentives to hire women)</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td>Training and skills development programmes</td>
<td>Are there skill development programmes and/or certification and qualification programmes targeting women? Are they organised in collaboration with enterprises?</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td>Information and facilitation services</td>
<td>Are there matchmaking programmes to help women connect with foreign employers and investors? (e.g. supplier diversity programmes, fairs)</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td>Other services and programmes</td>
<td>Are there initiatives in place to reduce gender bias and prejudices among companies and investors? (e.g. information campaign)</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td></td>
<td>Is safe public transport available to women, particularly in areas where foreign MNEs are located?</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td></td>
<td>Are there affordable childcare services available to families?</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td><strong>International instruments and principles</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RTAs and BITs</td>
<td>Is the country party of regional trade agreements or bilateral investment treaties, which incorporate gender provisions? Are those gender provisions covered by the dispute settlement procedure?</td>
<td>Monteiro (2018), OECD’s mapping of policies and institutions</td>
</tr>
<tr>
<td>International principles and standards</td>
<td>Has the country ratified the main international instruments on women’s human rights (ILO conventions)? Has the country made exceptions to specific articles?</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
<tr>
<td></td>
<td>Has the country adhered to the OECD Guidelines for Multinational Enterprises?</td>
<td>OECD Mapping of polices and institutions</td>
</tr>
</tbody>
</table>

Note: The list of core questions is not exhaustive and will be extended further. *14 weeks is the length of maternity leave recommended by ILO. Source: OECD elaboration
References


Annex 4.A. Initial insights from a mapping of institutions and policies in Jordan

This section presents initial insights from a mapping of institutions and policies in Jordan (details of the mapping approach are provided in Chapter 1). The information was gathered through desk research and will be complemented through interviews with government representatives and country experts. The mapping exercise focuses mainly on governmental institutions and their policies. It also covers aspects of the national regulatory framework and international agreements.

Institutional Framework

The mapping exercise has identified several governmental institutions that are responsible for designing, implementing, and evaluating policies affecting gender-specific FDI impacts. Some institutions are directly concerned with the promotion of gender equality and the empowerment of Jordanian women. The Jordanian National Commission for Women (JNCW) is the main focal point for women's affairs. It is composed of ministries, government agencies, civil society organisations, universities and private sector actors. Despite being the main institution for gender issues in the country, the JNWC receives minimal financial support as it is not linked to the national budget. Gender units are present in all government ministries and agencies. They develop studies and strategies to mainstream gender issues in the work of ministries. A key role is played by the Gender Unit of the Ministry of Planning and International Cooperation (MoPIC) whose mandate is to integrate gender policies in the country's development programmes. The Senate's Women Committee and the Parliament's Women and Family Affairs Committee study laws and issues related to women and the family and design policies that take this evidence into account to improve the conditions of women in the economy and society. The Interministerial Committee for Women Empowerment performs the same task, facilitating the coordination of policies that cut across sectors under the responsibility of different ministries.

Jordan has two main institutions in charge of investment policy. The Jordan Investment Commission (JIC) is the main agency for implementing Jordan's investment promotion policies, seeking to promote both domestic and foreign investment. The Ministry of Industry, Trade and Supply is responsible for, among other things, facilitating economic and investment activity. The gender unit within the ministry incorporates gender considerations into ministry policies and programmes and coordinates with other relevant ministries.

Several other institutions play an important role. They operate in the fields of vocational training, business development, finance and banking. The Vocational Training Corporation (VCT) provides vocational training programmes. The Jordan Enterprise Development Corporation (JEDCO) supports the development of emerging businesses and small and medium-sized enterprises (SMEs) through tailored technical and financial support. Jordan Loan Corporation Group (JLGC) encourage the internationalisation of SMEs by facilitating their access to credit. An important role is also played by the Jordan Forum of Business & Professional Women, which provides assistance to women entrepreneurs and women professionals, and the Microfund for Women, a non-profit registered under the Ministry of Industry, Trade and Supply and supervised by the Central Bank of Jordan, which offers financial and non-financial support to women entrepreneurs.
Policies

The data collection process has identified a wide range of policies that influence the impacts of FDI on gender equality. These policies include labour market regulations and laws, national strategies and plans, incentives, programmes and services, and international agreements and standards.

Table 4.4. Policies that influence FDI impacts on gender equality in Jordan

<table>
<thead>
<tr>
<th>Policy type</th>
<th>Policy instrument</th>
<th>Implementing Institution</th>
<th>Duration</th>
<th>Legal Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory framework</td>
<td>National plans and strategies</td>
<td>MoPIC</td>
<td>2020-2025</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Jordan 2025- A Vision and Strategy</td>
<td></td>
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<tr>
<td></td>
<td>National Strategy for Women 2020-2025</td>
<td>JNCW</td>
<td>2020-2025</td>
<td></td>
</tr>
<tr>
<td></td>
<td>NFIS 2018-2020</td>
<td>Prime Minister, Central Bank of Jordan</td>
<td>2018-2020</td>
<td></td>
</tr>
<tr>
<td>Labour market regulations</td>
<td>Law and participation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Elimination of provisions preventing women to work in some sectors, jobs or shifts.</td>
<td>Unlimited (since 2018)</td>
<td></td>
<td>Amendment to art. 69 of the Labor Code (Decision No.2/2018)</td>
</tr>
<tr>
<td></td>
<td>Law demanding equal pay for work of the same value</td>
<td>Unlimited (since 2019)</td>
<td></td>
<td>Law No.14 of 2019 amending the Labour Code</td>
</tr>
<tr>
<td>Workplace</td>
<td>Resignation from work without notice in case of sexual harassment</td>
<td>Unlimited (since 1996)</td>
<td></td>
<td>Law No. 48 of 2008 amending the Labour Code</td>
</tr>
<tr>
<td></td>
<td>Introduction of the right to request flexible working arrangements</td>
<td>Unlimited (since 2017)</td>
<td></td>
<td>Regulation No.22 of 2017</td>
</tr>
<tr>
<td></td>
<td>3 days of paid paternal leave</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Availability of governmental benefits for maternity leave</td>
<td>Unlimited (since 2014)</td>
<td></td>
<td>Social Security Law No. 1 of 2014, Art.42</td>
</tr>
<tr>
<td></td>
<td>Ban on dismissal for pregnant women</td>
<td>Unlimited (since 1996)</td>
<td></td>
<td>Labor Law No.8 of 1996, art.27</td>
</tr>
<tr>
<td>Incentives</td>
<td>Tax Incentives in SEZs that employ many women</td>
<td>Unlimited (2000,2014)</td>
<td></td>
<td>Aqaba Special Economic Zone Law No.32;</td>
</tr>
<tr>
<td></td>
<td>Tax incentives for firms hiring women</td>
<td>Unlimited (since 2018)</td>
<td></td>
<td>Industrial Sector Incentives Bylaw No.18</td>
</tr>
<tr>
<td></td>
<td>Microfinance loan for women entrepreneurs</td>
<td>Microfund for Women, EIB</td>
<td>2020</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Promoting Financial Inclusion Policies in Jordan</td>
<td>Central Bank of Jordan, the World Bank</td>
<td>2017</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Microfinance loan for women</td>
<td>Tamweelcom, IFC</td>
<td>2018</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Programmes for Emerging Enterprises with focus on women</td>
<td>JEDC</td>
<td>2015-2018</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Development and Employment Fund</td>
<td>Ministry of Labour</td>
<td>Unlimited (since 1991)</td>
<td></td>
</tr>
<tr>
<td>Training and skill development programmes</td>
<td>Productivity and Promotion Centers Program (IRAQA)</td>
<td>MoPIC, Royal Scientific Society</td>
<td>2002</td>
<td></td>
</tr>
<tr>
<td></td>
<td>HRH2030</td>
<td>Ministry of Health, USAID</td>
<td>2016-2018</td>
<td></td>
</tr>
<tr>
<td>Information and facilitation services</td>
<td>JEDCO SMEs Training Programmes</td>
<td>Local municipalities Arab Women Enterprise Fund (AWEF)</td>
<td>JEDCO</td>
<td>2015-2019</td>
</tr>
<tr>
<td>-----------------------------------------------</td>
<td>---------------------------------</td>
<td>------------------------------------------------------</td>
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</tr>
<tr>
<td>Women’s Economic Empowerment (WEE) Units</td>
<td></td>
<td></td>
<td></td>
<td>2015-2021</td>
</tr>
<tr>
<td>JEDCO SMEs Financing Programmes</td>
<td></td>
<td></td>
<td>JEDCO</td>
<td>2015-2019</td>
</tr>
<tr>
<td>Other services and programmes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash benefits for childcare services</td>
<td>Unlimited (since 2014)</td>
<td>Social Security Law No.1 of 2014</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Obligation to provide nurseries in the workplace</td>
<td>Unlimited (since 2019)</td>
<td>Amendment to Art 72 of the Labour Code (Decision No. 14/2019)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>International agreements and standards</td>
<td></td>
<td></td>
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<tr>
<td>Gender provisions in RTAs</td>
<td>EU-Jordan Association Agreement</td>
<td>Unlimited (since 2002) Art.82(2): Social Cooperation Chapter</td>
<td></td>
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<tr>
<td>International principles and standards</td>
<td>Canada-Jordan Agreement on Labour Cooperation</td>
<td>Unlimited (since 2012) Art 1: General Commitments Annex 1, art (k): Cooperative Activities</td>
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<tr>
<td>CEDAW*</td>
<td>Unlimited (since 1992)</td>
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<td>Beijing Declaration and Platform for Action</td>
<td>Unlimited (since 1995)</td>
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<tr>
<td>ILO Conventions on Discrimination (No.111) and on Equal Remuneration (No.100)***</td>
<td>Unlimited (since 1963 and 1996, respectively)</td>
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<tr>
<td>Adherence to the OECD Guidelines for Multinational Enterprises</td>
<td>Unlimited (since 2013)</td>
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</table>

Note:* The ILO Convention on maternity leave stipulates the period of leave should be at least 14 weeks; ** Reservations still exist on Art.9 (2); and Art. 16.(1)(c,d,g). The Optional Protocol has not yet been ratified;*** Jordan has not yet ratified the Workers with Family Responsibilities Convention (No. 156) and the Maternity Protection Convention (No. 183). Source: OECD elaboration

Regulatory framework

Jordan has a national strategy for gender equality since 1993: the National Strategy for Women. The strategy is designed by the JNCW and is reviewed approximately every five years. The new strategy (2020-2025), which is still under development, aims to align the country's targets and objectives with those of Sustainable Development Goal 5 on gender equality and women’s empowerment. The new strategy will also focus on strengthening the role and powers of the institutional frameworks that support its implementation (JNCW, 2019). Gender objectives are also incorporated in Jordan’s national development strategy, ‘Jordan 2025: a National Vision and Strategy’, which emphasises the importance of more inclusive economic development with a focus on women and children. Gender equality considerations are also included in the National Financial Inclusion Strategy 2018-2020 (NFIS) and the Employment, Education and Technical and Vocational Training (E-TVET) Strategy 2014-2020.

