FDI Qualities Policy Toolkit

Policies for improving the sustainable development impacts of investment

Consultation paper for 6th FDI Qualities Policy Network Meeting, 16 November 2021

This revised FDI Qualities Policy Toolkit includes a review of policy practices for improving the impacts of foreign direct investment (FDI) on sustainable development, notably in the areas of productivity and innovation, job quality and skills, gender equality, and decarbonisation. The report incorporates comments received from the OECD Investment Committee and the FDI Qualities Policy Network over 2019-21, stakeholders during the first public consultation process earlier in 2021, and OECD colleagues from across directorates.

The OECD Investment Committee will endeavour to deliver the FDI Qualities Policy Toolkit at the 2022 OECD Ministerial Council Meeting (MCM). Delegates of the OECD Investment Committee and all other stakeholders are invited to provide written feedback on this report. Please send comments to martin.wermelinger@oecd.org by 31 December 2021.
The FDI Qualities Policy Toolkit reviews policy practices for improving the impacts of foreign direct investment (FDI) on sustainable development. Chapter 1 explains the rationale and objectives of the Policy Toolkit, and describes a set of key policy principles drawn from the substantive chapters that delve into four areas of sustainable development: productivity and innovation (Chapter 2), job quality and skills (Chapter 3), gender equality (Chapter 4), and decarbonisation (Chapter 5). The Policy Toolkit complements the 2015 Policy Framework for Investment, providing more detailed and tailored guidance on improving investment impacts in these four areas of the Sustainable Development Goals (SDGs).

The four substantive chapters frame the core principles of the Policy Toolkit through the lens of the specific areas of sustainable development that they cover, and provide guidance on how to assess the impacts of FDI. These chapters provide policy directions related to governance, domestic and international regulation, financial and technical support, and information and facilitation services, supported by concrete examples that are derived from an initial mapping of FDI Qualities policies and institutions in ten OECD and partner countries and from in-depth country assessments of Jordan, Portugal and the Slovak Republic. Each chapter provides detailed questions that help governments in reflecting on and assessing, in a structured way, their policy conditions influencing the impacts of FDI on sustainable development. The final version of this Toolkit will be accompanied with a shorter, more practical document focusing on guiding questions for governments. The final version will also include a stand-alone Companion Guide for Donors’ Engagement.

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The OECD Investment Committee endeavours to deliver the FDI Qualities Policy Toolkit at the 2022 OECD Ministerial Council Meeting (MCM). Delegates of the Investment Committee and all other stakeholders are invited to provide written feedback on this revised consultation paper. Please send comments to martin.wermelinger@oecd.org by 31 December 2021.
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1 Overview and key principles

This chapter provides an overview of the rationale and objectives of the FDI Qualities Policy Toolkit and explains how governments and other stakeholders can use it. It discusses key policy principles on FDI Qualities, drawn from the substantive chapters that provide detailed policy guidance on improving the impacts of FDI on sustainable development, particularly in the area of productivity and innovation, job quality and skills, gender equality, and decarbonisation.
1.1. Rationale and objectives

Achieving the Sustainable Development Goals (SDGs) and fulfilling the commitments made in the Paris Agreement on climate change requires an acceleration in financing these global objectives. Before the COVID-19 pandemic, the UN estimated an average annual SDG funding gap of USD 2.5 trillion in developing countries (UN, 2018[1]). This gap could have increased by 70% in 2020, including due to a drop in foreign private finance (OECD, 2020[2]). Together with public and other private investments, foreign direct investment (FDI) is an important source of finance for inclusive and sustainable development.

Beyond the quantities of FDI, its qualities also matter, as shown by the OECD FDI Qualities Indicators (OECD, 2019[3]): FDI can play a crucial role in making progress toward the SDGs by advancing decarbonisation, increasing innovation, creating quality jobs, developing human capital, promoting gender equality and raising living standards (Figure 1.1). Yet, the effects of FDI are not always positive, and impacts can differ across areas of sustainable development. Among countries receiving FDI, some have benefited more than others and, within countries, some segments of the population have been left behind. Efforts to mobilise investment should be aligned with concerns on qualities and impacts of investment, including progress toward the SDGs. To realise the potential benefits from investment, policies and institutional arrangements play a critical role.

Figure 1.1. Conceptual framework: FDI Qualities Policy Toolkit

The FDI Qualities Policy Toolkit, together with the Indicators, aims to support governments in enhancing the impacts of FDI on inclusive and sustainable development. It complements the OECD Policy Framework for Investment (PFI) by providing governments with more detailed guidance (OECD, 2015[4]). The Policy Toolkit combines investment and related policies of the PFI with more specific policies in each of the following areas: productivity and innovation; job quality and skills; gender equality; and decarbonisation (Figure 1.1). It is thus a natural extension of the PFI. Like the PFI, it is not prescriptive, but provides broad policy directions for improving the impact of FDI on sustainable development, thus allowing for a flexible approach according to a country’s context and stage of development. In this context,

1 The OECD Council invited the Investment Committee (IC) to “develop and promote the FDI Qualities Policy Toolkit, which could possibly be welcomed by Ministers at the 2022 Ministerial Council Meeting as a tool to complement and support the use of the PFI, thereby further aligning the PFI with the SDG Agenda” (OECD, 2021[40]).
it also recognises that national governments have different priorities, resources and options at their disposal to leverage FDI to advance sustainable development.

The Policy Toolkit targets national governments and their implementing agencies, but has been vetted by a number of other stakeholder groups that are part of the FDI Qualities Policy Network\(^2\), which may also find it useful. Businesses, supported by investment promotion agencies (IPAs), and civil society can for instance use it for policy advocacy, highlighting potential opportunities of national and international policy communities with regards to FDI and sustainable development.\(^3\) To strengthen the cooperation between governments and the donor community, the Policy Toolkit also includes a companion guide for donors’ engagement (OECD, 2021\(^5\)).\(^4\) It is addressed to donors and developing country governments, willing to engage with donors, to enhance the impact of FDI in their economies.

1.2. User guide for the Policy Toolkit

The Policy Toolkit is a practical tool that aims to help governments to:

- assess the impacts of FDI in four areas of sustainable development based on the SDGs (productivity and innovation; job quality and skills; gender equality; and decarbonisation);
- identify opportunities for policy and institutional reforms to enhance such impacts;
- strengthen partnerships with the donor community to support efforts to improve the impacts of FDI in developing countries.

The Policy Toolkit outlines a structured process for reviewing policy and institutional frameworks. It can be used for stand-alone assessments (see Box 1.1 for a description of the pilot FDI Qualities Assessment of Jordan) or in combination with broader assessments of investment climate reforms (e.g. OECD Investment Policy Reviews). The Policy Toolkit can also be used for self-evaluation and reform design by governments as well as for peer reviews in regional or multilateral discussions.

This overview chapter describes and motivates a set of core policy principles drawn from the substantive chapters that delve into specific areas of sustainable development. These core principles provide overarching guidance to governments on using diagnostic tools to inform policy action that improves the sustainable development impacts of investment. The users of this Policy Toolkit can refer to the substantive chapters for more concrete guidance on policies for improving the impacts of FDI. These chapters tailor the core principles to the specific areas of sustainable development and provide guidance on how to assess the impacts of FDI on productivity and innovation, job quality and skills, gender equality; and decarbonisation. The chapters provide considerations for policy governance, discuss options for the use of concrete policy instruments and provide good practice examples derived from an initial mapping of FDI Qualities policies and institutions in ten OECD and partner countries (Box 1.2). Beyond the principles, each

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\(^2\) 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 OECD and partner countries; development cooperation practitioners; private sector and civil society; international organisations and academia; and experts from policy communities across the OECD.

\(^3\) The Policy Toolkit does not have dedicated recommendations to businesses, but it calls extensively on governments to adhere and implement the OECD Guidelines on Multinational Enterprises (OECD, 2011\(^9\)). The Guidelines 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. Under the FDI Qualities initiative, the role of businesses, including the identification of good business practices, could be further developed.

\(^4\) The OECD Council further invited the IC to “reinforce co-operation and alignment with development partners, particularly in the development of the FDI Qualities Policy Toolkit” (OECD, 2021\(^40\)).
chapter provides detailed questions and indicators that help policymakers reflect on and evaluate, in a structured way, their policy conditions influencing FDI impacts on sustainable development.

**Box 1.1. Improving the sustainable development impacts of investment in Jordan: a pilot FDI Qualities Assessment**

The OECD has been working with the government of Jordan, represented by the Jordan Investment Commission (JIC), on measuring the contribution of FDI to sustainable development and identifying policies to increase the positive impacts of FDI. This co-operation between Jordan and the OECD is part of the OECD FDI Qualities Initiative and has contributed to improving the FDI Qualities Policy Toolkit as a hands-on tool for policy analysis and advice. The work has taken place in the context of the EU-OECD Programme on Investment in the Mediterranean, which supports reform efforts to advance sustainable growth in the Middle East and North Africa region.

The assessment provides tailored policy advice to the government of Jordan on how to strengthen the impact of FDI in each of the four dimensions of sustainable development covered in the FDI Qualities Policy Toolkit. Based on a detailed mapping of policies and institutions, conducted jointly by the OECD and the government of Jordan, the study examines to what extent public policies support the channels through which FDI affects these sustainability dimensions.

The nine-month process of this pilot assessment has involved (i) a preparatory phase, including desk research and setting up an inter-ministerial taskforce, (ii) an analytical phase, including the collection of data, fact-finding, consultations, analysis and drafting, and (iii) a policy dialogue phase during which findings and policy recommendations have been discussed in the taskforce and, with peers, in a special session of the FDI Qualities Policy Network (Figure 1.2).

**Figure 1.2. Process of the assessment**

The taskforce has included more than 20 government agencies and international partners in Jordan that work at the intersection of investment and sustainable development. The taskforce has provided strategic guidance and ensured that the information collected by the OECD, and included in the mapping of policies and institutions, is accurate and complete. The taskforce has met early in 2021 to discuss the main objectives of the study, and in September 2021 to present the results of the study and to get feedback on policy priorities. The Jordan Investment Commission (JIC) and the OECD have jointly coordinated this taskforce.

Source: (OECD, 2021[6])
Box 1.2. An initial FDI Qualities Policy Mapping of 10 OECD and partner countries

The Policy Toolkit provides a novel typology to collect information allowing to assess policies and institutions at the intersection of investment and sustainable development. 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 provides a compendium of good policy practices on investment and sustainable development, which does not exist at the moment. Applying the typology in an initial mapping of ten OECD and partner countries has informed and helped improve this Policy Toolkit. Selected examples on varying institutional arrangements and policies on investment and sustainable development across these countries are illustrated in this report.

The mapping has involved the collection of data on institutional frameworks and coordination mechanisms across policy domains related to investment and the four areas of sustainable development covered in this Policy Toolkit (productivity and innovation, job quality and skills, gender equality, decarbonisation). Institutions that were mapped include ministries, government departments and implementing agencies responsible for these policy domains. Data on major national policy initiatives at the intersection of investment and sustainable development, designed or implemented by these institutions, are also collected. Specifically, information on policy targeting, beneficiaries of policy initiatives, policy instrument types and design features has been assembled.