In terms of labour market regulation, Jordan has taken considerable steps to create a gender-inclusive labour market. Core regulations and laws are grouped in main areas of interest:

- Parenthood: Women are entitled to 10 weeks of paid maternity leave (Labour Act No. 8 of 1996, art. 7): these are less than the minimum duration of maternity leave recommended by the ILO. Women are also entitled to paid leave of one hour per day for breastfeeding (Social Security Act No. 1 of 2014, art. 71). Maternity leave benefits are entirely administered by the government (Social Security Act No. 1 of 2014, Article 42). As of 2019, the 2-day paternity leave has been extended to 3 days (Labour Law No. 8 of 1996, Art. 66(c); Amended Jordanian Labour Law No.
Employers are prohibited from dismissing women due to pregnancy (Labour Code, Art. 67).

- Pay and participation: Article 6 of the 1952 Constitution guarantees equality before the law. However, the Constitution does not include an article addressing gender discrimination or prohibiting discrimination against women. The concept of gender-based wage discrimination was introduced in 2019, paired with sanctions (Labour Act No. 14 (2019)). Prior to 2019, no provision of the Labour Act effectively prohibited discrimination. The amendment of Article 69 of the Labour Code (Decision No.2/2018) abolished the power of the Ministry of Labour to have the final say on jobs, sectors and the arrangement of working hours from which women were interdicted.

- Workplace: Since 2008, the law allows an employee to resign from work without notice if he/she has been the victim of sexual violence perpetrated by the employer or his/her representative (Act No. 48 of 2008 amending the Labour Code). Sexual harassment can be punished as the offence of unwanted sexual conduct under Articles 305 and 306 of the Penal Code. The right and opportunity to choose, with the consent of the employer, a flexible working arrangement adapted to personal and family circumstances, needs and/or requirements were introduced in 2017 (Regulation No. 22 of 2017).

- Entrepreneurship: the law does not prohibit discrimination in access to credit based on gender. Women can sign a contract and set up a business in the same way as men, and can open a bank account under the same rules.

**Proactive policies and programmes**

To attract foreign investors, Jordan has established several free and development zones, and a special economic zone in Aqaba. In these zones, investors are granted significant tax incentives, such as tax exemptions, exemptions or reductions in corporate income tax and sales tax rates, which can vary depending on the business sector. These zones have created significant employment opportunities for women in neighbouring communities (The World Bank, 2011). Moreover, Jordan is one of the few countries currently using incentives to explicitly promote gender-inclusive business practices. The Industrial Sector Incentives Bylaw No. 18, adopted in 2020, introduced incentives for companies that hire Jordanian women (provided that the finished products contain at least 30 per cent local content).

There are several initiatives that provide financial support in the form of loans and grants to women entrepreneurs. These initiatives are managed by non-governmental institutions and are funded by international donors. In 2020, the European Investment Bank (EIB) issued a loan to the Microfund for Women with the aim of improving access to finance for women entrepreneurs. The World Bank has given a grant to the Central Bank of Jordan to promote financial inclusion policies in the country, which will enable women to have easier access to financial services. The IFC funded a loan to Tamweelcom, Jordan's second largest microfinance company, to increase its outreach to small business owners, including women. The Jordan Enterprise and Development Corporation (JEDCO) offers several programmes for emerging businesses, which provide financial assistance to small farmers, farmers' associations and producers and exporters of agricultural crops and SMEs. The programme has a special focus on women and youth. In addition, the Development and Employment Fund, created in 1991, offers financial resources to people from low-income groups or the unemployed to help them start a business project in the industry, handicrafts, services and tourism sectors.

The Royal Scientific Society and MoPIC launched the Productivity Production Centers programme in 2002, which aims to reduce poverty and unemployment by encouraging the economic inclusion of workers on the margins of production, such as women. Productivity Production Centers are located in all provinces of Jordan. They provide training and skills development programmes, including for entrepreneurs, and other information and facilitation services (e.g. technical advice). The Human Resources for Health Activity (HRH 2030) programme, implemented between 2016 and 2018 by USAID and the Ministry of Health, consisted
of a tailor-made two-year course to develop management and leadership skills in the health sector, aimed primarily at women. Between 2015 and 2019, JEDCO launched a wide range of initiatives with a focus on women and youth aimed at supporting SME owners, new entrepreneurs, emerging businesses and innovative and high-growth SMEs, respectively. The support consists of information and facilitation services, training, matchmaking platforms, networking programmes and business development advice. The Arab Women Enterprise Fund (AWEF) seeks to increase the economic inclusion and welfare of poor women in Egypt, Jordan and the occupied Palestinian territory. In Jordan, AWEF has led the establishment of Women's Economic Empowerment Units (WEE) within local municipalities, which aim to improve women's access to local services, licences and permits for their businesses. AWEF also works with private sector companies to encourage links between businesses and women suppliers.

Regarding the provision of childcare services, the Social Security Act No. (1) of 2014 provides working mothers with cash benefits to enable them to return to work while ensuring childcare for their children in a childcare facility or at home. It also allows registered childcare centres to receive direct cash benefits to cover their operating costs. In addition, Article 72 of the Labour Code requires an employer to establish a childcare facility at the workplace when employees cumulatively have at least 15 children under 5 years of age (Amendment to Article 72 of the Labour Code, Act No. (14) of 2019).

**International agreements and principles**

Jordan has concluded several bilateral trade agreements with gender provisions. The EU-Jordan Association Agreement contains a gender provision in the chapter on cooperation (Art. 82(2) in Chapter 2). The provision states that in order to consolidate social cooperation, the parties must undertake actions and programmes that promote, among other objectives, "the role of women in social and economic development through education and the media, in line with Jordanian policy in this area". From January 2021, these provisions also apply to the UK-Jordan Free Trade Agreement. The Canada-Jordan Labour Cooperation Agreement, which was signed in 2009 and entered into force in 2012 along with a Free Trade Agreement (FTA), contains two explicit gender-related provisions. Article 1 states that each party must ensure respect for internationally recognised labour principles and rights, including the elimination of discrimination in employment and occupation (including equal pay for women and men). Article 1(k) of Annex I includes the commitment to eliminate all forms of gender discrimination in labour markets in the list of cooperation activities.

Jordan is committed to the main international agreements on women's human rights. It ratified the Convention on the Elimination of Discrimination against Women (CEDAW) in 1992, although it placed reservations on Article 9 (2) on women granting Jordanian nationality to their children, Article 15 (4) on rights of movement and choice of residence (which was lifted in 2009), and Article 16.(1)(c,d,g) on equality in all matters relating to marriage and family relations. Moreover, the country has not yet ratified the Optional Protocol, thus denying women and NGOs the possibility to submit individual complaints to the CEDAW Committee on violations against women who have not received fair treatment by Jordanian courts. Jordan has also signed the Beijing Declaration and Platform for Action (1995), ILO Conventions on Discrimination (Employment and Occupation) No. 111 (1963) and Equal Remuneration No. 100 (1996). In 2013, Jordan adhered to the OECD Guidelines for Multinational Enterprises. Jordan was also among the first Arab countries to engage with the Millennium Development Goals and committed to the 2030 Agenda in 2015.
This chapter presents a Policy Toolkit to help governments attract FDI that contributes to decarbonisation, both by reducing the emissions associated with foreign investments and inducing low-carbon technology spillovers. The chapter describes the various transmission channels through which FDI affects carbon emissions as well as contextual factors determining the magnitude and direction of such impacts. The core objective of the Policy Toolkit is to provide an overview of the policies and institutional arrangements that can improve FDI’s carbon impacts.
5.1. The urgency of reducing CO₂ emissions

Adverse environmental developments are among the gravest global threats of current times. A global economy reliant on fossil fuels and the resulting rising greenhouse gas emissions, now 60% higher than their 1990 level (Figure 5.1), are creating drastic changes to the climate, including more frequent and extreme weather events, land degradation, ocean acidification, and biodiversity loss. Climate change and the resulting migration pressures and threats to food and health security are at the forefront of global efforts to sustain the planet (WEF, 2020[1]). To address these mounting challenges, on 12 December 2015, 190 countries signed the Paris Agreement, a landmark agreement to combat climate change and accelerate and intensify actions and investments needed for a sustainable low-carbon future, pledging to achieve carbon neutrality by 2050 (UNFCCC, 2015[2]).

Figure 5.1. Global annual CO₂ emissions

The COVID-19 pandemic has exposed a lack of resilience and preparedness to deal with such systemic crises. Government efforts to support economic recovery are essential but should not undermine actions to limit the climate crisis, which could be as destabilising to societies and economies as COVID-19. Stimulus measures and policy responses must be aligned with ambitions on climate change, biodiversity and wider environmental protection (OECD, 2020[3]; OECD, 2020[4]). With just under ten years left to achieve the Sustainable Development Goals and Paris Agreement goals, the window of opportunity for climate action is closing fast and short-term economic measures will have a significant impact on the ability to meet global goals (United Nations, 2015[5]; UNFCCC, 2015[2]).

The climate crisis has serious financial repercussions, including disaster-related damage costs that amount to hundreds of billions of dollars, annually (IPCC, 2018[6]); adaptation costs associated with protection and reinforcement; and mitigation costs associated with decarbonisation. Climate change mitigation and adaptation will require an estimated USD 6.9 trillion per year worth of investments alone to meet global infrastructure development needs and climate objectives through 2030 (OECD, 2017[7]). Of these, USD 4 trillion per year are needed across emerging economies, and USD 1.7 trillion per year are needed in emerging Asia (OECD, 2020[8]). This chapter focuses on FDI’s potential contribution to climate change mitigation. Box 5.1Box 5.1 provides some definitions and clarifications for the following discussion.
Box 5.1. Key terms and concepts

**CO₂ emissions**: Carbon dioxide (CO₂) is the primary greenhouse gas (GHG) responsible for global warming. Other greenhouse gases are beyond the scope of this Policy Toolkit. The GHG Protocol jointly developed by the World Resources Institute and the World Business Council for Sustainable Development uses a delineation that has become standard, dividing emissions into three types:

- **Scope 1**: Direct emissions generated by industrial processes and any other on-site activities.
- **Scope 2**: Indirect emissions associated with energy (i.e., electricity, heat or steam) imported from off-site.
- **Scope 3**: All other indirect emissions in the life cycle of the products produced, including those associated with any intermediate goods, transport of goods to market, emissions in end use and disposal of products produced. It includes also emissions associated with leased assets, franchises and investments.

**Carbon intensity**: the emission rate of CO₂ relative to the intensity of a specific economic activity. A common measure used to compare emissions from different sources of electrical power is carbon intensity per kilowatt-hour (CIPK).

**Low-carbon technology**: a technology that helps reduce CO₂ emissions by (1) reducing energy use (e.g. energy-saving); (2) generating zero carbon emissions from use (e.g. renewable energy); (3) removing carbon from the atmosphere (e.g. carbon capture); or (4) conserving resources (e.g. recycling). The Policy Toolkit focuses primarily on the first two classes of technologies.

**Renewable energy**: energy from sources that are naturally replenishing. It generally is considered to include six renewable-power generation sectors: geothermal, marine/tidal, small hydroelectric, solar, wind, and the combined sector biomass and waste.


5.2. FDI impacts on carbon emissions

Evidence stemming from the traditional literature on the trade-FDI-environment nexus (Grossman and Kruger, 1991[13]; Copeland and Taylor, 1994[14]; Porter and van der Linde, 1995[15]) proposes that FDI affects the host country’s carbon footprint in contending ways by expanding the scale of economic activity, changing the structural composition of economic activity and delivering new techniques of production. In isolation, the *scale effect* is generally expected to increase carbon emissions, since an increase in the size of an economy implies more production and, in turn, more emissions. The *technique effect* refers to a change in production methods resulting from an economy’s growth process, which can in turn be influenced by FDI inflows, for instance through the transfer of technology from foreign to domestic firms. It is expected to reduce emissions by helping diffuse cleaner or energy-saving technologies (Pazienza, 2015[16]). The *composition effect* is associated with a change in industrial structure driven by FDI, and its impact on emissions will depend on the production specialisation of a country. An FDI-driven shift toward services would for instance be associated with a reduction in emissions, while a shift toward heavy manufacturing would deteriorate the host country’s carbon footprint.

These various effects underpin the transmission channels for FDI’s carbon implications (Figure 5.2, yellow box). Specifically, FDI generates emissions from production processes and energy use, as well as all other emissions associated with any intermediate goods, transport of goods to market, emissions in end use and
disposal of products produced (see Box 5.1 Box 5.1). These emissions are influenced by investor-specific attributes (e.g. technology, motive). Foreign investors also generate spillovers arising from (1) their supply chain relationships with domestic firms; (2) market interactions through competition and imitation effects; (3) and labour mobility of workers between foreign and domestic firms.

The motivation behind this Policy Toolkit is that, under certain circumstances, FDI can contribute the needed financial and technological resources to advance the low-carbon transition. Resulting benefits for host countries include: improving energy security, diversifying energy sources, reducing reliance on energy imports and electrifying remote rural areas; fostering innovation, creating new industries and jobs related to low-carbon technologies, and gaining an edge over competitors and attendant export opportunities in key industries; and the localised benefits of mitigating climate change, reducing environmental degradation, and improving air quality and associated health impacts. Developing countries that face greater constraints both in mobilising finance and acquiring and disseminating technologies may draw particular benefits from FDI in their efforts to tackle climate change (Figure 5.2, green box).

The extent to which FDI can play a role in de-carbonising economies depends on a number of contextual factors that are the focus of this chapter, including FDI characteristics and spillover potential, market and regulatory environments of home and host countries and the international frameworks that link them, and proactive policies to promote low-carbon FDI. Targeted policy interventions can create incentives for foreign investors to actively contribute to low-carbon objectives, and influence the spillover potential of their investments. The next section will look closely at the type of framework conditions and policies that facilitate FDI’s low-carbon impacts (Figure 5.2, blue box).

Figure 5.2. Conceptual framework: FDI impacts on carbon emissions
FDI’s direct impacts on carbon emissions

The carbon intensity of foreign investments depends on a range of characteristics specific to investors, including the technologies they use, the energy they consume, the products and services they offer, their motives for investing internationally, their environmental policies, and their sourcing choices.

Low-carbon technologies

Low-carbon technologies, by definition, reduce the CO₂ emissions associated with economic activity in any sector and are therefore key attributes that determine the carbon intensity of FDI (see Box 5.1). The energy sector, one of the largest contributors to CO₂ emissions, is a noteworthy example in which FDI can deliver innovations in energy generation, storage, and distribution (e.g. smart grids). Large-scale diffusion of these technologies is particularly important as it reduces the indirect emissions of all electricity-consuming activities. In fact, electrifying other sectors is an important avenue for decarbonisation provided that electricity generation itself is decarbonised. Thanks to their financial and technical advantages, MNEs are key players in the deployment of capital- and R&D-intensive clean energy technologies across borders, and particularly relevant for developing economies, where demand for energy is expected to grow most rapidly in the coming decades. The share of FDI captured by renewables, for example, has more than doubled relative to FDI in fossil fuels in the last decade in regions across the world (Figure 5.3).

In the industrial sector, decarbonising production processes requires switching to lower-carbon fuels for production and making more efficient use of materials. According to some studies, 20% of the energy consumed in industry is electricity, while it is already technologically possible to electrify up to half of the industrial fuel consumption (McKinsey, 2020[17]). In the transport sector, new low-carbon vehicles are being developed for road transport, rail, waterborne transport and aviation, including vehicles that run on electricity, hydrogen fuel cells, and compressed or liquefied natural gas. In the construction sector, advanced building materials and energy-efficient home appliances are being developed and existing technologies improved. As multinationals are key players in these emissions-intensive activities, they can make an important contribution to furthering electrification or developing altogether new breakthrough technologies for emissions reductions (e.g. hydrogen fuel cell, carbon capture utilisation and storage).

Figure 5.3. Renewables as a share of total FDI in the energy sector

Note: The energy sector includes renewables (wind, solar, geothermal, tide/wave/ocean, small hydroelectric, and biomass) and fossil fuels (coal, oil and natural gas) and related extraction activities. See OECD (2019[10]) for further details. Regional groups follow the World Bank classification of developing regions.
Source: Update of OECD (2019[10])
**FDI motives**

FDI motives are among the factors that push firms to invest abroad in low-carbon technologies. Foreign markets offer opportunities to sell new low-carbon products and services designed in relatively small or saturated home jurisdictions. Scarcity of production factors, natural resources (e.g. wind power) or strategic assets (e.g. infrastructure) in home countries may also drive MNEs to seek cross-border opportunities for their low-carbon investments, while accumulated technical knowhow related to low-carbon technologies in home countries can give investors a competitive edge internationally.

**Consumer and shareholder expectations**

Home country consumer and shareholder expectations and pressures from civil society can further contribute to green branding strategies and drive MNEs to reconsider their foreign operations and supply chains, strengthen environmental reporting or adopt carbon labelling. These considerations are consistent with the ‘Pollution Halo’ hypothesis, whereby, MNEs apply a universal environmental standard across borders and, in so doing, tend to spread their greener technology to their affiliates in host countries (Porter and van der Linde, 1995[15]). Home country governments can influence green corporate values and branding strategies through environmental policymaking, such as transparency and reporting requirements. They can further support low-carbon technological development and its cross-border diffusion, through investment and export promotion policies (e.g. investment guarantees, export credits), and technical cooperation programmes (e.g. ODA).

**Investor entry mode**

Investor entry modes also have implications on the carbon intensity of FDI activities. Mergers and acquisitions entail changes in corporate ownership, structure and governance, which in turn can affect the environmental policies and implications of existing establishments in host countries, for better or worse. Yet, greenfield investments involve new economic activity or expansions of existing activities and will typically result in greater (positive or negative) impacts on host countries. From a climate perspective, the direction of the impact will depend on the carbon intensity of the new investments and the technologies they generate and deploy.

**FDI’s carbon spillovers**

The premise behind FDI spillovers is that foreign firms have access to superior technology, skills, and capital, as a result of their ties to the parent company, and that this advantage can allow knowledge to spill over to domestic firms. This has important implications for the broader uptake of low-carbon technologies in the host country beyond the foreign firm. The spillover potential varies across technology and spillover channel. FDI spillovers on carbon emissions need not be positive, if, for instance, foreign investors are attracted by weaker environmental regulation (i.e. the ‘pollution haven hypothesis) and they induce a race to the bottom with respect to environmental standards.

**Value chain relationships**

Linkages with local suppliers and buyers are an important channel of knowledge and technology diffusion (see Chapter 2). In the context of the low-carbon agenda, these types of spillovers can take many forms, ranging from increased compliance with environmental regulations to innovations in energy use and industrial processes. Broadly speaking, these spillovers are more likely to occur in manufacturing industries and services sectors, as the opportunities for local linkages are greater than in the energy, building and transport sectors. A key requirement for these spillovers to materialise is that local businesses have sufficient absorptive capacity to meet the demands of foreign investors. This means that the realisation of
FDI’s low-carbon spillovers through value chain linkages requires a parallel evolution of skills and shifts in the labour force (OECD, 2015[18]).

In addition to supplier and buyer linkages, a key conduit for FDI’s low-carbon spillovers is through local partnerships, strategic alliances and joint ventures. This may be the most important transmission channel of R&D-intensive investments in the development and commercialisation of breakthrough technologies, where research collaborations across a number of private and public sector actors are common.

**Competition and imitation effects**

The entry and establishment of foreign investors heightens the level of competitive pressure on domestic companies, inducing them to innovate or imitate in order to keep up and remain competitive. In order for these competitive pressures to apply to low-carbon investment, there must be clear and consistent signals from policy makers indicating long-term commitment to the low-carbon agenda. A noteworthy example where anticompetitive structure and practices can inhibit low-carbon innovation is the energy sector, often dominated by state-owned incumbents particularly in developing economies. Ensuring competitive rules apply to electricity markets is a key prerequisite for attracting foreign independent low-carbon power producers (Prag, Röttgers and Scherrer, 2018[19]; Ang, Röttgers and Bürli, 2017[20]).

**Labour mobility**

Movement of workers between foreign and domestic firms as well as corporate spin-offs originating from foreign MNEs can further propagate knowledge spillovers from foreign to domestic firms, and help diffuse low-carbon business practices, as well as the skills necessary to operate low-carbon technologies. In the low-carbon context, this transmission channel is likely to be most relevant for human capital-intensive technologies, such as services and high-tech manufacturing. Labour mobility also allows new foreign entrants to seek out talent and hire the skilled workers needed to run their businesses.