The initial FDI Qualities Policy Mapping includes Jordan, Morocco, Indonesia, Thailand, Rwanda, Senegal, Uzbekistan, Costa Rica, Sweden, and Canada. In addition, as part of an OECD-European Commission project on FDI and SMEs, the mapping is done for all 27 EU Member States, focusing on policies for FDI impacts on productivity and innovation (OECD, 2021[7]).
1.3. Key policy principles on FDI Qualities

1. *Provide coherent strategic direction on investment and sustainable development and ensure policy continuity and effective implementation*

- National strategies and plans on investment should be coherent with sustainable development objectives.
- Cross-ministerial coordination should be used to ensure effective policy implementation and continuity of policy priorities in the area of investment and sustainable development.
- Public consultations should be used to promote innovative solutions to emerging issues driven by foreign direct investment, and to build consensus on policy reforms on investment and sustainable development.
- Governments should establish comprehensive monitoring and evaluation frameworks to assess the impacts of foreign direct investment on sustainable development and related policies, and to identify bottlenecks in policy implementation.

**Ensuring policy coherence and coordination on investment and sustainable development**

National strategies and plans on investment, growth, innovation, jobs, skills development, gender equality, and decarbonisation should be as coherent as possible. Just like for investment climate reforms under the PFI, policy coherence to enhance the impacts of FDI requires a whole-of-government approach. It requires policy responses that do not fit neatly within any single governmental department or agency. Policies and institutions cannot be considered in silos but rather require an adequate and coherent policy mix – including not just investment policies but a variety of policy areas. Cross-ministerial coordination mechanisms can help guarantee and monitor effective implementation of strategic frameworks and ensure continuity of policy priorities in the area of investment and sustainable development. Poor co-ordination can increase the risk of duplication, inefficient spending, lower-quality service, and contradictory objectives and targets, all of which can undermine investor confidence and, importantly, the potential of investment on sustainable development.

The institutional framework that governs policy formulation and implementation differs from country to country. The approach that governments pursue to organise the institutional framework reflects the priority they give to the role of investment for sustainable development (see Figure 1.3 for the example of three countries). 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. The more institutions are involved at the intersection of investment and sustainable development policies, the more complex their governance systems become. Complex systems also involve higher risks of information asymmetry, rising transaction costs, trade-offs and inefficiency. The need for policy coordination and coherence is thus even greater in countries with more complex governance structures, requiring a strong governing body that brings together all policy areas at the intersection of investment and sustainable development. Such a body can be an existing committee, such as one that is governing investment policy and promotion more broadly (OECD, 2021[6]).

**Engaging in public consultations for innovative solutions to emerging issues and for building consensus on policy reforms on investment and sustainable development**

Public-private consultations and social dialogue can promote collective and innovative solutions to emerging issues that are, at least partly, driven by FDI. These may include digitalisation, automation, artificial intelligence and the future of work. Stakeholder consultations also allow for feedback and build legitimacy and consensus around policy reforms and programmes at the intersection of investment and sustainable development. More open and inclusive policy-making processes help to ensure that policies...
will better match the needs and expectations of citizens and businesses. Greater participation of stakeholders in policy design and implementation leads to better targeted and more effective policies.

Multinational enterprises (MNEs) can, for example, provide useful insights and information on emerging global trends and give directions on what type of policy approaches would be required in the medium- and long-term. For example, in the area of skills, 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 (Chapter 3).

Figure 1.3. Varying institutional setups for investment and sustainable development policy

Source: OECD FDI Qualities Policy Mapping (2021)
Assessing the impacts of FDI on 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.

The impacts of FDI involve several transmission channels. Impacts might result from foreign firms’ direct operations in the host country. The FDI Qualities Indicators show for selected OECD and partner countries that foreign firms are on average more productive than domestic firms (Figure 1.4). Often, they are also performing better on some environmental and social metrics such as energy efficiency, job creation and wages. Foreign firms’ operations also have spillover effects on domestic businesses arising from value chain relationships between foreign and domestic firms, market interactions through competition and imitation effects, and labour mobility of workers (Figure 1.1, orange box). The premise underlying the existence of FDI spillovers is that foreign firms are often 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 not only among countries, but also across sustainability outcomes. 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.

Governments should routinely examine the characteristics of foreign direct investment and its impact on sustainable development, both through the activities of foreign affiliates and through spillovers on domestic firms. Understanding the impacts of FDI across economic activities and locations is a pre-condition for identifying weaknesses and strengths of the governance and policy framework. Regularly assessing such impacts should therefore inform policy efforts in that respect. The substantive chapters provide a more detailed overview on how FDI relates to different outcomes and comprise a list of questions and indicators that can guide policymakers in their efforts to better understand FDI impacts and transmission channels. OECD tools, including primarily the FDI Qualities Indicators, and other data tools are described and can be used to address those questions.

The availability of data to assess the impacts of FDI, or specific aspects of these impacts, is not always guaranteed. Therefore, the timely collection of internationally comparable data on investment and business practices related to innovation, employment, gender, and environment can assist governments in assessing the impact of investment on sustainable development. In this context, international and inter-ministerial collaboration can help improve data collection efforts.
Developing monitoring and evaluation frameworks to improve the effectiveness of policies influencing the impacts of FDI

Comprehensive monitoring and evaluation (M&E) frameworks are important to improve the effectiveness of government efforts to promote sustainable investment through FDI. M&E has received increasing attention as a result of expectations over the performance and efficiency of government institutions. The purpose of M&E is to ensure that a policy action progresses according to schedule and achieves planned milestones, and to evaluate the performance of the action against policy objectives. A comprehensive M&E framework for policies related to the impact of FDI is crucial to identify potential bottlenecks in policy design and implementation, and take corrective action when their performance is not in line with expectations. Although many different approaches to M&E exist, some practices are widely used, such as the setting up of a dedicated evaluation unit, the use of key performance indicators (KPIs) and qualitative evaluation methodologies (e.g. surveys, benchmarking, consultations), and the establishment of data tracking tools and feedback processes to ensure that relevant and reliable data are available. A comprehensive M&E framework may involve both ex ante and ex post evaluations of policies, including social and environmental impact assessments.

A recent OECD survey finds that three quarters of Investment Promotion Agencies (IPAs) view M&E as a key factor that influences their prioritisation strategy. Most IPAs use sustainability-related KPIs such as on productivity and innovation or jobs and about half of the IPAs use metrics related to export and decarbonisation. KPIs such as on job quality or gender equality are rarely used. Yet, KPIs used by IPAs for prioritisation and those for M&E do not always match. For example, no IPA has reported using indicators related to decarbonisation for their M&E although nearly half of IPAs use such indicators to prioritise their activities (OECD, 2021[9]).
2. Ensure that domestic regulation is aligned with international standards and supports positive impacts of investment on sustainable development

- International investment and trade agreements that are aligned with sustainable development objectives and that allow sufficient domestic policy space to achieve these objectives can support government efforts to enhance the impact of investment on sustainable development.
- Governments should endeavour to join major international agreements and conventions promoting sustainable development and set domestic standards that are aligned with sustainable development objectives and that support responsible business conduct.
- Investment climates should follow the core principles of the OECD Policy Framework for Investment, including open, transparent and non-discriminatory investment policies, the rule of law and integrity, and quality regulation.
- Domestic regulatory frameworks on sustainable development should integrate the possibility that sustainable development objectives can be reached notably by leveraging foreign direct investment.

Aligning international investment and trade agreements with sustainable development standards and principles

Many countries have concluded investment treaties over the past half century as part of their efforts to foster international investment and, in turn, advance economic development in home and host countries. These treaties take various forms: Since 1959, when the first modern bilateral investment treaty (BIT) was signed, well over 3,000 BITs have been negotiated, of which more than 2,200 are in force today. An ever increasing number of bilateral or multilateral preferential trade agreements (PTAs) containing provisions on investment cover hundreds of additional bilateral relationships. The focus of these treaties has traditionally been on investment protection. Governments have sought to use investment treaties as instruments to improve legal certainty and reduce unwarranted risk for foreign investors wishing to locate long-term investments abroad. An overarching goal of this approach has been to foster more investment from abroad than may otherwise have been possible in the absence of a treaty, although existing research finds mixed evidence of the impacts of treaties on investment flows (Pohl, 2018[10]; Mistura and Roulet, 2019[11]).

Only recently have governments begun to consider investment treaties as instruments to influence not only the quantities but also the qualities of international investment in terms of its impacts on sustainable development. However, relatively little is known today about the ways that investment treaties influence sustainability impacts of FDI. So far, no attempt has been made to assess whether and how investment treaties in general or certain design elements and features in particular influence the qualities of international investment. Very little empirical evidence is available so far that would allow any quantitative statements in this regard. Further research will need to reflect through which mechanisms investment treaties influence the qualities of FDI, which specific treaty provisions are observed in treaties that are tuned towards the qualities of FDI, and what effects these clauses have.

It appears likely nonetheless that obligations in some of these international agreements may prompt treaty parties to make adjustments to their domestic laws that improve regulation and enforcement in several key areas relating to the qualities of FDI. This may take place through their impact on policy space for governments, their provisions that buttress domestic law or its enforcement, or their provisions that directly address business by, for example, encouraging observance of RBC standards, requiring compliance with domestic laws or establishing conditions for access to investment treaty benefits (Gaukrodger, 2020[12]).

International investment and trade agreements that are aligned with climate objectives, international labour standards and principles on gender equality and encourage cooperation and monitoring of commitments will thus provide support to government efforts to enhance the positive impact of investment on sustainable
development. Yet, these treaties remain a single policy tool among many for governments seeking to improve the sustainability impacts of international investment. Such treaties should not be seen as a substitute for other international and domestic policies designed for long-term improvements in the investment climate and for advancing sustainable development.

**Endeavouring to join major international agreements and conventions that promote sustainable development and foster responsible business conduct**

A fundamental condition for FDI to positively influencing sustainable development is that domestic legislation fulfils international standards and principles on sustainability objectives, such as on climate action, job quality and gender equality, or sets national standards that are even more ambitious than the international ones. Endeavouring to join major international agreements and conventions promoting sustainable development is thus important.

In the area of climate action, the Paris Agreement (2015) is the central international effort to combat climate change aiming to limit global mean temperature change to 1.5°C, and expects progressively more ambitious climate mitigation commitments from all states party to the treaty over the coming decades. As of January 2021, 187 states and the EU, representing about 80% of global greenhouse gas emissions, have ratified or acceded to the Paris Agreement. 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. The Paris Agreement gives governments, as well as industry and the general public, reassurance of commensurate action from their trade partners (Chapter 5).

International labour standards are essential for ensuring that the global economy, including FDI, provides benefits to all (Chapter 3). 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, related to eliminating all forms of forced or compulsory labour, effectively abolishing child labour, eliminating discrimination in respect of employment and occupation, and ensuring the freedom of association and the right to collective bargaining. The Declaration covers eight fundamental conventions and the majority of countries has formally subscribed to some or all them, which has strongly influenced 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. 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 (see Principle 2).

Gender equality and non-discrimination based on sex are fundamental rights enshrined in numerous international human rights instruments (Chapter 4). The UN Charter of 1945 is the first international instrument to establish the principle of equality between men and women. Since then, numerous international human rights instruments have promoted women’s rights and contributed to the inclusion of gender equality principles in national legislation, including the UN Convention on the Elimination of All Forms of Discrimination against Women (1979), the Beijing Declaration and Platform for Action (1995), and a number of ILO conventions dealing with gender-specific issues such as the Equal Remuneration Convention, the Discrimination (Employment and Occupation) Convention, the Convention on Workers with Family Responsibilities and the Maternity Protection Convention.