**Socio-economic determinants of FDI’s carbon impacts**

The level of socio-economic development determines a country’s production specialisation, industrial structure, positioning in global value chains, and the sophistication of its infrastructure and technology. Some theories conjecture an inverted-U relationship between output growth and the level of emissions (known as the ‘Environmental Kuznets Curve’), expected to increase as a country develops and the economy grows but begin to decrease as rising incomes pass a turning point and create demands for tougher environmental regulation, bringing forth cleaner techniques of production (Grossman and Kruger, 1991[13]). According to these theories, differences in comparative advantage of advanced and developing countries result in differing FDI profiles, with developing countries attracting relatively more polluting investments in heavy manufacturing and extraction activities, and advanced economies attracting less polluting investments in services and high-tech manufacturing. Broadly speaking, empirical studies are consistent with this hypothesis, as they find evidence of positive FDI effects on emissions more frequently in low- and middle-income countries than in high-income countries (Hoffman et al., 2005[21]; Pao and Tsai, 2010[22]; Behera and Dash, 2017[23]).

The *OECD FDI Qualities Indicators* also suggest that differences in the carbon intensity of FDI can be explained in part by differences in comparative advantages. According to the indicators, only resource-rich countries, where fossil fuels constitute a large share of GDP, tend to attract carbon-intensive FDI (Figure 5.4). This is likely because extraction and energy transformation offer lucrative investment opportunities for large MNEs with the requisite capacity for these heavily capital- and energy-intensive activities.

Locational pull factors specific to low-carbon investments are related to the characteristics of FDI discussed above, and in particular to investor motives. Countries with underdeveloped electricity grids outside of
Urban centres offer viable untapped markets for producers of small-scale low-carbon electricity alternatives, compared to those with more extensive and dependable grids. Consumers that are aware of and responsive to green credentials such as carbon labels provide attractive markets for producers of low-carbon consumer goods. Countries that enjoy an abundance of wind, sun or tidal bays are the most profitable destinations for investments in wind turbines, solar plants, and tidal generators. Industry and technology clusters appeal to producers of low-carbon equipment seeking to gain from agglomeration effects, and other strategic assets such as skills or technologies similarly attract investors seeking to acquire knowledge and technical capabilities (UNCTAD, 2010[24]; Hanni et al., 2011[25]).

**Figure 5.4. FDI and CO₂ emissions**

Is greenfield FDI concentrated in cleaner activities? (yes if value > 0; no if value < 0)

Note: See OECD (2019[10]) for explanatory details.
Source: Update of OECD (2019[10])

**Core questions to analyse impacts**

The following set of questions provides an analytical framework for understanding the economic and market conditions that govern the relationship between FDI and carbon emissions. Table 5.1 provides additional questions and existing data tools that can help shed light on these questions. Cross-country data sources are limited and may require additional information from national statistics. The aim of this exercise is also to identify potential data gaps in national statistics and to draw attention to the importance of collecting data.

- **Carbon performance**: How have carbon emissions generated within the country evolved in recent years? Which sectors are responsible for the bulk of emissions? How much of the country’s energy mix is generated by renewables? To what extent is there innovation in low-carbon technologies?

- **Economic and market context**: Which natural resources is the country endowed with? Which sectors drive economic growth and how carbon intensive are they? Are consumers responsive to green credentials? How large or saturated is the market for green products?

- **GVC integrations**: To what extent is the country internationalised? How carbon intensive are the goods and services the country exports/imports? To what extent does the country participate in green GVCs and what does its positioning in these GVCs?

- **FDI transmission channels**: What sectors account for the bulk of FDI? How carbon and energy intensive are the activities of foreign investors? How does this compare to domestic investors? To what extent do foreign investors engage in supply chain relationships with domestic business and how does this vary across activities with different carbon intensities?
Table 5.1. Supplemental questions and data tools (preliminary)

<table>
<thead>
<tr>
<th>Core dimensions</th>
<th>Questions</th>
<th>Indicators (Source)</th>
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<tbody>
<tr>
<td><strong>Carbon performance</strong></td>
<td>How does the country perform in terms of carbon emissions?</td>
<td>Carbon emissions by sector (IEA)</td>
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<tr>
<td></td>
<td>How does the country perform in terms of energy, fuel and resource efficiency?</td>
<td>Energy intensity by sector (IEA)</td>
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<td>How much does the country invest in R&amp;D related to low-carbon technologies?</td>
<td>Public R&amp;D budget for low-carbon technology (IEA)</td>
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<td></td>
<td>To what extent is there innovation in clean energy technologies?</td>
<td>Patents in environment-related technologies (OECD), Renewable power-related patents (IMF)</td>
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<tr>
<td><strong>Economic structure and comparative advantage</strong></td>
<td>Is economic activity concentrated in carbon-intensive sectors?</td>
<td>Value added by sector (OECD)</td>
</tr>
<tr>
<td></td>
<td>Is the country endowed with fossil fuels? Is it endowed with renewable natural resources?</td>
<td>Oil / coal rents as a share of GDP (WB), Global RE Atlas (IRENA)</td>
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<tr>
<td></td>
<td>Does the country export fossil fuels? Does it export electricity? Does it export high-tech goods?</td>
<td>Export data by sector (WITS)</td>
</tr>
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<td></td>
<td>To what extent does the country participate in green global value chains? Where is it position along these value chains?</td>
<td>Foreign value added share of gross exports (OECD TiVA)</td>
</tr>
<tr>
<td><strong>FDI transmission channels</strong></td>
<td>How polluting are the sectors that account for most of the FDI?</td>
<td>FDI inflows by sector (OECD, National sources*)</td>
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<td></td>
<td>How much FDI do renewables/ fossil fuels attract?</td>
<td>Greenfield FDI by sector (Financial Times)</td>
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<td></td>
<td>How energy intensive are foreign firms operations relative to domestic firms?</td>
<td>Energy efficiency of investors (WBES)</td>
</tr>
<tr>
<td></td>
<td>How does the extent of supply chain linkages between foreign and domestic firms vary across sectors with differing carbon emissions?</td>
<td>Share of local sourcing of foreign firms (WBES), Share of FDI output used as input by domestic firms (WBES)</td>
</tr>
</tbody>
</table>

Note: The list of core questions is not exhaustive and will be extended further. *Data may not exists an should be collected

5.3. Policies that influence FDI impacts on carbon emissions

The host country’s policy framework influences its business environment, including the FDI entering the country and its carbon implications (Figure 5.2, blue box). A policy framework for low-carbon investment is in many respects comparable to an enabling environment that is conducive to investment in general. Policies conducive to FDI, however, will not automatically result in a substantial increase in low-carbon FDI. A policy framework for investment is thus a necessary but insufficient condition for low-carbon investment. Policy makers will also need to improve specific enabling conditions for low-carbon investment by developing policies and regulations that systematically internalise the cost of carbon emissions, and facilitate low-carbon FDI and its knowledge and technology spillovers (OECD, 2015[26]). Such proactive policies and programmes include a mix of FDI, innovation and climate policies that take into account national circumstances and potential competitiveness impacts. International agreements and standards can further reinforce such proactive policies and programmes, or preserve domestic policy space for addressing climate concerns.

This Policy Toolkit aims to provide a comprehensive policy framework for countries to maximise positive impacts of FDI on carbon footprint while mitigating adverse effects, in line with the OECD Guidelines for Multinational Enterprises. It builds on chapter twelve on “Investment for framework for green growth” of the OECD Policy Framework for Investment, and on the OECD Policy Guidance for Investment in Clean Energy Infrastructure. Once finalised, it will complement these instruments by offering a comprehensive mapping of policies and institutional settings that influence FDI’s carbon impacts across selected advanced and developing countries (see Chapter 1).
Table 5.2. Summary of policies that affect FDI’s carbon impacts

<table>
<thead>
<tr>
<th>Policy type</th>
<th>Instrument type</th>
<th>Direct impact</th>
<th>Spillovers</th>
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<td></td>
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<td></td>
<td>Supply chain</td>
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<tr>
<td>Regulatory framework</td>
<td>FDI openness and non-discrimination</td>
<td>✓</td>
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<td></td>
<td>Transparency and predictability</td>
<td>✓</td>
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<td>Competition policy</td>
<td>✓</td>
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<td>IP protection</td>
<td>✓</td>
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<td>Contract enforcement and land use rights</td>
<td>✓</td>
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<td></td>
<td>Access to finance</td>
<td>✓</td>
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<td></td>
<td>Responsible business conduct</td>
<td>✓</td>
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<tr>
<td>Proactive policies and programmes</td>
<td>Price-based instruments</td>
<td>✓</td>
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<td></td>
<td>Standards, disclosure and information</td>
<td>✓</td>
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<td></td>
<td>Technology support</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td></td>
<td>Cluster and linkages policies</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>International agreements &amp; standards</td>
<td>Climate change conventions</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td></td>
<td>International investment agreements</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td></td>
<td>RBC principles and standards</td>
<td>✓</td>
<td>✓</td>
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</table>

Note: This table serves as a starting point for the mapping of policies and institutions that will inform the Policy Toolkit. It is not intended to be exhaustive and will be further updated as the Toolkit is developed. Some policy instruments can have an impact on multiple transmission channels. For simplicity, only the most important ones are selected here.

**Regulatory framework**

Regulatory factors are important drivers of FDI and have been found to influence the effectiveness of climate mitigation policies in promoting low-carbon innovation (Ang, Röttgers and Burli, 2017[20]). Key elements of the regulatory framework that are conducive to a healthy and attractive investment climate and particularly relevant for FDI’s low-carbon impacts include policies that guarantee openness and non-discrimination of foreign investors, contract enforcement and access to land, protection of intellectual property rights, the functioning and structure of markets (e.g. competition, transparency), and environmentally responsible business conduct (OECD, 2015[26]).

**Strengthening commitment, transparency and predictability**

A fair, transparent, clear and predictable regulatory framework for investment is a critical determinant of investment decisions and their contribution to development. Transparency and predictability matter even more when considering returns on investments with long time horizons. Strong government commitments at both the international and national level are necessary to catalyse low-carbon green investment. With clear, long-term and ambitious signals and emission goals, nationally and internationally, investors and markets will have a better view on where to invest (OECD, 2015[18]). While these signals are important for all business, they are crucial for giving the confidence to multinational investors with the requisite capacity and skills to invest in risky new technologies that are highly capital- and R&D-intensive.

**Ensuring openness and non-discrimination**

The non-discrimination principle provides that investors are treated equally, irrespective of their ownership. Discriminatory restrictions on the establishment and operations of foreign investors can deter FDI in general, and diminish its low-carbon impacts. While manufacturing industries have undergone significant FDI liberalisation worldwide, over the last three decades, some sectors that present significant opportunities for decarbonisation efforts remain partly off-limits to foreign investors in many countries – notably, transport, electricity generation and distribution, and construction. Many services, typically
associated with lower carbon emissions and in some cases crucial for energy-saving technologies (e.g. digital services), are also more frequently restricted to foreign participation (Gaukrodger and Gordon, 2012[27]). Restrictions on FDI in these sectors are likely to result in sub-optimal flows of investment, limit the transfer of know-how and hamper the deployment of low-carbon technologies.

Discriminatory measures can also be used to actively target low-carbon investments, enhance their spillover potential, or deter carbon intensive-investments. FDI screening mechanisms or public procurement conditional on pre-specified carbon criteria, could, in theory, be used to limit the adverse carbon impacts of FDI. Technology transfer obligations could support low-carbon spillovers to domestic firms. However, trade-distorting discriminatory measures, such as local content requirements (LCRs) and subsidies, even if targeting low-carbon products, can hinder international investment across the value chains by raising the cost of inputs for downstream activities. Particularly in small developing countries with low domestic demand and relatively poor supporting infrastructure, policies of this type could increase the costs of domestically purchased environmental goods (OECD, 2015[26]).

In addition, the opportunities presented by international investment occasionally bring risks, including for security interests of host countries. Since 2016, governments are taking these risks increasingly seriously and most OECD countries now have screening mechanisms allowing them to intervene in a much broader section of the economy if international investment may threaten their essential security interests (OECD, 2020[29]). Investment screening could conceivably affect the energy transition and low-carbon innovation in several ways: energy infrastructure (e.g. energy storage) is itself considered “critical infrastructure” in many countries (EU, 2019[29]); advanced technologies (e.g. semiconductors) are likewise typically included under investment review mechanisms, with knock-on effects on energy-related technologies (e.g. solar panels, smart grids). Finally, foreign funded research and international R&D cooperation, which may be needed or accelerate the energy transition, have come under scrutiny for their national security implications as well, and governments may heighten their attention to such arrangements. Policymakers need to balance the benefits of international investment and international cooperation with the potential implications for essential security interests and seek to mitigate and manage the associated risks.

**Reinforcing competition policies**

Competition rules are designed to promote and protect effective competition in markets, encouraging firms to invest efficiently and to innovate and adopt more energy-efficient technologies. Such competitive pressure is a powerful incentive to use scarce resources efficiently and complements climate policies and regulations aimed at internalising the environmental costs of carbon emissions. By helping to achieve efficient and competitive market outcomes, competition policy hence contributes in itself to the effectiveness of climate policies. These pressures not only influence the foreign investor’s operations and direct carbon impacts, but also push local businesses to imitate or improve foreign low-carbon technologies in order to remain competitive.

Competition policy may be especially important for supporting decarbonisation of the energy sector. Dominant incumbent enterprises may deter independent renewable power producers from entering a market through tender procedures (Ang, Röttgers and Burli, 2017[20]). Therefore, countries in which competition authorities strengthen competition rules and adequately address anticompetitive practices by incumbent utilities, including state-owned enterprises (SOEs), are likely to be more attractive destinations for multinationals seeking investment opportunities in renewable power. Strengthening competition policy can also help address outstanding electricity market design issues that prevent the generation, transmission and distribution of renewables.

Governments can establish a level playing field between SOEs and private actors – including independent power producers and network operators – as well as between foreign and domestic actors in the electricity sector, in order to attract investment in low-carbon generation. In particular, policymakers need to ensure that producers of low-carbon electricity benefit from non-discriminatory access to the grid, as uncertain
grid access increases project risk; investment in the grid is open to private investment, including foreign investment (potentially through joint ventures); private developers benefit from non-discriminatory access to finance, e.g. from state-owned banks; tenders for public procurement are carefully designed with clear and transparent bid evaluation and selection criteria (OECD, 2015[18]).

Protecting intellectual property

Intellectual property rights (IPRs) create strong incentives for innovation as they ensure that investors earn a fair return on their technological innovations. IPRs can be used to generate revenues from licences, encourage synergistic partnerships, or create a market advantage and be the basis for productive activities, and are especially important for the development of low-carbon technologies, which are both research- and capital-intensive (IRENA, 2013[30]). At the same time IPRs can be perceived as an obstacle to the transfer of low-carbon technologies from developed and emerging economies to developing countries. Defining an IPR regime conducive to low-carbon innovation is particularly challenging as it needs to strike a balance between providing a secure environment for investment in innovation, while ensuring that small investors can afford valuable technologies.

The importance and impact of IPRs on the transfer of technology are likely to be context specific. In remote areas of low-income countries, the need to expand energy access requires the rapid deployment of well-known renewable energy technologies, for which IPR protection might be less critical. In some African markets very few low-carbon technologies are protected under IP regimes (Haščič, Silva and Johnstone, 2012[31]). By contrast, a strengthening of the IPR regime is likely to play a positive role in emerging economies, responsible for a third of global patenting in clean energy technologies, and representing most of the projected growth in energy demand in the coming decades. With two thirds of the patenting in clean energy technology being submitted by foreign companies, consolidating the IPR regime could give more incentives to foreign developers to transfer technologies to these emerging markets (OECD, 2015[32]).

Enforcing contracts and land use rights

The ability to enforce contracts and minimise transaction costs associated with litigation plays an important role in investment decisions in general, but may be crucial for largescale low-carbon infrastructure projects, which typically require a set of complex and interlinked contractual arrangements. The potential costs of litigation are magnified by the many risks associated with low-carbon infrastructure projects (e.g. completion risk, technology risk, revenue risk, supply risk, weather risk, etc.), and may disproportionately affect smaller investors (OECD, 2015[32]).

Securing land use rights is similarly vital for large-scale utility projects, which so far have dominated renewable energy investment in developing countries. Most renewable energy plants demand more surface per megawatt installed than their fossil-fuel counterparts, and will require the company leading the project to engage with more than one landowner. Therefore, although not strictly related to low-carbon investments, inadequate property registration systems can increase the transaction costs associated such projects, particularly in the area of clean energy investments. At the same time, governments need to ensure that land concessions do not undermine the subsistence of vulnerable members of the population, which may depend on plots of land that offer the critical natural renewable resources. Prior mapping of natural resources and stakeholder consultations can help minimise these risks.

Facilitating access to finance

A wide range of financial instruments (e.g. credit enhancement, leasing, guarantees, grants and bonds) offered by public and private financial institutions, by investors via capital markets, and supported by an efficient financial infrastructure, are required to facilitate low-carbon investments. In some countries however, access to long-term finance is constrained by shallow and illiquid financial markets. Accessing international capital markets can also be difficult for many developing countries. These challenges can be
further exacerbated for low-carbon infrastructure projects, as lenders may be reluctant to lend due to insufficient knowledge of local markets and a higher technology risk.

There are several factors that can lead to scarcity of long-term domestic finance in many developing countries, including lack of competition in the banking sector; shallow domestic financial markets; banks lack of technical expertise for accurate risk evaluation; aversion to lending to new actors, such as innovative SMEs; and preference for short-term maturities. These challenges are particularly acute in Africa, where bank loans with long maturities are very rare, interest rates are excessively high; and infrastructure-related bonds are issued in only a few countries (OECD, 2015[32]).

Small and medium-sized enterprises (SMEs) face exacerbated problems of access to finance, being too large for micro-finance and too small to benefit from commercial or international financing. This disadvantage is further compounded by the fact that the costs of due diligence have a disproportionate impact on smaller projects, and has been found to have effect on both renewable energy and energy efficiency projects (Blyth & Savage, 2011; UNEP, 2009)

Promoting environmentally responsible business conduct

Businesses face increasing pressure to address climate change. Policy support to climate-friendly practices can leverage companies' contributions to addressing climate change over and above the influence of regulatory approaches (such as emissions standards). Countries have put in place a number of mandatory or voluntary schemes that require or encourage investors to measure and report their GHG emissions (discussed in greater detail under proactive policies and programmes). Other approaches include encouraging broad stakeholder participation in the setting of climate and low-carbon investment strategies, requiring environmental impact assessments and encouraging use of environmental management systems. Multilateral approaches to promoting RBC are discussed in the context of international agreements and standards.

Proactive policies and programmes

Proactive policies and programmes that are conducive to FDI’s low-carbon impacts include a wide range of instruments that span across different policy spaces. Broadly speaking, this system of policies seek to correct market failures and externalities associated with carbon emissions that result in over-investment in carbon-intensive activities, and thereby (1) promote low-carbon investments/FDI; and (2) promote low-carbon technology spillovers from foreign to domestic firms (Table 5.3).

In designing and implementing the policy mix for maximising FDI’s low-carbon impacts, it is important that the broad system of instruments and resulting incentives and disincentives are aligned to support national low-carbon objectives, and green growth more generally. Co-ordination efforts across institutions from relevant policy areas (e.g. investment, energy, environment, trade, industry) is crucial, given the cross-cutting nature of climate challenges and related policies. Many of the policies discussed here could equally be viewed as energy, climate or investment promotion policies. It is worth noting also that the following discussion is not exhaustive, neither in breadth of instruments nor in depth of analysis. Only the more obvious instruments that can influence FDI’s low-carbon impacts are examined, and the discussion will be further informed by mapping these policies across countries and implementing country studies (see Chapter 1).
### Table 5.3. Summary of proactive policies for low-carbon FDI

<table>
<thead>
<tr>
<th>Instrument type</th>
<th>Policy option</th>
<th>Direct impact</th>
<th>Spillovers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price-based instruments</td>
<td>Fossil fuel subsidy reform</td>
<td>✓</td>
<td></td>
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<tr>
<td></td>
<td>Taxes on energy use</td>
<td>✓</td>
<td></td>
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<tr>
<td></td>
<td>Emissions trading systems</td>
<td>✓</td>
<td></td>
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<tr>
<td></td>
<td>Border Carbon Adjustment</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Standards, disclosure &amp; information</td>
<td>Technology/ performance standards</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Voluntary disclosure and reporting</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Public information campaigns</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Award schemes</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Technology support</td>
<td>Fiscal incentives</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Public procurement</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Feed-in tariffs &amp; premiums</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Green certificates</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Cluster and linkages policies</td>
<td>Economic zones</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Supplier development programmes</td>
<td>✓</td>
<td></td>
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<tr>
<td></td>
<td>Business match-making services</td>
<td>✓</td>
<td></td>
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<tr>
<td></td>
<td>Education and training</td>
<td>✓</td>
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</tbody>
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Note: This table serves as a starting point for the FDI Qualities Mapping of policies and institutions that influence FDI’s carbon impacts. It is not intended to be exhaustive and will be further updated as the Policy Toolkit is developed.