Multilateral initiatives such as the OECD Guidelines for Multinational Enterprises and the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy can help raise awareness about responsible business conduct (RBC), including on labour practices, gender equality and climate action (OECD, 2011[13]). They are non-binding recommendations by adhering governments, supported by employer and worker organisations, which are directly addressed to MNEs. They recommend MNEs, for example, to observe standards of employment no worse than those observed by employers in the host
countries, or to mitigate 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. They also recommend MNEs to carry out
due diligence through their value chain relationships to address existing or potential adverse risks on
sustainable development (OECD, 2011[13]).

**Guaranteeing open, transparent and non-discriminatory investment policies, the rule of law
and integrity, and quality regulation**

Open, transparent and non-discriminatory investment policies are key for attracting investment in OECD
and partner countries and provide the foundation for an investment climate that is conducive to sustainable
development (Box 1.3). The PFI provides guidance in 12 policy areas for investment climate reforms that
range from the domestic and international legal framework for investment, competition and taxation to
green growth and responsible business conduct (OECD, 2015[4]).

The PFI also highlights the role of strong institutions and good public governance for effective
implementation of investment policies, which also applies to policies at the intersection of investment and
sustainable development discussed in this Policy Toolkit. The pre-requisites for strong institutions include
respect for the rule of law, quality regulation, transparency and non-discrimination and integrity. Effective
action across these dimensions will encourage investment and reduce the costs of doing business. Strong
institutions help to maintain a predictable and transparent environment for investors, domestic firms and
workers. Policy continuity and effective implementation are further facilitated by an environment of trust.
High levels of trust can facilitate compliance with laws and regulations, strengthen confidence of investors
and workers and reduce risk aversion.
Box 1.3. Openness to FDI can support sustainable development

Openness to FDI does not only involve higher investment stocks (Mistura and Roulet, 2019[11]), but is also associated with higher productivity in industries that access new markets as well as in downstream sectors that benefit from potentially better access to high quality inputs and services domestically (Chapter 2). Recent OECD research shows that liberalising FDI in services is positively associated with productivity in downstream manufacturing industries, where SMEs benefit in particular (Figure 1.5.).

More open FDI regimes also affect the labour market, skills and gender equality. Opening sectors to FDI that are skill-intensive is associated with more demand for skills, although, in the short-term, opening may also crowd out domestic firms as their skilled workers move to better paid jobs in foreign affiliates, increasing skill-based inequalities. Increased competitive pressure from FDI also affects the need for domestic firms to invest in innovation and skills development to pay higher wages and retain workers, which leads to an overall increase in the supply of skills in the longer term (Chapter 3). Reducing FDI restrictions in sectors that employ relatively more women could, due to increased demand, increase labour market participation of women and their wages. FDI restrictions tend to be highest in services, which are globally dominated by women (Chapter 4).

Discriminatory restrictions on the establishment and operations of foreign investors can also diminish the potential of FDI on decarbonisation (Chapter 5). 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[14]).

Figure 1.5. FDI openness in services and productivity in downstream manufacturing sectors

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[15])
Ensuring that domestic regulations reinforce possible benefits of FDI on sustainable development

Open and competitive markets are not sufficient to tackle the major societal and environmental challenges that, if not addressed, may jeopardise a prosperous and healthy future for people and the planet. Ensuring improved impacts of FDI on sustainable development requires more tailored policy considerations and more focus on policies beyond the PFI, including regulatory frameworks on innovation, skills, the labour market, gender equality and the environment. Aligning these frameworks with objectives related to investment as a tool to support sustainable development is key in this context.

Environmental regulations and reporting requirements are, for example, increasingly being adapted to address the cross-border environmental footprint of multinational enterprises (Chapter 5). The EU Taxonomy Regulation, which entered into law in 2020, for instance, places a reporting obligation on certain companies to disclose how much of their global investment is aligned with environmentally sustainable activities. Starting from 2022, large investors (with over 500 employees) with operations in the EU must disclose which proportion of their turnover, capital expenditure and operating expenditure is associated with environmentally sustainable economic activities. This Regulation is likely to have significant influence on the carbon footprint of inward and outward FDI in the EU.

In the area of job quality, stringent employment protection legislation can increase firms’ labour adjustment costs but also improves job security. 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 (Javorcik and Spatareanu, 2005[16]). But job security also protects workers from being fired in response to small fluctuations, which can encourage them to invest in long-term training. Moreover, 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[17]). But it may also protect vulnerable workers that otherwise would have been displaced to lower wage jobs or that would have experienced long-term unemployment. When local production 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[18]). Labour market policy is most effective when negotiated with trade unions and workers’ representatives (Chapter 3).

The creation of good quality jobs for women by foreign investors is ensured when domestic regulation ensures decent labour standards on minimum wages, occupational health and safety, employment protection, social protection (e.g. maternity leave), flexible working arrangements, and protection from gender discrimination and sexual harassment in the workplace (Chapter 4). FDI can also support female entrepreneurship by creating business opportunities along the value chains of MNEs or through technology and productivity spillovers. However, regulatory barriers such as non-transparent procedures or restrictions to business registrations, signing contracts or owning bank accounts and land can hinder women’s ability to take advantage of these opportunities (World Bank, 2021[19]).

3. Financial and technical support should stimulate investment and build domestic capabilities to support sustainable development

- If financial support is used to stimulate investment, it should address market failures that hamper sustainable development, and should be transparent, time-limited and subject to regular reviews. It should not be used as an alternative to addressing shortcomings in the investment climate.
- Financial and technical support should be considered to help build production capabilities of firms, entrepreneurs and workers that enhance the impact of investment on sustainable development.
Ensuring that financial support to stimulate investment addresses market failures and is transparent, time-limited and subject to regular reviews

Governments often use financial support, such as investment tax incentives or subsidised loans and grants, to attract investors and promote investment in specific activities, sectors and locations. Financial support for investors is sometimes conditional on specific criteria related to sustainable development and has thus the potential to advance sustainable development. A new OECD Investment Tax Incentives Database, currently covering 36 developing countries, shows that about a quarter of all tax incentive schemes promote at least one area of sustainable development and 28 of the 36 countries use such tax incentives (OECD, 2021[20]). About half of the countries use tax incentives to promote exports; a third of the countries use tax incentives with specific eligibility conditions and design features to create employment and improve job quality. Other areas – including those associated with skills development, improving environmental outcomes, local supply linkages, and gender equality – are less frequently observed.

The benefits of these policies are not well understood (OECD, 2021, forthcoming[21]). Further analysis is needed to evaluate the effectiveness of financial support to advance sustainable development. Costs, including impacts on tax revenue for example and the potential to spur rent-seeking behaviour, may outweigh their gains. Transparency about the benefits available to investors is often incomplete; this complicates the assessment of whether the policies in place address market failures, achieve their goals, and at what costs.

The benefits of transparency are recognised among tax and investment policy communities. Under the OECD Declaration on International Investment and Multinational Enterprises, adhering countries agree to “endeavour to make such measures [investment incentives] as transparent as possible, so that their importance and purpose can be ascertained and that information on them can be readily available” (OECD, 2011[22]). The OECD’s Task Force on Tax and Development has also identified the need for a more effective global transparency framework for tax incentives for investment (OECD, 2013[23]), and transparency is listed as an essential element of good governance in the IMF-OECD-UN-World Bank report to the G-20 Development Working Group on improving use of tax incentives in low income countries (IMF-OECD-UN-World Bank, 2015[24]). Fostering transparency of investment incentives is also an important objective for many countries in ongoing negotiations on investment facilitation at the WTO.

Improving transparency of investment incentives is a first step to better understanding their effectiveness and efficiency. This is particularly important in the context of the COVID-19 recovery, where many governments are considering new incentives to attract investors, while facing reduced budgets and growing debt. In addition to supporting policy evaluation, increasing transparency and awareness of available benefits, eligibility criteria, and awarding processes could also help countries attract untapped investment sources. For example, small and medium enterprises (SMEs) have fewer resources to navigate the often complex legal framework governing incentives (and less power to negotiate agreements directly with governments). But all investors would benefit from access to clear and regularly-updated information to assess new investment opportunities. Combined with good governance, greater transparency around investment incentives can support coordination across different agencies involved in granting incentives, and strengthen confidence that incentives are granted in a fair and not overly-discretionary manner.

Greater transparency on investment incentives could also help foster trust and cooperation across countries. This is timely in light of discussions around a global minimum tax considered by the OECD/G20 Inclusive Framework on BEPS, which may affect how governments use investment incentives.

In addition to the need for transparency, financial support should be time-limited and subject to regular review. Net benefits of financial support programmes are context-specific and may change over time. Monitoring and re-evaluation of financial support is often neglected (IMF-OECD-UN-World Bank, 2015[24]). The PFI suggests that authorities regularly prepare tax expenditure statements to measure and monitor the costs of tax incentives (OECD, 2015[4]). The government should periodically carry out audits to ensure that financial support measures are not abused. Financial support measures should be reviewed.
periodically to assess their effectiveness in helping meet desired goals. A natural way to introduce assessments of incentive schemes is to make incentive policies temporary rather than permanent. Temporary schemes require regularly reconsidering whether the incentive should be continued, reformed or repealed. Such temporary schemes are often referred to as incentives with sunset clauses.

Considering financial and technical support to help build domestic capabilities of firms, entrepreneurs and workers that enhance the impact of FDI on sustainable development

Governments can use financial and technical support measures, as well as information and facilitation services (as discussed in the next section) to foster decarbonisation, productivity and innovation, as well as job quality, skills and gender equality. Depending on the priorities for sustainable development, policy attention and types of policy instruments may vary across areas of the SDGs (Figure 1.6).

Figure 1.6. Mix of financial & technical support and information & facilitation services by area of sustainable development

Area reflects share of total financial & technical support and information & facilitation measures that target the four areas of sustainable development

Financial and fiscal incentives may be used to strengthen production capacities of local firms, particularly small and medium-sized enterprises (SMEs), that enhance the impact of FDI on sustainable development (Chapter 2). Direct lending and grants can be provided to SMEs to help them invest in R&D, acquire new technology, adopt digital and low carbon solutions, and engage in innovation and internationalisation activities. Various tax relief measures can also be granted to support subgroups of the SME population such as innovative firms and startups to expand their business and join global value chains.

Supplier development programmes are increasingly part of government support to improve the production capacity of local SMEs and help them become partners and suppliers of foreign firms. These programmes usually assess the need for upgrading SME capabilities in various aspects of their performance – management, production, energy efficiency, decarbonisation performance, 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. Government agencies may also organise seminars and courses for SMEs, and provide a range of business diagnostic tools to help them assess their innovation and technological capabilities.

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[18]). Training programmes by government agencies, albeit costly, have shown some success when well-designed and targeting the right beneficiaries (Bown and Freund, 2019[25]). For instance, sectoral training or re-training programmes in transferable certifiable skills can facilitate labour mobility and help workers move to better-paid jobs (Autor et al., 2020[26]). These programmes could be particularly helpful for women and other vulnerable workers affected by rapidly changing labour markets due to, inter alia, evolving needs of MNEs. Pre-employment training programmes can help host countries quickly respond to the needs of foreign firms considering to invest (Chapters 3 and 4).

Governments can 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[27]). Providing all firms with financial support to run such programmes is, however, not always a cost-effective solution. Policies to increase on-the-job training demand need to consider other policy aspects, such as encouraging product market reforms to increase competition.

Fiscal and financial incentives can also be used to promote gender equality goals (Chapter 4). Tax exemptions can be given to companies that encourage the hiring or training of women, or that provide services such as childcare. Similarly, subsidies and grants can be given to companies to help offset the higher costs companies may face in hiring, promoting and training women. Currently, the use of incentives to promote gender inclusive practices in the workplace remains limited (Kronfol, Nichols and ThuTran, 2019[28]). Due to various economic, social and cultural barriers, female entrepreneurs tend to have fewer entrepreneurial and managerial skills and have more difficulty accessing formal credit than male entrepreneurs (Union, 2019[29]). The 2013 OECD Council Recommendation on Gender Equality in Education, Employment and Entrepreneurship encourages countries to design policy instruments to help female entrepreneurs overcome barriers related to lack of skills and credit. Financial support can take the form of soft loans or microcredit, or tax benefits (OECD, 2017[30]). Technical support can help women entrepreneurs strengthen their skills and grow their business, including to internationalise their operations. This can include training programmes to develop skills in business, management and digitisation, professional advice on legal and tax issues and other business development services.

4. Facilitate investment and sustainable development opportunities by addressing information failures and administrative barriers

Governments should:

- raise public and stakeholder awareness on impacts of investment on sustainable development;
- support firms in disclosing their compliance with international standards on sustainable development;
- improve the link between investment promotion and facilitation activities and sustainable development objectives;
- reinforce efforts to enhance business linkages and labour mobility between foreign investors and domestic firms by implementing networking and matchmaking programmes;
- make efforts to streamline procedures for obtaining permits needed for investors to engage in business activities fostering sustainable development.
Raising stakeholder awareness on impacts of FDI on sustainable development and encouraging corporate disclosure

Examining the impacts of FDI on sustainable development is not only essential for governments to identify possible policy responses but also to raise awareness among stakeholders and the general public on these impacts and to discuss related policy challenges and opportunities to enhance the impacts of investment on sustainable development. Governments can use assessments on the impacts of FDI to inform the general public and engage with stakeholders, resulting in a better informed and more inclusive policy debate.

Social and cultural norms in FDI recipient countries can also shape the extent to which countries can leverage FDI for sustainable development. For example, in the area of gender equality, women in host countries may not be able to benefit from the job opportunities generated by foreign investors due to various social and cultural barriers (Chapter 4). Gender stereotypes are at the root of patterns of gender inequality in the labour market, e.g. the fact that women tend to be concentrated in low-value-added sectors and in part-time jobs. Public information and awareness-raising campaigns can help change traditional norms that harm investment impacts on sustainable development.

Policy support to inclusive and sustainable business practices can leverage companies’ contributions to sustainable development over and above the influence of regulatory approaches (such as labour protection legislation or carbon emissions standards). Countries have put in place a number of mandatory or voluntary schemes that require or encourage investors to disclose information/performance related to sustainable development. In this context, governments should encourage businesses to implement the OECD Guidelines for MNEs, including the OECD Due Diligence Guidance for Responsible Business Conduct (OECD, 2011[31]).

Linking investment promotion and facilitation to sustainable development objectives

IPAs are key players in bridging information gaps that may otherwise hinder the realisation of foreign investments, and their potential sustainable development impacts. Their primary role is to create awareness of existing investment opportunities, attract investors, and facilitate their establishment and expansion in the economy, including by linking them to potential local partners. The tools used by IPAs vary widely, ranging from intelligence gathering (e.g. market studies) and sector specific events (inward and outward missions) to pro-active investor engagement (one-to-one meetings, email/phone campaigns, enquiry handling).

Most IPAs prioritise certain types of investments over others, by selecting priority sectors, countries or investment projects, and allocating resources accordingly (OECD, 2018[32]). The approaches and tools adopted by IPAs increasingly aim to attract investment that supports national sustainable development priorities. A recent OECD survey shows that sustainable development considerations are important for IPAs when setting their prioritisation strategy (OECD, 2021[9]): 90% of IPAs in the OECD use productivity and innovation performance indicators to prioritise investment attraction, and 87% use indicators linked to job creation and skills. About half use low-carbon transition-related indicators.

Implementing networking and matchmaking programmes to enhance business linkages and labour mobility between foreign investors and domestic firms

Many IPAs provide matchmaking services and organise business-to-business meetings where representatives of foreign and domestic firms are introduced to each other. Many IPAs also organise demonstration and networking events which include knowledge exchange and information sharing. The policy goal is to bring down information barriers and allow foreign firms to identify local suppliers for future collaboration (Chapter 2). Some of these matchmaking programmes specifically target women entrepreneurs to help them connect with foreign investors (Chapter 4). In addition to matchmaking between
firms, 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[33]). Some displaced workers can lose out following FDI entry and experience long unemployment durations or activity in lower-paid jobs (Chapter 3).

Information programmes to stimulate labour mobility could particularly help job seekers from geographic 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[34]). 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[33]). Programmes providing information about job opportunities in a different location or subsidising job search in different parts of the city have been found to be effective (Abebe et al., 2016[35]).

Streamlining procedures for obtaining permits needed for investors to engage in business activities that foster sustainable development

Regulatory burdens and complicated procedures for obtaining permits can dissuade foreign firms from investing when faced with more welcoming environments elsewhere. They can hamper the growth of smaller businesses and their move towards high value added, knowledge-based and low carbon production, which would allow them to establish business linkages with foreign investors too. It is therefore important that regulatory procedures (such as to start a business and to deal with construction permits, environmental licensing, getting electricity, paying taxes, and enforcing contracts) are streamlined, easily accessible and consistent with investment licensing procedures. Having a single window portal for all administrative procedures can help reduce transaction costs for investors, as long as it does not create additional duplication and complexity in the company establishment process.

Less regulation is not always better, however, and may ignore the potential economic, social and environmental benefits of regulation (Thomsen, 2019[36]). An investment and business climate is a complex organism and requires a holistic approach to reform, such as that provided by the PFI. Regulatory reforms should therefore be informed by regulatory impact assessments, including environmental and social impact assessments.

5. **Strengthen the role of development cooperation for mobilising foreign direct investment and enhancing its positive impact in developing countries**

<table>
<thead>
<tr>
<th>Governments and the donor community are encouraged to cooperate to:</th>
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<tbody>
<tr>
<td>• identify solutions for financial and technical assistance towards the implementation of the above four principles to enhance the impact of foreign direct investment on sustainable development;</td>
</tr>
<tr>
<td>• ensure alignment of donors’ relevant interventions with national priorities, including through the mapping of such interventions, and the identification of potential support gaps or opportunities to replicate or scale-up existing interventions;</td>
</tr>
<tr>
<td>• further engage with the private sector and civil society, and promote multi-stakeholder partnerships aimed at enhancing the impacts of investment on sustainable development.</td>
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Strengthening cooperation between governments and the donor community to enhance the impact of FDI on sustainable development

Donors devote a significant portion of their resources to supporting the private sector, including to support improvements to the investment climate, to enhance productive capacities and develop physical infrastructure. Over the period 2013-19, total private-related support through official development finance reached USD 755 billion in disbursements, representing 45% of total official development finance (OECD, 2021[37]). While donors have traditionally focused on incentivising FDI in developing countries, further consideration to the qualitative dimensions of investment can make donors’ interventions more effective and foster greater impact of investment on the SDGs, including on decarbonisation, productivity and innovation, employment, job quality and skills, and gender equality.

Greater cooperation between governments and the donor community can help more systematically integrate the qualitative aspects of investment into donors’ activities, and support governments’ efforts to enhance the positive impact of investment on sustainable development. Governments and the donor community can notably work together to identify financial and technical assistance solutions to support policy reforms and implementation, promote alignment with international standards, reduce exposure to financial and sustainability risks, and provide support to the private sector through financial and other instruments, as well as support for business strategies. The FDI Qualities Companion Guide to Donors’ Engagement explores different modalities for leveraging development co-operation to enhance the sustainability impact of FDI, and can serve as a framework for donors and developing country governments willing to cooperate in this agenda.

Ensuring alignment of donors’ interventions with national priorities

In order to ensure the effectiveness of donors’ interventions, it is essential to ensure alignment of such interventions with national priorities on investment and sustainable development in recipient countries. Various international instruments aiming to strengthen aid effectiveness, including the Paris Declaration on Aid Effectiveness (2005), Nairobi Outcome Document (2016), and Kampala Principles on Effective Private Sector Engagement in Development Co-operation (2019) reflect a growing recognition that development efforts need to be led by the countries receiving development support (OECD, 2019[38]).

Development cooperation actors and partner countries may consider various modalities to mobilise and enhance the positive effects of FDI, including through support to governments to improve the investment climate, or direct engagement with the private sector to influence the behaviour of foreign investors. The nature and type of relevant interventions may vary depending on the areas of sustainability covered by the FDI Qualities Policy Toolkit donors and partner countries wish to target.

Identifying and mapping existing donors’ interventions can help assess alignment with national priorities on investment and sustainable development, and inform development cooperation strategies. Such a mapping can also help identify potential gaps in the breadth of modalities used and areas of the SDGs targeted, support greater coordination of donors interventions, and help identify opportunities to replicate or scale-up relevant interventions.

Engaging with the private sector and civil society

The private sector and civil society are key actors and stakeholders of development co-operation efforts to promote investment and sustainable development. Engaging with both the private sector and civil society is therefore essential to inform, implement and monitor development co-operation programmes and projects aimed at mobilising FDI and enhancing its impacts on sustainable development.

Results from a review of 919 private sector engagement projects carried out by the Global Partnership for Effective Development Co-operation (GPEDC) found that only 9% of reviewed projects listed civil society
as partners, and even fewer listed business associations (5%) or trade unions (0%). The Kampala Principles on Effective Private Sector Engagement in Development Co-operation, developed by the GPEDC, emphasise the importance of establishing more inclusive partnerships to foster trust through inclusive dialogue and consultation in projects that aim to engage the private sector for development results (GPEDC, 2019[39]).

Donors and governments in developing countries have an opportunity to involve the private sector and promote multi-stakeholder partnerships through interventions directly targeting businesses. Such interventions may include financial participation in sustainable private investment projects, support for responsible business conduct standards (e.g. the OECD Guidelines for Multinational Enterprises and associated due diligence guidance) and multi-stakeholder partnerships that include voluntary, collaborative arrangements between various actors with the aim to work towards a sustainability goal. More broadly, across and throughout interventions targeting the investment climate and spill-over effects, donors and recipient country governments can make development co-operation efforts more effective by consulting and involving various actors and stakeholders, including policymakers, the private sector, civil society and trade unions at all stages of programmes and project cycles.

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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 affects 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 other complementary policies that can enhance the impacts of FDI on productivity and innovation.
Main policy principles

1. **Provide strategic direction and ensure policy coordination and coherence across the investment, innovation and SME development policy areas**
   - Align strategic objectives in the areas of investment promotion, innovation, SME and entrepreneurship development. Ensure that national strategies and action plans consider the role of FDI in fostering productivity growth, innovation and SME upgrading.
   - Improve policy coordination and collaboration among government actors involved in the design and implementation of investment promotion, innovation and SME policies (e.g. through the establishment of high-level government councils, inter-agency joint programming, etc.)
   - Assess the impact of FDI and relevant policies on the productivity and innovation of the domestic economy to improve policy design and implementation. Promote policy dialogue with foreign investors, local SMEs and other actors of the domestic research and innovation ecosystem.