### Price-based instruments

Price-based instruments primarily seek to internalise the costs of carbon emissions by putting an explicit price on emissions from energy use. They also include initiatives to reform distortionary policies that keep the price of carbon artificially low, such as direct transfers and preferential tax treatments granted to the extraction and production of fossil fuels. In the absence of carbon pricing policies, final energy prices do not reflect the costs carbon emissions from energy use impose on society, resulting in inefficient over-consumption of some energy products. While carbon pricing policies do not specifically target FDI, they are a necessary first step to send the socially optimal price signals to all investors, including foreign ones, and raise the returns on low-carbon relative to high-carbon investments. Moreover, carbon pricing is pro-competitive as it prepares companies for strong performance in a low-carbon economy (OECD, 2018[34]).

**Taxes on energy use** (comprising fuel excise taxes, electricity excise taxes, and explicit carbon taxes) increase the final price of the taxed energy products, encouraging businesses and consumers to use less energy and, if appropriately designed, to switch to cleaner energy sources. Since different energy products have different energy and emission characteristics, taxes that are equal in physical terms or energy terms will not be equal in carbon terms. In fact, differences in effective energy tax rates (i.e. the sum of fuel electricity and carbon taxes, net of exemptions, reductions, and refunds) are generally not proportional to energy products’ carbon contents in OECD and G20 countries, and this discrepancy is particularly pronounced for coal and other solid fossil fuels (OECD, 2019[35]). **Carbon taxes** explicitly link the tax rate to the carbon content of the fuel, irrespective of whether the resulting carbon price is uniform across fuels and uses, thereby providing abatement incentives in support of decarbonisation objectives.\(^{20}\)

**Emissions trading systems** (or cap-and-trade) are a type of flexible environmental regulation that allow markets to decide how best to meet policy targets. Authorised bodies set a cap on GHG emissions and allocate or auction a limited number of tradable permits that allow a discharge of a specific quantity of a specific pollutant (e.g. CO\(_2\)) over a set time period. Emitters are required to hold permits in amount

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\(^{20}\) See OECD (2019[36]) for a detailed analysis of carbon pricing instruments, and their use in OECD and G20 countries.
equal to their emissions, but can increase their emissions by buying permits from others willing to sell them. ETS are cost-effective in that they provide incentives for emissions abatement where it can be done at least cost, but setting the cap too high results in a low carbon price that provides little incentive to invest in carbon abatement.

Domestic climate policies, such as carbon pricing, can reduce the competitiveness of locally established firms (both foreign and domestic) as they raise costs of production. In theory, this can discourage new FDI or push existing investors to relocate carbon-intensive operations to countries with less stringent climate policies (i.e. the ‘Pollution Haven’ hypothesis). Indeed, there are growing concerns that cross-country differences in climate policy stringency can lead to changes in countries’ comparative advantages, trade flows, and the geographic distribution of production. For a global pollutant like CO₂, this implies that the abatement efforts of one country are offset by a rise in emissions in other countries (i.e. carbon leakage), both undermining the efficacy of domestic climate policies and diminishing domestic competitiveness.

Foreign multinationals may be particularly susceptible to relocating emissions-intensive activities to other countries given their networks of affiliates spread across the globe. A recent study on the role of the European Union’s Emissions Trading System (EU ETS) as a possible driver of outward FDI by Italian manufacturing firms in the automotive industry suggests that the EU ETS had a weak effect on the number of new subsidiaries abroad, while it had a larger impact on production taking place in foreign subsidiaries, especially in trade-intensive sectors (Borghesi, Franco and Marin, 2020[36]). As countries consider more ambitious climate policies in order to curb GHG emissions, securing buy-in by domestic consumers and producers will require carbon leakage and competitiveness effects to be addressed (OECD, 2020[9]).

A border carbon adjustment (BCA) is a “measure applied to traded products that seeks to make their prices in destination markets reflect the costs they would have incurred had they been regulated under the destination market’s greenhouse gas emission regime” (Cosbey et al., 2012[37]). BCA regimes have long been discussed but, but only recently started gaining traction in the EU and US as a potential instrument to address carbon leakage and competitiveness issues. A number of design and implementation challenges associated with such regimes that will need to be overcome include compatibility with WTO rules, scope of coverage, carbon embodiment measurement issues, and use of revenues.21 Potential conflicts between climate, trade and investment objectives must be taken into consideration in designing a suitable policy mix to promote low-carbon FDI.

Technology support

Innovation plays a key role in broadening the range of low-carbon technology options available. The private sector is likely to underfund R&D in low-carbon technologies due to the fact that the positive spillovers of these technologies are not fully captured by investors. Targeted policies that support low-carbon innovation are needed at all stages of the research, development, demonstration and deployment chain. Different policies may be appropriate at different stages of the R&D chain. Direct grants and public research programmes are often needed at the early stages. Tax incentives, feed-in tariffs and regulatory standards can accelerate deployment and commercialisation of more mature technologies at later stages. Government departments and research laboratories can also play an important role in convening domestic and foreign industry members. Some of these instruments that have been particularly successful in promoting clean energy investments are discussed here, although many more exist for different low-carbon technologies.

Investment tax incentives are widely used to promote FDI and to influence its characteristics and impacts. Incentive programmes can target low-carbon investments by increasing related profits (e.g. corporate tax
holidays), reducing costs associated with certain expenses (e.g., tax deductions on R&D expenses, accelerated depreciation) or exempting recipients from indirect taxes (e.g., VAT on imported machinery).

**Feed-in tariffs (FiTs)** are a type of incentive designed specifically to accelerate investment in renewable energy technologies by offering long-term contracts to renewable energy producers. They reduce the risk of renewable energy investments by guaranteeing a predetermined price (or revenue) for the electricity generated for a predefined period of time. Payments can be provided at a fixed 'tariff' level set independently of the wholesale electricity price, or as a 'premium' payment above the wholesale electricity price. They are typically combined with guaranteed access to the grid for renewable generators. Recent studies have found evidence that feed-in-tariffs are a powerful tool for attracting FDI in renewables, both in advanced and developing countries (Wall et al., 2019[38]; Kathuria, 2015[39]; Zhang, n.d.[40]).

At the same time, feed-in-tariffs come with some important drawbacks. Setting the tariff too high can lead to over-investment and a surge in electricity prices. The resulting reaction from government is often a retroactive readjustment of the tariff, which increases policy risk and uncertainty for investors. Governments can hedge against a surge in investment by setting a capacity cap above which any additional investment will not benefit from the FIT. On the other hand, setting the tariff too low will not induce the expected investment flows. The tariff needs to be accurately calculated, and clarity needs to be given to investors as to when and on what basis the tariff is susceptible to change (e.g. to adapt to changes in input costs, achievement of targets, etc.). Setting the right tariff is a complex exercise, with the rapidly decreasing cost of the technologies, and particularly in young markets where government capacity in the design of FiTs may be low and there may be asymmetry of information between regulator and companies.

**Public procurement** is recognised as an important instrument of innovation policy. Beyond bringing existing low-carbon solutions to market today, it can create 'lead' markets, for instance where government demand is significant (e.g. transport, construction), and can spur innovation without engaging new spending (OECD, 2016[41]). Partly as a result of their experience with fossil-fuel technologies, developing countries tend to have greater experience in using procurement methods than with support mechanisms specific to low-carbon technologies. If used in combination with long-term power purchasing agreements (PPAs), tenders can be an alternative way to attract private investment in clean energy. In Brazil, for example, the use of reverse auctions for wind energy (with 20-year PPAs) resulted in winning bids for which tariff rates were 42% lower than previously established feed-in-tariffs. Especially for procuring entities that lack technical capacity or experience in the renewable energy field, however, tenders can be risky. Governments should therefore design tenders with a view to guaranteeing competitive neutrality and minimising the risks of fraud and bid rigging (OECD, 2015[32]).

**Green certificates** (also known as renewable energy credits or green tags) can also be used to support clean energy investments. They consist of a market-based mechanism involving the exchange of certificates derived from electricity generation from renewable energy sources. They are usually combined with renewable portfolio standards that require electric utilities to source a fixed share or quantity of electricity from renewable sources, either by installing an equivalent amount of renewable electricity generation capacity, or by purchasing green certificates. Tradability enhances the cost-effectiveness of renewable power generation, although high administrative costs may reduce the cost-effectiveness of implementation.

Studies have shown that the variations in the cost-effectiveness of these technology support policies depend on the country context rather than on the specific tool used. In other words, ensuring that the tool is used in the correct context is more important than the choice of the policy support tool itself. In terms of impact, there is some evidence, however, that price-based support schemes (e.g. FiTs) have a stronger positive association with flows of private finance for investment in renewable energy than quota-based support schemes (e.g. green certificates) (Cárdenas-Rodríguez, Haščič and Johnstone, 2014[42]).
Standards, voluntary disclosure and information programmes

This range of policies are often used to promote or mandate the use of more efficient technologies that help achieve energy savings or emissions reductions. What they have in common is that they are designed to address certain barriers to the adoption of superior technologies, such as informational failures that are not addressed by carbon pricing mechanisms. For instance, insufficient, inaccurate or costly information on the energy performance of different technologies, and the costs and benefits of energy-efficiency measures, leads to suboptimal decisions by consumers and investors, and generally results in under-investment in energy efficiency (IEA, 2011[43]).

Regulatory standards, such as technology and performance standards, restrict the emissions or energy use of vehicles, power plants, buildings, appliances and industrial processes. For instance, fuel economy standards apply to the fuel efficiency of new road vehicles, and blending mandates apply to the use of biofuels in transport. Building standards apply to the thermal insulation of new buildings or to the retrofitting of old ones. Emissions standards of power plants regulate the carbon intensity of their electricity mix. Efficiency standards for consumer appliances remove certain products from the markets. Given that performance standards require, the uptake of more efficient technologies, but do not make their use more expensive, not all energy-efficiency improvements result in net energy savings (OECD, 2019[35]).

Voluntary disclosure and information programmes, such as energy labels or carbon labels can contribute to a race-to-the-top in best products and technologies.

Cluster and linkages policies

Cluster and linkages policies are widely used tools to influence the spillover potential of FDI, and can be designed to target low-carbon spillovers. Cluster policies promote agglomeration, which in turn influences spillover potential, while linkages programmes explicitly seek to connect foreign and domestic businesses to facilitate the transfer of knowledge and technology.

Economic zones have become the preferred instrument of many governments to achieve a number of policy objectives, ranging from FDI attraction to industrial development. Common features of zones include a defined geographic perimeter, reduced tax burden, infrastructure support, simplified regulatory requirements (e.g. with respect to land access, permits and licences, or employment rules), and streamlined administrative procedures (e.g. for registration, customs, etc.) that are often governed by a single autonomous authority. Their attractiveness to policymakers stems also from their potential use as experimental laboratories where new policies can be tested before being rolled out to the rest of the economy. These features make them well-suited also to target low-carbon FDI, innovation and spillovers, or potentially to test low-carbon policies. In addition, existing zones and industrial parks can be transformed into hubs for low-carbon growth to help achieve climate objectives.