2. **Ensure that domestic and international regulations create a conducive business environment for FDI-driven productivity growth and innovation**
   - Ensure an open, transparent and non-discriminatory regulatory environment for investments in productive and knowledge-intensive sectors and activities.
   - Simplify overly burdensome regulations that may undermine domestic firms’ capacity and incentive to expand their business operations, engage in innovative activities and become suppliers and partners of foreign firms.
   - Ensure that labour market laws and regulations enable domestic firms, in particular SMEs, to retain and attract highly skilled workers. Provide incentives to encourage labour mobility from foreign to domestic firms.
   - Ensure that financial market laws and regulations facilitate access to finance for innovative and technology-intensive investment projects.
   - Integrate SME policy considerations and promote international cooperation on science, technology and innovation within international investment agreements.

3. **Stimulate knowledge-intensive investment and support the productive and innovation capabilities of the domestic economy**
   - Design and implement transparent, clearly defined and rules-based investment incentive schemes that target FDI in productive and knowledge-intensive activities.
   - Provide financial support and technical assistance to strengthen the absorptive capacities of domestic SMEs. Ensure that they have access to supplier development and skills upgrading programmes, technology extension services, and innovation and R&D support.
   - Develop network and knowledge infrastructure to promote agglomeration economies and facilitate business-to-business and science-to-business collaboration.

4. **Facilitate knowledge and technology spillovers from FDI by eliminating information barriers and administrative hurdles**
   - Provide comprehensive investment facilitation and aftercare services to foster greater embedding of foreign firms in local economies; for instance through matchmaking services, networking meetings and local supplier databases.
   - Ensure that investment facilitation services are aligned with supplier development programmes and contribute to supply chain development and strengthening domestic SME capacities.
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 (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]).

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 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 creation in the OECD has picked up over the last decade, especially in services, but newly created jobs are concentrated in low-productive and low-wage sectors, and have increased over time, even if SMEs outperform large enterprises in the services sector in many countries (OECD, 2019[5]; OECD, 2021[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 digitally-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, innovative SMEs and R&D organisations with access to resources and markets. Digitalisation creates a range of innovative financial services for SMEs and eases SME access to skills through better job recruitment sites, outsourcing and online task hiring, or by connecting them with knowledge partners.

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 spillovers and capitalising on more robust growth in emerging markets. In 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, 2021[7]).

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[8]). 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/Eurostat, 2005[9]). 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[10]). 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]).

2.2. FDI impacts on productivity and innovation

FDI can contribute to enhanced productivity and innovation through the activities of foreign firms (direct impact) and via knowledge and technology spillovers that arise from market interactions with domestic firms (indirect impact). The impacts of FDI may not materialise automatically, and depend on a number of economic, market and firm-specific factors. These framework conditions underpin the channels through which FDI affects domestic productivity growth and innovation and shape the magnitude and direction of spillovers in the host economy (Figure 2.1). Examining the performance of transmission channels and their framework conditions can shed light on the trends and complexities of the relationship between FDI and productivity, triggering dialogue and facilitating the identification of policy priorities and possible trade-offs. Annex 2.A provides a detailed checklist of questions for governments to self-assess the impacts of FDI on productivity and innovation.

**FDI can contribute directly to productivity enhancement**

Foreign firms’ direct impact relates to their own activities and how they contribute to aggregate and sectoral productivity and innovation (Cadenet et al., 2018[11]). 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.

**Figure 2.1. Conceptual framework: FDI impacts on productivity and innovation**

The OECD FDI Qualities Indicators suggest that, in OECD economies, sectors receiving more FDI tend to have higher labour productivity and R&D intensity levels. They also experience higher growth in labour productivity than other sectors (Figure 2.2.). The extent of FDI concentration in highly productive sectors varies across OECD countries, but tends to be greater in those with large natural resources industries (e.g. Norway, Netherlands, Canada) where highly profitable and capital-intensive mining and extraction activities attract significant foreign MNE activity (OECD, 2019[2]). In some OECD countries, R&D-intensive manufacturing (e.g. computer equipment and electronics, chemicals, machinery) and services sectors (e.g. logistics, finance, communications) are also associated with higher FDI activity. In the US, these high-tech and R&D-intensive sectors account for more than 50% of greenfield FDI. Expanding the analysis to developing countries reveals a rather mixed picture; foreign manufacturers do not always operate in sectors with higher average labour productivity or sectors in which process innovation is more common. This is mainly due to the large concentration of FDI in labour-intensive industries, such as food processing and garments, where the intensity of innovation is expected to be lower than in capital-intensive manufacturing.

Besides the fact that foreign investors tend to invest in sectors that are typically more technology intensive, FDI's direct impact on productivity growth is also the result of foreign firms being on average more productive than domestic firms (Figure 2.3). So, FDI can raise overall productivity even in low value-added sectors if it is more productive than local firms. The FDI Qualities Indicators show that productivity gaps between foreign and domestic firms exhibit considerable variation across OECD and developing economies, with substantial gaps in some countries and negligible gaps in others (Figure 2.3). A recent study for the United Kingdom shows that foreign firms are around twice as productive as domestic companies (Batten and Jacobs, 2017[12]). This is linked to foreign affiliates having stronger access to technology, better managerial skills and more adequate resources for capital investment than domestic firms (Javorcik, 2004[13]; Javorcik, 2020[14]). 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[15]; Desai, Foley and Forbes, 2007[16]).
**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

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.


**Figure 2.3. Productivity premium of foreign firms in OECD and non-OECD economies**

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

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


**FDI can involve productivity and innovation spillovers on host economy firms**

Due to foreign firms’ performance premium relative to domestic firms, policymakers often expect FDI to generate knowledge and technology spillovers that will result in increased productivity of domestic firms, especially SMEs (Caves, 2007[17]; Blomstrom and Kokko, 1998[18]). Domestic firms 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 domestic firms as well as broader policy and non-policy framework conditions (Gorg and Strobl, 2001[19]; Crespo and Fontoura, 2007[20]; Smeets, 2008[21]; OECD, forthcoming[22]).

Value chain relationships involve knowledge spillovers from foreign MNEs to their suppliers, customers and partners

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, forthcoming[23]). A recent study of New Zealand, for example, found that small firms do benefit from economies of scale when they supply foreign MNEs and, thereby catch up technologically with foreign firms (Doan, Maré and Iyer, 2014[24]). For such technology spillovers to happen, domestic firms 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[25]; Javorcik, 2004[13]; Blalock and Gertler, 2008[26]) (see section 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, forthcoming[23]).

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 (Criscuolo and Timmis, 2017[27]). 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[28]).

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

<table>
<thead>
<tr>
<th>Foreign affiliates</th>
<th>Domestic large firms</th>
<th>Domestic SMEs</th>
<th>Import</th>
</tr>
</thead>
</table>

Source: OECD based on the OECD Analytical AMNE database.
The emergence of GVCs has brought new types of FDI-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[29]; OECD, 2008[30]).

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[31]). 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. 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).

**The movement of highly skilled workers from foreign MNEs to domestic firms can bring new knowledge and skills to domestic markets**

Labour mobility can be an important source of knowledge spillovers in the context of FDI, notably through the movement of MNE workers to domestic firms – either through temporary arrangements such as detachments and 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 Strobl, 2005[32]). 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[33]). 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[34]). Labour mobility within Ireland is also very common among highly 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[34]).

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[35]). 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 EU Member States (Becker et al., 2020[36]). 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 with foreign MNEs and imitation of their business practices provide significant learning and upgrading opportunities for domestic firms**

The entry of foreign 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[36]). The new standards set by foreign 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 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 companies may also result in the exit of some domestic firms. Increased competition for talent may also make it more difficult for local companies to recruit skilled workers (Lembcke and Wildnerova, 2020[37]). These effects are more likely to happen to local companies operating in the same sector or value chain of the foreign 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[38]; Farole and Winkler, 2014[39]; Crespo and Fontoura, 2007[20]).

**Magnitude and direction of FDI impacts depend on contextual factors**

The magnitude and direction of FDI transmission impacts depend on contextual factors, including the structure of the economy, the type of FDI that a country attracts, the capacity of domestic firms, in particular SMEs, to absorb knowledge and technology from foreign firms, and economic geography factors.

*The industrial structure, technological sophistication and internationalisation of the domestic economy influence domestic capacities and potential to benefit from FDI*

Factors relating to the national endowment, the macro-economic context, sectoral drivers of growth, productivity and innovation as well as to the level of integration in the global economy are expected to affect the impacts of FDI on host economies.

The industrial structure, economic specialisation and technological sophistication of the host country are primary determinants of FDI inflows and closely related to the productive and innovation capabilities of domestic firms, in particular SMEs. In general, economies driven by sectors with higher average productivity levels and technological intensity are expected to have greater potential to absorb and utilise the knowledge and technology brought by foreign MNEs. Countries with more advanced industrial structures tend to attract FDI in higher value added activities, involving more productive and technology-intensive activities that allow them to further advance the industrialisation process (Benfratello and Sembenelli, 2006[40]; Criscuolo and Martin, 2003[41]). Conversely, countries at early stages of the industrialisation process may benefit more from investments in lower value added sectors where local producers have a comparative advantage, allowing them to move up the value chain within those sectors into more complex activities. Integration into GVCs is another important driver of aggregate productivity growth and can have important consequences on the ability (and the incentives) of firms to exploit the knowledge transmitted through international production networks (Gal and Witheridge, 2019[42]). The degree of GVC integration is also an indicator of the internationalisation of the host economy and its potential to develop value chain linkages with foreign firms.
The magnitude of knowledge spillovers often depends on the type and characteristics of FDI

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[43]). In the context of the United States, FDI spillovers are particularly strong in high technology sectors, while they are largely absent in low technology sectors (Keller and Yeaple, 2009[44]). Furthermore, low-productivity small firms benefit more from FDI spillovers than high-productivity larger firms. FDI can however 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[45]; OECD, 2019[46]).

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 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[46]). 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 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[20]; Braconier, Ekholm and Knarvik, 2001[47]; Branstetter, Fisman and Foley, 2006[48]).

The degree and structure of foreign ownership is also an important factor affecting the strength of linkages between domestic and foreign firms. Empirical evidence shows that MNEs with fully foreign-owned affiliates exert greater control upon the technologies they transfer to their foreign locations and seek to avoid knowledge and technology leakages, thereby limiting the potential for FDI spillovers (Konwar et al., 2015[49]). In contrast, MNEs with more domestic participation may have greater potential for linkages with the local economy due to better knowledge of, and well-established relations with, domestic supplier networks (Farole and Winkler, 2014[49]). This is particularly the case for joint venture agreements, which have been found to have positive horizontal spillovers on local firms (Abraham, Konings and Slootmaekers, 2010[50]). However, as highlighted in the following sections, restrictions on foreign ownership as a means to achieve knowledge spillovers should be generally avoided as they have been found to deter FDI, especially when intellectual property rights are not protected (OECD, 2021[51]).

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.

**Domestic firms with strong absorptive capacities are better positioned to integrate new knowledge and technologies into their production processes**

Global production networks and the presence of foreign MNEs provide domestic firms with an important opportunity to increase their productivity and acquire new knowledge. Technology transfers are more effective when domestic firms possess previously accumulated knowledge and innovative capabilities. This set of knowledge and capabilities is generally identified by the literature as absorptive capacity (OECD,
More specifically, absorptive capacity is defined as the ability of the firm to acquire, assimilate and exploit the available information, knowledge and technology that comes through interaction with other firms (Cohen and Levinthal, 1990[52]; Todorova and Durisin, 2007[53]). It largely depends on the financial, human and knowledge-based capital of companies and their ability to access the strategic resources they need to adapt to market conditions, become more productive and innovate (i.e. access to finance, skills and innovation assets, including technology, data and networks).

Empirical evidence shows that the absorptive capacity of domestic firms is an important determinant of knowledge spillovers. Domestic suppliers with better technical capabilities tend to develop more knowledge-intensive types of linkages with foreign firms (Saliola and Zanfei, 2009[54]). 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 (Nicolini and Resmini, 2010[43]). The absorptive capacity is typically measured in terms of performance gaps (e.g. productivity gaps) between foreign and domestic companies as illustrated in Figure 2.3 (OECD, 2019[2]; Gal and Witheridge, 2019[22]; Farole and Winkler, 2014[46]).

However, domestic firms vary in terms of size, business model, performance and ability to access and make use of the necessary strategic resources for their growth and upgrading. This heterogeneity means that different types of firms have different chances to enter into knowledge-sharing relationships with foreign MNEs. For instance, SMEs typically have greater difficulty in attracting skilled workers, face internal and external barriers in accessing finance, and often struggle to find the technology, information and networks that would enable them to participate in innovative activities with foreign MNEs (OECD, 2019[4]; OECD, 2020[55]; OECD, 2021[56]). Given that SMEs account for almost all enterprises in both OECD and developing economies, strengthening their absorptive capacities is key to enhancing FDI’s spillover potential for domestic productivity and innovation (OECD, forthcoming[23]).

Recent OECD work on FDI-SME linkages and spillovers in Portugal and the Slovak Republic shows that cross-country differences in SME productivity and innovation performance can explain differences in the sourcing strategies of foreign MNEs. In Portugal, foreign investors source extensively from the domestic market, reflecting the fact that SMEs are relatively more innovative and digitally savvy than those in many other OECD economies (OECD, forthcoming[22]). In contrast, foreign investors in the Slovak Republic rely mainly on imports for the sourcing of inputs, which is linked to the poor productivity performance and innovation capacity of the Slovak SME population.

**Economic geography factors shape agglomeration and network dynamics, which are key for domestic firms to benefit from FDI’s presence**

Economic geography factors generate spatial and agglomeration effects. The localised nature of FDI means that geographical and cultural 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[57]). 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[37]; Girma, Görg and Pisu, 2008[58]). When deciding where to invest, foreign firms are considering the specific factor endowment of a region - rather than just of the country. SME activity and performance are also unevenly distributed within countries, with high concentration of R&D and innovation activities and investments in few regions, and large cross-regional disparities in productivity (OECD, 2016[59]).

Agglomeration effects, notably through the presence of local industrial clusters, have been also reported to affect the volume of FDI and its potential for knowledge 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 and in other
sectors. However, these benefits do not materialise for companies located outside the clusters (De Propris and Driffield, 2005[60]; Menghinello, De Propris and Driffield, 2010[61]; Franco and Kozovska, 2008[62]).

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 economic and market conditions as well as firm-specific factors, public policies and institutional arrangements play an important role in fostering positive impacts of FDI on domestic productivity growth. Policies and institutions are also essential to avoid negative implications that may result from the presence of foreign firms, such as crowding out of local SMEs and jobs (Chapter 3). Most public policies do not specifically target foreign firms; they treat foreign and domestic investors alike. Yet, the extent to which they affect the two groups, and with that their outcomes on sustainable development, can vary. Laws, regulations and public support schemes directly affect foreign firms’ choice of location, incentivise specific types of foreign firms to invest and keep away others.

The OECD Policy Framework for Investment (PFI) provides guidance on investment climate reforms that are concurrent with enabling investment for productivity growth. Yet, ensuring that FDI leads to higher productivity levels and supports the competitiveness and innovation of domestic firms, in particular SMEs, requires more tailored policy considerations and increased focus on complementary policies outside the PFI, including industrial, innovation, SME and entrepreneurship policies. In fact, interest in industrial policies has grown over the past decade as both OECD and developing economies are looking at how to strengthen their domestic industrial capacities, advance technological development, and improve their global positioning in higher value-added segments of production (OECD, 2016[63]). OECD work on the role that industrial policies (including innovation and general business framework policies) can play in advancing the SDGs demonstrates that a diverse set of policy instruments (e.g. rewards and incentives, government assistance policies, compliance instruments), adequate business framework conditions, and enhanced focus on SMEs, innovative startups and local entrepreneurial ecosystems are needed to improve domestic productive capacities (OECD, 2021[64]).

This Policy Toolkit aims to provide a thorough assessment of policy initiatives, from national strategies and regulations to financial incentives and technical assistance programmes, at the intersection of these policy areas to help policymakers enhance the impacts of FDI in the area of productivity and innovation. It explains what institutional settings, regulatory conditions, policies and programmes are important ingredients of a policy mix that enables FDI impacts – both directly and through spillovers. The Policy Toolkit is structured around four broad principles and the policy instruments that support these principles (Figure 2.5). Annex 2.B provides a detailed checklist of questions for governments to self-assess policies influencing the impacts of FDI on productivity and innovation.
Providing strategic direction and ensuring policy coordination and coherence across the investment, innovation and SME development policy areas

Ensuring coherence across national strategies and action plans addressing investment, innovation and SME policy issues

The institutional framework that governs the investment, innovation and SME development policy areas differs from country to country. Different governance arrangements are feasible as long as appropriate reporting mechanisms and communication channels are in place to ensure policy alignment among different institutions and tiers of government. 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 productivity and innovation.

National strategies and action plans can be important instruments for policy coherence as they are crosscutting in nature and often require whole-of-government responses to ensure their effective implementation. Establishing a clear, overarching and comprehensive strategic framework for investment promotion policy allows to create an integrated vision across government, and set out long-term strategic objectives, quantifiable targets, policy pillars, related programme actions and clearly defined roles for all the institutions involved in its implementation. Such a long-term and country-wide vision for inward investment attraction should connect FDI’s contribution to economic growth with other sustainable
development objectives, including the internationalisation of the economy, innovation promotion and the development of domestic productive capacities.

It is critical that investment policy strategies are not developed in silos, but are sufficiently aligned with and include cross-references to national strategies addressing innovation, SME and industrial policy issues. Many OECD countries have dedicated national strategies on these policy areas, while others mainstream relevant policy priorities in economic reform programmes, sectoral action plans and national development strategies. As part of their policy response to the supply chain disruptions caused by the COVID-19 pandemic, both Ireland and the Czech Republic have recently developed dedicated SME and entrepreneurship strategies, focusing on strengthening their productivity, internationalisation and innovation including through linkages with foreign MNEs (OECD, 2021[7]). Conversely, many investment and innovation promotion strategies increasingly consider the role that FDI can play in strengthening the domestic R&D ecosystem. The national investment strategies of Norway, Spain, Slovenia and the UK include specific measures aimed at supporting the upgrading of SMEs in GVCs, while the Czech Republic’s National Research, Development and Innovation Policy Strategy (2016-20) foresees new services to help SMEs become more involved in international R&D collaborations (OECD, 2019[4]).

Ensuring policy coordination and collaboration among government actors involved in the design and implementation of investment, innovation and SME policies

Actions to improve the impact of FDI on productivity and innovation need to be aligned with the objectives and priorities set by government across different sectors and policy areas. This often entails cooperating with a number of government institutions at national and subnational levels. Although coordination is a fundamental and longstanding problem for public administrations, much of the success or failure of attempts to coordinate appear to depend upon country contexts, including the complexity of the institutional setting and the coordination instruments at play.

In many OECD and developing economies, the institutional framework governing investment promotion, innovation and SME policies is structured along lines reflecting different policy domains. In Belgium, Portugal and Canada, for instance, several implementing agencies operate across the three policy areas under the supervision of different ministries. Such institutional settings may induce more complex governance systems – i.e. higher risks of information asymmetry, transaction costs and trade-offs – and require strong inter-institutional coordination mechanisms to overcome potential policy silos. In contrast, other governments (e.g. Croatia, Finland, Lithuania, Luxembourg, Slovenia) target the entire FDI-SME-innovation ecosystem through a single government entity to facilitate coordination among the policy domains and make available comprehensive packages of support that help foreign and domestic firms at every aspect of their entrepreneurial activity.

Irrespective of the complexity of the institutional setting, the set-up of effective inter-institutional coordination mechanisms at the strategic and policy implementation level is key. Instruments of coordination can be formal or informal; based on regulation, incentives, norms and information sharing; top-down relying on the authority of a lead government body, or bottom-up and emergent. For instance, high-level government councils can bring together line ministries responsible for investment, SME, innovation and industrial policy issues, implementing agencies and regional and local governments to identify priority areas where cross-ministerial policy planning and decision-making is necessary. In many countries, some of these councils are also responsible for the coordination of national strategies while others have been given broader mandates to foster policy dialogue, convene stakeholders and issue opinions on legislative initiatives. Inter-agency joint programming can also facilitate the implementation of targeted policies at the intersection of FDI, SME and innovation promotion, in particular in countries with highly fragmented institutional settings. Finally, informal channels of communication between officials or job circulation (of civil servants) can play an important role and often suggest a relatively well-developed culture of inter-agency trust and communication.
Assessing the impact of FDI and relevant policies on the productivity and innovation of the domestic economy to improve policy design and implementation

Monitoring and evaluation (M&E) practices have been at the centre of governance frameworks as a result of the emergence of multi-dimensional policy issues and the increasing expectations over the effectiveness of public policy. The systematic collection of disaggregated data for the assessment of FDI impacts on productivity and innovation can help governments assess the economic and market conditions that underpin FDI-driven productivity growth, identify market failures and possible policy responses. The OECD FDI Qualities Indicators allow policymakers to make the necessary link between investment and host economy impacts, and help them assess how FDI supports national policy objectives with regard to productivity, innovation, SME growth and upgrading (OECD, 2019[2]).

Furthermore, a comprehensive framework for evaluating the impact of policies on foreign direct investors, local SMEs and other actors of the domestic research and innovation ecosystem (e.g. R&D organisations, technology parks, applied research centres, collaborative laboratories, universities) could play a crucial role as an "early warning mechanism" to identify potential policy gaps and take corrective action. For line ministries and implementing agencies responsible for investment promotion, it is critical that impacts on innovation, R&D and the capacities of domestic firms are sufficiently considered when measuring success in reaching the policy objectives of related investment promotion measures. In fact, 53% of OECD IPAs and 60% of MENA IPAs use innovation and R&D-related performance indicators when measuring the impact of their policy actions in the economy (OECD, 2018[65]). Policy impacts on the capacities of domestic firms are also evaluated by 22% of OECD IPAs and 60% of MENA IPAs.