For economic zones to generate impact beyond their confines, accompanying measures need to be put in place, including appropriate connectivity to the rest of the country, reduced barriers to investment, and engagement of the private sector and education institutes. In practical terms, zone spillovers require establishing conditions that favour linkages between investors in the zones and economic actors outside the zones that enable the transfer of knowledge and technology. The extent of these linkages depends crucially on how wide the gap is between the capabilities of the local business elite and the sophistication of what is demanded by foreign investors, so that a more robust local private sector translates to a greater probability of knowledge transfer. Research suggests that partnerships between economic zones and local universities and vocational training institutes constitute an important magnet in attracting anchor investors, and expanding backward linkages into the host economy (Moran, 2011).

Linkage programmes are policy interventions designed to facilitate supply chain relationships between foreign investors and local businesses. Specific instruments include supplier development programmes, business matchmaking services and events, supplier databases and portals, and MNE secondment
programmes. These programmes seek to increase local capabilities and promote the transfer of knowledge and technologies from foreign investors to local businesses, and can be applied to low-carbon technologies to support their diffusion.

**International agreements and standards**

Carbon emissions have global effects, regardless of where they were released, meaning that the impact of one country’s climate policies is dependent on the climate policies of other countries. Given the short-term economic costs of climate policies, the ambition of domestic policies depends on the perceived economic impacts those policies may create, as well as the perceived risks of carbon leakage that may render domestic climate action vain. Policy makers, as well as industry and the general public, seek reassurance of commensurate action from their trade partners, through treaties or other forms of international agreement, whether bilaterally or multilaterally (OECD, 2015[18]).

**Multilateral negotiations on climate change**

The United Nations Framework Convention on Climate Change (UNFCCC) is the central forum for global negotiations on climate change and for international co-ordination of climate policies. Such co-ordination provides the sought-after assurances to domestic policy makers that commensurate efforts are being taken internationally by key trading partners, and can play an important role in advancing national climate policies.

In December 2015, 196 states negotiated a landmark climate change agreement at the 21st Conference of the Parties (COP21) of the UNFCCC in Paris. The resulting Paris Agreement aims to limit climate change to 1.5°C global mean temperature change, and expects progressively more ambitious climate mitigation commitments from all states party to the treaty over the coming decades. As of January 2021, 190 members of the UNFCCC are parties to the agreement, and 187 states and the EU, representing about 79% of global greenhouse gas emissions, have ratified or acceded to the Agreement (UNFCCC, 2015[2]).

The central mechanism of the Paris Agreement is a ‘pledge-and-review’ process. Every five years the parties submit increasingly ambitious nationally determined contributions (NDCs) that lay out mitigation plans, and may include ones related to adaptation. Parties are left to establish their own national policy framework to achieve the commitments outlined in such NDCs. Countries are also required to report emissions, with progress reviewed by a ‘facilitative, nonintrusive, non-punitive’ independent review system, with flexibility given to developing countries in light of their weaker capacity to collect and report data.

Technology transfer is a crucial element of the new international climate regime. Developing countries, led by India, advocated for strong technology transfer provisions, and in particular the increased availability of free intellectual property for the purpose of faster diffusion of clean technologies. Section G of the Paris Agreement creates scope for further development of a regime for technology transfer: it establishes as norms the ‘strengthening of co-operative action’ and ‘promoting and enhancing access’, and builds on the ‘Technology Mechanism’ established under its predecessor treaty, the 2010 Kyoto Protocol. While little detail is provided as to how these norms should be pursued in practice, international trade and investment are likely to play a pivotal role in fostering the needed technology transfer.

The Paris Agreement is instrumental in providing political space for policy makers to strengthen climate action domestically. Fulfilling the Paris Agreement will require substantial new domestic climate policies in each state party to the treaty, including pollution controls that also result in GHG mitigation, land use regulations, clean infrastructure investment targets, or policies aimed at fostering low-carbon innovations. International trade and investment law may in some cases be perceived to conflict with the measures taken by states to implement the Paris Agreement. For instance, foreign investors may regard changes to domestic environmental law and policy as ‘indirect expropriation’ of their investments, and may seek compensatory claims against the host country (see below). Similarly, WTO rules may prevent states from
regulating traded goods on the basis of the climate impacts of their production (OECD, 2020). Alternatively, states may seek to protect low-carbon industries as a means of achieving long-term decarbonisation targets, and these trade protections may run contrary to free trade principles. States with both an interest in seeing robust climate action and a deep involvement in trade negotiations are in an important position to ensure alignment and mutual reinforcement across climate, trade and investment regimes.

International investment agreements

International investment agreements (IIAs) – including bilateral investment treaties and regional trade agreements with investment chapters – define how the treaty partners balance investor protection with other public policy objectives. They way in which treaties address environmental concerns, or fail to address them, can potentially stand in the way of achieving climate objectives. IIAs restrict domestic policy space and can for instance limit the ability of governments to use incentives to encourage renewable energy projects, impose restrictions on new fossil fuel-exploration or exploitation projects, or phase out fossil-fuel-based infrastructure. Provisions that guarantee pre-establishment rights can limit the ability of developing countries to hold foreign investments to their home countries’ higher environmental standards in cases where domestic laws on environmental protection applicable to domestic companies are weak or missing. It has also been argued that the risk of treaty-based litigation can lead governments to abandon otherwise legitimate public interest measures, including on climate action (Johnson, Sachs and Lobel, 2019).

At the same time, investment treaties can form part of wider policy efforts to create incentives for investments that help transition to low-carbon energy infrastructure, reform the current reliance on fossil fuels or correct regulations that weaken the business case for investment and innovation in low-carbon infrastructure. Newer BITs and RTAs, in particular, increasingly feature explicit language that reflects environmental concerns (Gordon and Pohl, 2011; Yamaguchi, 2020).

Broadly speaking, language in IIAs designed to address environmental and climate concerns can be grouped along four main policy objectives: (1) encouraging international cooperation; (2) reinforcing domestic law; (3) preserving domestic policy space; and (4) influencing investor conduct (Table 5.4).

IIAs increasingly include language to promote international cooperation on a variety of policy objectives, including climate action. These references vary in their specificity and concreteness:

- **Signalling an intent to promote progress on environmental protection and cooperation.** Promotion of international cooperation on climate matters is often limited to general language in the preamble that establishes the treaty parties’ ambitions to cooperate on environmental protection, sustainable development, or the transfer of technology as an overall objective of the treaty. References to specific climate objectives, such as the removal of tariff and non-tariff trade barriers related to climate-friendly goods and services, or the reduction of fossil fuel subsidies, are sometimes included in hortatory provisions about shared government goals and imperatives (e.g. EU-Singapore FTA 2018).

- **Committing to cooperate on environmental matters.** In other cases, treaty parties explicitly commit to specific measures of cooperation, such as exchanging expertise on environmental regulations and their implementation; sharing investor records of compliance with the home state environmental laws; or establishing a committee to supervise the enforcement of environment and trade matters covered in the agreement (e.g. US-CAFTA-DR 2018).
Table 5.4. Illustration of how IIAs explicitly address environmental protection and climate action

<table>
<thead>
<tr>
<th>Policy objective</th>
<th>Type of reference</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Encourage international cooperation</td>
<td>General promotion of progress in environmental protection and cooperation</td>
<td>EU-Singapore FTA (2018), Chapter 7; EFTA-Georgia FTA (2016), Art. 10.8; EU-Ukraine AA (2014), Art. 293; Japan-Switzerland FTA (2009), Art. 9</td>
</tr>
<tr>
<td>Reinforce domestic law</td>
<td>Explicit safeguards or enhancements of international environmental agreements</td>
<td>CARIForum-EU FTA (2008), Art. 72; Peru-US FTA (2006), Art. 18.2, 18.13;</td>
</tr>
<tr>
<td></td>
<td>Non-lowering of environmental standards for the purpose of attracting investment</td>
<td>EU-Singapore FTA (2018), Art. 12; EU-Ukraine AA (2014), Art. 296; Canada-Burkina Faso BIT (2015), Art. 15; Japan-Switzerland FTA (2009), Art. 101; China-Madagascar BIT (2005);</td>
</tr>
<tr>
<td>Preserve domestic policy space</td>
<td>Explicit affirmation of environmental regulatory power of host state</td>
<td>Morocco-Nigeria BIT (2016), Art. 13</td>
</tr>
<tr>
<td></td>
<td>Carve-out clauses for environmental measures with respect to certain treaty provisions</td>
<td>Canada-Peru BIT (2006), Art. 10; Russia-Sweden BIT (1995), Art. 3; Korea-Australia FTA (2014), Art. 11.9; China-Madagascar BIT 2005; Exchange of Letters on Expropriation to the Singapore-United States FTA (2003);</td>
</tr>
<tr>
<td></td>
<td>Exclusion of non-discriminatory environmental measures from ISDS</td>
<td>China-Australia FTA (2015), Art. 9.11;</td>
</tr>
<tr>
<td>Influence investor conduct</td>
<td>Investor obligations related to environmental protection</td>
<td>Morocco-Nigeria BIT (2016), Art. 14, 18, 24; 2019 Dutch Model BIT;</td>
</tr>
</tbody>
</table>

Note: This table will be updated as the Toolkit is developed. It contains a non-exhaustive list of examples for treaty provisions that fall into the categories identified for illustrative purposes only.

IIAs can also help to reinforce laws and regulations related to the climate and strengthen environmental governance:

- **Safeguarding or enhancing the implementation of international environmental agreements.** Several principles and performance standards included in multilateral environmental agreements (e.g. precautionary principle, polluter pays principle) may come into conflict with the investment protection obligations of IIAs. Measures to safeguard the implementation of MEAs therefore include clarifications of hierarchy in the event of a conflict to the advantage of the environmental agreements. Some IIAs go even further and oblige the parties to adopt, maintain, and implement laws, regulations, and all other measures to fulfil their obligations under the MEA. For instance, the EU’s proposal to modernise the Energy Charter Treaty includes an article that would require each signatory to “effectively implement” the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement.

- **Not lowering environmental standards.** The fear of a ‘race to the bottom’ in the competition to attract foreign investment (conjectured by the pollution haven hypothesis) has motivated the inclusion of clauses in IIAs that discourage or prohibit the lowering of environmental standards for the purpose of investment attraction. Such clauses have appeared in BITs since 1990, and do not try to transform the investment protection provisions of the treaty, rather they constitute an independent obligation by the state parties. The obligation is somewhat weak and difficult to enforce, as assessment of government intentions in changing environmental regulation is problematic (Romson, 2012[47]).

IIAs can be adjusted to preserve policy space to regulate on environmental matters by affirming the right to regulate of the host state, or carving out exemptions from the applicability of IIA provisions:

- **Reserving policy space for environmental regulation.** A growing number of IIAs include clauses in the body of the treaty that seek to reserve the host state’s right to regulate environmental matters. The scope of the environmental concern that the clauses describe varies in specificity. Some IIAs
define the scope of reserved policy space with reference to the area of regulation, including the prevention or control of the emission of pollutants (e.g. BLEU-Colombia BIT 2009).

- **Reserving policy space with respect to certain treaty provisions.** A smaller set of treaties reserve policy space for specific, limited purposes. These carve-outs include clarifications that measures taken for reasons of environmental protection are not considered a violation of fair and equitable treatment (e.g. China-Madagascar BIT 2005); exceptions to national treatment for the purpose of environmental protection (e.g. Sweden-Russia BIT 1995); environmental or energy performance requirements for investments and the technologies they use (e.g. Korea-Australia FTA 2014); and clarification of the conditions under which environmental regulation cannot be considered indirect expropriation (e.g. Singapore-US FTA, 2013).

- **Excluding environmental matters from ISDS.** The ISDS system is designed to permit foreign investors to bring claims for alleged harms that infringe treaty obligations to an international arbitration mechanism instead of – or in addition to – domestic courts in host countries (Gaukrodger and Gordon, 2012(48)). In some cases, provisions limit treaty coverage, and potential recourse to international arbitration, to investments made in accordance with applicable environmental laws, (including international law), or carve out non-discriminatory and legitimate environmental measures from the scope of ISDS mechanisms (China-Australia FTA, 2015).

Lastly, IIAs can take a more proactive stance on environmental and climate concerns by seeking to influence investor conduct:

- **Obligations related to environmental protection.** Treaty provisions may require investors to comply with environmental assessment and screening processes; maintain an environmental management system; observe RBC standards related to the environment; or conduct an environmental impact assessment (e.g. Morocco-Nigeria BIT 2016). Such provisions are rare in IIAs to date but may come increasingly to the fore in new treaty negotiations as governments grapple with ways to act coherently on their commitments towards climate goals.

Aside from express treaty provisions that address the environment, it is understood that IIAs can have a range of other impacts that may affect efforts to achieve goals on climate action. For example, to the extent that IIAs can catalyse increased levels of FDI, this could help to enable the positive environment-related aspects of FDI more generally. This and other such effects are the subject of ongoing OECD work, the results of which will be reflected in future iterations of this note.

**RBC principles and standards**

Major multilateral initiatives to promote responsible business conduct such as the OECD’s Guidelines for Multinational Enterprises recommend that MNEs take due account of the need to protect the environment, including mitigating the climate impacts of their operations, within the framework of laws, regulations and administrative practices in the countries in which they operate, and in consideration of relevant international agreements, principles, objectives, and standards. In particular, Chapter six of the Guidelines on “Environment” addresses aspects such as environmental management systems, continual improvement of corporate environmental performance, training of workers on environmental matters, and raising environmental awareness (Box 5.2).
Box 5.2. OECD Guidelines for Multinational Enterprises: Environment

The Environment chapter of the OECD Guidelines for Multinational Enterprises include several clauses calling multinationals to promote environmentally sustainable business practices, including reducing GHG emissions and increasing resource efficiency. According to the Guidelines, multinationals should:

- Establish and maintain a system of environmental management appropriate to the enterprise, including establishment of measurable objectives and targets for improved environmental performance and resource utilisation, consistent with relevant national policies and international environmental commitments.
- Explore and assess ways of improving the environmental performance of the enterprise over the longer term, for instance by developing strategies for emission reduction, efficient resource utilisation and recycling,
- Promote higher levels of awareness among customers of the environmental implications of using the products and services of the enterprise, including, by providing accurate information on their products (e.g. on GHG emissions, resource efficiency).
- Provide adequate education and training to workers in environmental health and safety matters, including the handling of hazardous materials and the prevention of environmental accidents, as well as more general environmental management areas, such as environmental impact assessment procedures, public relations, and environmental technologies.
- Contribute to the development of environmentally meaningful and economically efficient public policy, for example, by means of partnerships or initiatives that will enhance environmental awareness and protection.

Source: OECD (2011[49])

Core questions to assess policies and institutions

The following set of questions is designed to provide guidance on assessing policies and institutions that improve FDI’s carbon impacts. These questions are structured around aspects of the institutional setting, the broader regulatory framework, proactive policies and programmes, and international agreements and standards that matter for FDI’s carbon impacts. Table 5.5 provides supplemental questions and suggestions for available tools to investigate these questions. Available policy data are limited. Additional data collection, the OECD FDI Qualities Mapping, is undertaken to develop this Policy Toolkit (see Chapter 1 for details of the methodology). The aim of this exercise is also to identify potential data gaps and to draw attention to the importance of collecting data.

- **Institutional setting:** What is the quality of the broader institutional framework that affects the impact of FDI on carbon emissions? Do relevant institutions (e.g. investment promotion agencies, innovation agencies, environmental regulatory authorities) have enough decisional power and financial resources? Do these institutions coordinate their policies, activities and strategic priorities?
- **Regulatory framework:** Is the government taking steps to make low-carbon investment policies part of a broader national infrastructure, energy, land-use planning, environment and climate strategy framework? Are sectors critical for the low-carbon transition (e.g. energy, transport, construction, services) open to trade and FDI? Do competition rules ensure a level playing field for
foreign, domestic and state-owned enterprises (particularly in the energy sector)? Do rules on intellectual property support low-carbon innovation?

- **Proactive policies and programmes:** Has the government aligned the broad system of investment incentives and disincentives to support low-carbon objectives? Has the government taken steps to phase out and phase out inefficient fossil-fuel subsidies? Has it taken steps to help link low-carbon FDIs to local businesses? What measures are in place to promote skills development and prepare the labour force in areas relevant to low-carbon investment?

- **International agreements and standards:** Is the country a party to the Paris Agreement? Has the country adhered to the OECD Guidelines for Multinational Enterprises? Do the international investment treaties and free trade agreements to which the country is a party, take into account environmental issues?
<table>
<thead>
<tr>
<th>Dimension</th>
<th>Policy questions</th>
<th>Indicator/Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Institutional setting</strong></td>
<td>* Are there high-level cross-ministerial coordination mechanisms in the policy areas of investment promotion, environmental regulation and energy policy?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>* Do investment promotion agencies, environmental agencies and innovation agencies coordinate their policies, activities and strategic priorities to ensure that FDI creates linkages with the domestic economy?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>* Have relevant institutions set up mechanisms to consult with the foreign investors to receive feedback on the relevance of their policy programmes?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>* Do relevant institutions monitor and evaluate the impact of policies designed influence FDI’s carbon impacts, including knowledge spillovers to domestic firms?</td>
<td></td>
</tr>
<tr>
<td><strong>Regulatory framework</strong></td>
<td>* Has the government adopted a national climate strategy? Has it set GHG reduction targets? Has it set renewable energy or energy efficiency targets?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>National climate strategy</td>
<td>* Are there any exceptions to national treatment in sectors with large emissions reduction potential (e.g. energy, transport, construction)? Are low-emission industries restricted to foreign investors (e.g. services)?</td>
<td>OECD FDI RRI</td>
</tr>
<tr>
<td>FDI openness and non-discrimination</td>
<td>* Are technologies critical for the energy transition subject to investment review mechanisms?</td>
<td>OECD STRI</td>
</tr>
<tr>
<td>Competition policy</td>
<td>* Are SOEs and private companies competing on a level playing field on the energy markets? Are any anti-competitive practices adequately addressed?</td>
<td>OECD Product Market Regulations Indicators</td>
</tr>
<tr>
<td>IP Protection</td>
<td>* What steps is the government taking to protect intellectual property rights for low-carbon technologies? What steps is the government taking to facilitate patenting of innovations in clean energy?</td>
<td>WIPO</td>
</tr>
<tr>
<td>Contract enforcement and land use</td>
<td>* What steps is the government taking to ensure that contracts between clean energy providers and their partners are enforced?</td>
<td>WB Doing Business</td>
</tr>
<tr>
<td>Access to finance</td>
<td>* How do existing public finance institutions (e.g. national development banks, green investment banks, etc) seek to mobilise and scale up investment financing from the private sector?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Green business conduct</td>
<td>* What measures has the government taken to promote “green” responsible business conduct? What environmental impact assessment and strategic environmental assessment requirements are in place and are they adequately enforced?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td><strong>Proactive policies and programmes</strong></td>
<td>* Has the government taken measures to remove inefficient fossil-fuel subsidies? Has the government put in place pricing mechanisms, such as carbon taxes or emissions trading systems?</td>
<td>OECD Taxing</td>
</tr>
<tr>
<td>Price-based instruments</td>
<td>* Are existing performance and technology standards aligned with the country’s emission reduction objectives?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Standards, disclosure and information</td>
<td>* What voluntary disclosure mechanisms exist? How are they promoted?</td>
<td></td>
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<tr>
<td></td>
<td>* How is the government consulting with civil society groups and encouraging public awareness of and engagement with low-carbon objectives?</td>
<td></td>
</tr>
<tr>
<td>Technology support</td>
<td>* What incentives (e.g. subsidies, tax exemptions and feed-in tariffs) are in place to stimulate private investment in support of low-carbon technologies? Are incentives time-limited and appropriately targeted?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>* Do public procurement policies include environmental and green growth considerations such as resource efficiency, pollution abatement and climate resilience?</td>
<td></td>
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<tr>
<td>Cluster and linkages policies</td>
<td>* Do green technology parks exist? Have efforts been made to reduce the carbon footprint of existing economic zones?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td></td>
<td>* Does the government maintain a local supplier database? Is it easily accessible and regularly updated? Are any publically funded business matchmaking services available?</td>
<td></td>
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<tr>
<td></td>
<td>* What measures are in place to promote skills development and prepare the labour force in areas relevant to low-carbon investment?</td>
<td></td>
</tr>
<tr>
<td><strong>International agreements and standards</strong></td>
<td>* What are the country’s international commitments in terms of GHG emission reduction targets under the UNFCCC?</td>
<td>OECD FDI Qualities Mapping</td>
</tr>
<tr>
<td>Climate change conventions</td>
<td>* Do international investment agreements to which the country is a party, take into account environmental issues? If so, which ones and how?</td>
<td></td>
</tr>
<tr>
<td>RTAs and BITs</td>
<td>* Has the country adhered to the OECD Guidelines for Multinational Enterprises?</td>
<td></td>
</tr>
<tr>
<td>RBC Guidelines</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: The list of core questions is not exhaustive and will be extended further. *Data may not exist and should be collected.
References


OECD (2016), “The Role of Public Procurement in Low-Carbon Innovation”, Background paper for the 33rd Round Table on Sustainable Development.