For many OECD and developing countries, the development of better systems to track and collect reliable statistical data based on international standards is a pre-requisite to the development of more robust outcome indicators, including on productivity and innovation. The use of qualitative evaluation methodologies (e.g. surveys, benchmarking, consultations), and the establishment of data tracking tools and feedback processes can ensure that relevant and reliable data on the impact of policy interventions are available. Coordination and collaboration between investment promotion, innovation and SME agencies can facilitate the exchange of data, experiences and expertise. Apart from the use of quantifiable outcome-based performance indicators, a reliable assessment of policy impacts also requires strong internal capacity to plan, prepare and execute ex ante and ex post evaluations. Setting up dedicated evaluation units within implementing agencies and involving specialised staff with technical knowledge of M&E principles and implementation tools could strengthen internal competences and improve the effectiveness of their programmes.

Active engagement and consultation with foreign direct investors, local SMEs and R&D organisations is necessary for the effective implementation of relevant policies. Through their interactions with the private sector, public institutions are able to understand the challenges and expectations of foreign and domestic firms, receive feedback on the relevance of their policy programmes, and enrich policy-making processes with insights from various stakeholders of the domestic research and innovation ecosystem. Mechanisms for regular public-private dialogue within specific sectors and supply chains should be combined with bottom-up communication processes to ensure that local level market needs and perspectives are fed into higher level policy processes.
Ensuring that domestic and international regulations create a conducive business environment for FDI-driven productivity growth and innovation

Ensuring an open, transparent and non-discriminatory regulatory environment for knowledge- and technology-intensive investment

An open and non-discriminatory regulatory environment can increase the amount and spillover potential of FDI and strengthen the absorptive capacities of domestic firms, in particular SMEs (Figure 2.6). Fewer restrictions for investments in more productive, innovative and knowledge-intensive sectors and fewer procedural steps to establish a foreign affiliate can increase the direct impact that foreign firms have through their own activities on sectoral and aggregate productivity growth. 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 (OECD, 2019[66]).

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 regulatory requirements 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 and may prove to be detrimental for FDI attraction and productivity growth in the long run (Stone, Messent and Flaig, 2015[67]).

Figure 2.6. FDI openness in services and productivity in downstream manufacturing sectors

![Graph showing the relationship between FDI openness in services and log labour productivity in manufacturing](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[66])

FDI spillovers also tend to be larger in countries that are more open towards trade (Meyer and Sinani, 2009[68]; Havranek and Irsova, 2011[69]; Du, Harrison and Jefferson, 2011[70]). 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[70]). 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 (Havranek and Irsova, 2011[69]).

FDI-driven productivity growth and innovation may not automatically materialise just because a country is able to attract FDI (Alfaro, 2017[71]). 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[37]). 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 effects are an important channel through which knowledge and technology spillovers from FDI take 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.

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[72]). Branstetter et al. (Branstetter, Fisman and Foley, 2006[49]) 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 (Javorcik, 2004[13]) 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.

Considering the impact of laws and regulations on business capacity and incentives to grow, become more productive and innovate

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. 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. Overly burdensome regulations often perpetuate informality, particularly of smaller and less productive firms, which have less capacity to screen the regulatory landscape and allocate the necessary resources to address legal and regulatory requirements (OECD, 2018[73]). It is important that a conducive business environment is created and regulatory hurdles removed to enable small businesses to expand. These include areas such as the ease of registering a business, dealing with reporting and tax compliance requirements, trading across borders, resolving insolvency and dealing with licence and permit systems.

At the same time, stringent regulations can deter innovation by imposing high compliance costs that limit the capacity of entrepreneurs to experiment with alternative business and production models and reduce the attractiveness of R&D (Davidson, Kauffmann and de Liedekerke, 2021[74]). One option for encouraging FDI-driven productivity growth and innovation is to develop laws and regulations that are sufficiently flexible and forward-looking to anticipate and adapt to fast-changing technologies. This is particularly the case for regulations addressing issues related to digital innovation (e.g. use of AI applications, robotics, Internet of Things). Related technological standards should be also updated regularly to catch up with the latest market developments. Finally, regulatory impact assessment (RIA) tools and processes should move beyond assessing the economic impacts of regulations (e.g. impacts on competition, economic growth, etc.) to also cover impacts on SME competitiveness, innovation and internationalisation.
In many countries, the simplification of the regulatory framework is often combined with targeted easing of the regulatory burden for certain types of investment. This usually comes in the form of special investment regimes granted to FDI projects that are deemed to be of strategic importance for the host economy, giving access to expedited administrative and licensing procedures. These special regimes are usually predicated on certain conditions such as creating a number of jobs, investing in knowledge-intensive and productivity-enhancing sectors, or benefitting specific geographic areas. In Portugal, for instance, the government has introduced several special regulatory regimes allowing investors to benefit from simplified licensing procedures, conditional to introducing innovative and technology-based production processes in cooperation with domestic R&D institutions. Many developing countries have also established special economic zones (SEZs) as a tool to attract FDI that creates linkages with the local economy.

Evidence on the effectiveness of these regulatory measures has been mixed. Anecdotal evidence on their impacts, in particular of the SEZs, shows that they have often failed to sustain innovation and competitiveness over time, delivering little technological upgrading or new firm creation. In many instances, SEZs have been criticised for negative social and environmental impacts as a result of excessive competition between regions and a misuse of resources and land where the SEZs are located (Farole and Akinci, 2011[76]; OECD, 2018[78]). In principle, regulatory concessions should not be used as a substitute for improving the general investment climate but instead be embedded in broader national development strategies. Accompanying measures need to be in place to generate productivity spillovers on the rest of the economy, including supplier development programmes, business matchmaking services, and initiatives to engage the private sector and local education institutions in cluster building activities.

Moreover, it is critical that policy efforts to reduce the regulatory burden on business do not lead to a “race to the bottom” in terms of social and environmental standards (see chapters 3, 4 and 5). This becomes even more crucial for industries driven by digital innovation, which rely on alternative business models and often lead to new and more precarious forms of employment or weakened social protection conditions (OECD, 2020[77]). In fact, regulation should mitigate the potential socio-economic risks arising from the adoption of new, innovative and digitally enabled business models while at the same time ensuring that regulatory responses are proportional, set out some level of certainty and predictability, and do not stifle the innovation potential of the economy.

Ensuring that labour market laws and regulations enable domestic firms, in particular SMEs, to retain and attract highly skilled workers

Labour market regulations shape FDI impacts on productivity and innovation by affecting the potential for knowledge and technology spillovers through labour mobility (see section 2.2) and the availability of skills in the local labour force. Recent evidence from EU countries shows that less rigid labour markets with strong absorptive capacities are better positioned to moderate any adverse labour market effects of FDI, in particular the crowding out of employees in domestic firms, which occurs when foreign and domestic firms compete for the same scarce labour resources (Becker et al., 2020[36]). In contrast, the benefits for a local economy from FDI are lowest where there exist a combination of stringent employment protection legislation and low absorptive capacities. This is because foreign firms seek to attract local talent by offering higher wages that less productive domestic firms 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, holding back labour mobility and the potential for knowledge spillovers that this entails.

These findings highlight the need to examine labour market regulations and their role in FDI-driven productivity growth by looking at how they relate to other drivers of FDI impacts, namely domestic SME performance and the availability (or lack) of skills in the local labour force. Spillovers from labour mobility cannot be fully leveraged unless structural challenges related to the absorptive capacities of domestic firms, in particular SMEs, are addressed, and the complexity of hiring regulations reduced (and with that the disproportionate impact they may have on small businesses). Targeted measures that allow micro and
small firms to be exempted from certain procedural requirements or other hiring restrictions of the labour legislation can facilitate the movement of highly skilled workers from foreign affiliates to the domestic entrepreneurial ecosystem.

Encouraging the uptake of permanent employment can also have a positive impact on domestic firms’ willingness to invest in job training of their employees, which is an important component of a firm’s absorptive capacity. Evidence on the role of employment protection regulations in shaping the incentives of firms to invest in formal training shows that enforcing stricter hiring regulations for temporary contracts and less rigid regulations for dismissals of permanent workers is associated with higher investment by firms in the human capital of their employees (Almeida and Aterido, 2011[78]). Similarly, a stricter enforcement of employment protection regulation is found to have a positive impact on firms’ willingness to upskill their employees. This is mainly because firms have greater incentive to invest in firm-specific knowledge and skills for employees who stay longer on the job and seek to exploit the career advancement opportunities provided by the firm (OECD, 2020[79]). Chapter 3 provides a detailed analysis of the positive impacts that labour market regulations can have on human capital formation.

Linked to the need for a skilled labour force is the increasing number of governments that introduce regulatory incentives to encourage workforce skills development and facilitate the immigration of business talent as a way to help domestic economies address labour shortages. Some OECD countries have introduced statutory rights for employees for training leave – however, their take-up is generally not high with less than 2% of employees benefitting from such measures (OECD, 2019[4]). In recent years, there has been also an increase of entrepreneur visa programmes (e.g. Startup Visa, Tech Visa), which seek to attract innovative entrepreneurs and highly skilled workers by allowing them to obtain residence and employment 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.

Ensuring that financial market laws and regulations facilitate access to finance for innovative and technology-intensive investment projects

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[46]). For many SMEs, the high fixed costs of establishing a distribution network and adjusting their products for overseas standards, often require external finance (OECD, 2020[55]). Similarly, access to finance is an important condition for foreign firms that seek to finance collaborative technology-based projects or enter into partnerships with domestic firms (for instance, through joint ventures).

Financial stability risks (e.g. low bank profitability, high sovereign and corporate debt) and structural market deficiencies (e.g. underdeveloped equity markets and credit rating systems, insufficient market liquidity, weak contract enforcement, inefficiencies in the judicial system, etc.) are often the most common causes that hold back the necessary capital that foreign and domestic firms need to expand their operations. 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 easily accessible financial support schemes (OECD, 2019[46]). Regulatory reforms that facilitate market-based long-term debt financing, increase the availability of alternative financing instruments, and promote access to equity capital through the stock market can help free up capital for innovative business projects. Raising awareness about alternative forms of financing such as crowdfunding, venture capital...
and business angels, and encouraging firms to source finance from equity markets can also further stimulate collaborative innovative activities.

**Integrating SME policy considerations and promoting science, technology and innovation (STI) cooperation within international investment agreements**

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. 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 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 myriad other obstacles to effective entry and success of FDI in foreign markets. Recent IIAs have sought to alleviate 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. As described in the previous section, performance requirements have been found to deter FDI inflows and undermine the long-term competitiveness of the domestic economy. 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. incentive schemes, 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.
Stimulating knowledge-intensive investment and supporting the productive and innovation capabilities of the domestic economy

Designing and implementing clearly defined, transparent and rules-based investment incentive schemes that target FDI in productive and knowledge-intensive activities

Financial incentives are widely used by governments to attract investment and encourage or discourage certain types of business activities (Table 2.1, Box 2.2). Direct financial support (e.g. grants, subsidised loans) is 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, through reduced corporate tax rates, tax holidays, investment tax credits and accelerated depreciation allowances. Financial incentives have the potential to attract investment with positive spillovers on sectoral and aggregate productivity levels. For instance, cross-country differences in the generosity of R&D tax allowances can lead to differences in the cost of capital faced by firms – and subsequently encourage or discourage them from increasing their R&D investment or locating their R&D functions in a given country (González Cabral, Appelt and Hanappi, 2021[80]).

However, financial incentives are not always aligned with the objective to enhance domestic resource mobilisation for productivity growth and innovation. The design, eligibility conditions, sectoral targeting and administration of incentive schemes are important factors that influence their impact on the domestic economy. There is growing anecdotal evidence suggesting that profit-based tax incentives (e.g. tax holidays, preferential tax rates), which reduce the rate applied to profits/income already secured, tend to attract mobile activities rather than long-term FDI projects that are more likely to create linkages with the local economy and generate knowledge and technology spillovers (OECD, 2019[68]). Profit-based tax incentives may also have limited effectiveness in attracting new investment and often come at a substantial cost to a country by resulting in windfall gains for projects that would already have taken place in the absence of the incentive. In contrast, cost-based tax incentives – such as tax deductions and credits, accelerated depreciation and trade tax exemptions – that lower the cost of specific inputs of production factors allow to link investments to performance criteria that support progress towards specific development objectives, including SME linkages and innovation activities.

Beyond the type of incentive, more targeted approaches in terms of supported sectors and activities should be preferred. Governments could consider making the granting of tax relief conditional to creating linkages with local SMEs, undertaking R&D locally, or investing in more productive, knowledge-intensive and high-tech sectors. The conditions and criteria for the granting of incentives should be transparent, clearly defined and rules-based to facilitate their verification, avoid discretionary and distortive granting decisions, and strengthen the link to the intended policy goal of increasing productivity gains for the domestic economy. Such a targeted approach requires, however, higher tax administration capacities and the necessary resources to monitor the compliance of beneficiaries to outcome-based criteria, carry out regular audits to avoid fraudulent behaviour, and measure their costs and overall effectiveness over time.

Given the ever-changing nature of innovation and the fast pace of technological developments, investment incentives targeting R&D and high-tech activities should be also reviewed periodically to ensure that they continue to reflect the latest market developments. One option to ensure periodic reviews is to make incentive policies temporary rather than permanent. Temporary schemes require regularly reconsidering whether the incentive should be continued, reformed or abolished. Serious policy consideration should be also given to the impact that incentive schemes have on the complexity of the tax system and the capacity of the tax administration to implement such targeted approaches. Country contexts and institutional arrangements discussed in the previous section should be taken into account. For developing countries, where institutional capacities are lagging, a simple and unspecific incentives scheme may bring longer-term benefits to the domestic economy by creating more certainty for potential investors.
Table 2.1. Tax incentives targeting SME linkages, exports/GVC linkages, SEZs, R&D and high-tech activities in ASEAN countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Local sourcing, SME linkages</th>
<th>R&amp;D and other strategic sectors</th>
<th>High-tech activities</th>
<th>Exports, GVC linkages</th>
<th>Less developed regions and SEZs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brunei Darussalam</td>
<td>Deduction</td>
<td>Deduction</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Cambodia</td>
<td></td>
<td></td>
<td></td>
<td>Trade tax exemption</td>
<td>Trade tax exemption</td>
</tr>
<tr>
<td>Indonesia</td>
<td></td>
<td></td>
<td>Tax holiday</td>
<td></td>
<td>Deduction, trade tax exemption</td>
</tr>
<tr>
<td>Laos</td>
<td></td>
<td></td>
<td></td>
<td>Trade tax exemption</td>
<td>Tax holiday</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Tax holiday, reduction</td>
<td>Tax holiday, reduction</td>
<td>Tax holiday, reduction</td>
<td>Trade tax exemption</td>
<td>Reduction</td>
</tr>
<tr>
<td>Myanmar</td>
<td>Deduction</td>
<td></td>
<td></td>
<td>Trade tax exemption</td>
<td>Reduction</td>
</tr>
<tr>
<td>Philippines</td>
<td></td>
<td></td>
<td></td>
<td>Trade tax exemption</td>
<td>Reduction</td>
</tr>
<tr>
<td>Singapore</td>
<td>Deduction</td>
<td>Tax holiday, deduction</td>
<td></td>
<td>Trade tax exemption</td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>Deduction</td>
<td>Deduction</td>
<td></td>
<td>Tax holiday</td>
<td></td>
</tr>
<tr>
<td>Viet Nam</td>
<td>Deduction</td>
<td>Deduction</td>
<td></td>
<td>Tax holiday, reduction, trade tax exemption</td>
<td></td>
</tr>
</tbody>
</table>

Note: Tax holiday = total income tax exemption over defined period; reduction = income tax rate reduction over defined period; deduction = deductions of certain expenses from taxable income; tax credits = deduction of certain expenses from payable taxes (loss carried forward and accelerated depreciation also fall under this category for simplicity); trade tax exemption = exemption from import duties, export taxes or VAT.
Source: (OECD, 2019[66])
Box 2.2. Investment incentives for knowledge- and technology-intensive activities in Thailand and Rwanda

Thailand

Following the development of its investment promotion strategy in 2015, Thailand moved from a system of location-based investment incentives (economic zones) to an activity- and merit-based one, with emphasis on SME linkages, R&D investments and skills development (OECD, 2021[51]). Thailand’s investment promotion policy aims to attract investment into research and development (R&D) projects in 10 target sectors and particularly in areas that involve technologies in which Thailand is considered to have potential to enhance the country’s overall competitiveness. Supported investment projects must involve a component on technology transfer by cooperating with educational and research institutions, for example via programmes of the National Science and Technology Development Agency (NSTDA) or the Thailand Institute of Scientific and Technological Research.

Activity-based incentives are granted for knowledge-based activities as well as investment projects that strengthen supply chain development. Merit-based incentives provide an add-on to the basic scheme with additional corporate income tax (CIT) exemptions and tax deductions if a project undertakes R&D or skills development activities or locates in specific regions and industrial zones. In 2017, the government amended the Investment Promotion Act to introduce an additional set of technology-based incentives that grant CIT exemption for up to 10 years to projects with targeted core technology development such as biotechnology, nanotechnology, advanced materials technology and digital technology.

Rwanda

In January 2021, Rwanda enacted a new Investment Promotion and Facilitation Law, which introduces new priority sectors and various tax incentives aimed at improving the competitiveness and productivity of the economy and make Kigali, the country’s capital, a hub for innovative investors and startups (Government of Rwanda, 2021[81]). Investments in the construction of specialised industrial and innovation parks, R&D and skills development facilities, creative arts, e-mobility and high-value horticulture figure among the new priority economic activities that will drive Rwanda’s investment promotion policy in the coming decade. Foreign firms that establish a R&D facility, ICT training centre, software build and test lab, ICT specialised institution or a business incubator benefit from a 15% preferential CIT rate. The incentives apply for investments that take place in the Kigali Innovation City, a technology cluster area located in Kigali’s special economic zone.

Rwanda’s new investment law also exhibits a strong focus on the role that small investors and startups can play in spurring innovation and productivity growth. Small, medium and emerging investors are given access to a Seed Innovation Fund that will provide grants, loans and equity for training costs, technology acquisition, professional services and costs incurred on intellectual property rights. A 150% tax deduction also applies to expenditures relating to internationalisation activities (e.g. exports, participation in overseas trade fairs and business missions, etc.). In an effort to attract business talent, innovative foreign entrepreneurs are eligible for a two-year entrepreneurship visa to start or move their business to Rwanda, while highly skilled international students can apply for a two-year talent visa to gain access to the local labour market.
Providing financial support and technical assistance to strengthen the absorptive capacities of domestic firms, in particular SMEs

Governments can strengthen the absorptive capacity of domestic firms, in particular SMEs, not only by ensuring that the regulatory environment is conducive to business growth but also by implementing targeted measures that support the development of strategic assets and resources at the firm level (e.g. access to skills, finance, innovation and digitalisation, etc.) (OECD, 2021[7]). Such measures often involve financial support and technical assistance in diagnosing weaknesses in business performance, experimenting with and adopting alternative business models, and undertaking innovative, technology-based activities with foreign firms. In many cases, financial and technical support is supplemented with training and guidance on the skills, managerial and organisational changes that are required to strengthen firm productivity and innovation.

Supplier development programmes can play a crucial role in enhancing the absorptive capacity of local SMEs and increasing 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, product certification and foreign market standards. As part of these programmes, many government agencies organise seminars, workshops and courses (e.g. SME academies) to help domestic firms become familiar with foreign markets, enhance their export capacities and explore alternative sales strategies based on the use of ICT tools (e.g. e-commerce). To maximise the effectiveness of supplier development programmes, it is critical that their scope and content is aligned with the investment facilitation and aftercare services offered to foreign firms to ensure that the goods and services of domestic suppliers respond to the needs of foreign direct investors, especially in FDI-intensive sectors.

Given the increasing digitalisation of supply chain management processes, supplier development programmes should be combined with technology extension services (TES) to improve the use of “new-to-firm” innovation by SMEs through technological and other solutions (Shapira, Youtie and Kay, 2011[82]). The main objective of these services is not to develop new technology but rather to facilitate the adoption of existing technology through diagnostic assessments of a firms’ operations, processes and technological maturity; information services to bring awareness of new business models and digitally-enabled sale practices; benchmarking to identify areas for improvement; consulting, training and technical assistance to implement internal organisational changes.

Financial and fiscal incentives may be also used to strengthen the innovation performance of domestic firms and enable them to collaborate with foreign investors. Many countries have taken policy action to support SMEs and entrepreneurs to access the finance they need for their growth and upgrading. Direct lending as well as grants and subsidies are provided to SMEs to help them invest in R&D, acquire new technologies, adopt digital tools and processes, and engage in innovation and internationalisation activities. Tax relief measures are often provided to support subgroups of the SME population such as young high-growth firms and startups to expand their business operations and join GVCs. Many of these financial support schemes 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.

Programmes that facilitate SME access to qualified human capital should be also available to domestic firms to strengthen their capabilities in areas that require highly specialised expertise and skillsets such as those involving the use of innovative production processes, automation and digitalisation. Small businesses tend to offer fewer training and upskilling opportunities than large firms due to the increased financial costs of organising tailored training programmes, the lack of internal organisational capacities, and lower levels of resources to anticipate skill needs (OECD, 2015[83]). Many OECD countries provide tax
exemptions to encourage small businesses to provide on-the-job training to their employees, while others offer direct subsidies such as training vouchers that allow SMEs to purchase training hours from accredited training and educational institutions (OECD, 2021[7]).

Managerial skill development programmes in the form of seminars, workshops and individual consulting should be part of technical support packages provided by investment promotion and enterprise development agencies. Canada’s Operational Efficiency Programme, for example, strengthens operational efficiency in manufacturing SMEs by enabling participating companies to benchmark and monitor their operational performance against the industry average (OECD, 2019[84]). Linking the development of SME workforce skills to vocational education and training (VET) frameworks can also foster greater collaboration between employers and vocational schools and help SMEs access highly skilled young employees through apprenticeship programmes. By combining school-based education and on-the-job training, apprenticeships can stimulate company productivity and profitability. Evidence from countries for which data are available show that more than half of all apprentices work in companies with 50 employees or fewer (Kergroach, 2021[85]). Work placement, employee exchange programmes and wage subsidies for highly skilled or R&D workers can be also used to ensure that SMEs have access to high quality human capital. For instance, the Portuguese investment promotion agency, AICEP, 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. Such programmes play a crucial role in strengthening labour mobility and facilitating the transfer of knowledge and skills to domestic firms.

Table 2.2. Technical support to strengthen the absorptive capacities of domestic firms, in particular SMEs, in selected OECD and developing countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Policy initiative</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portugal</td>
<td>Internationalisation Academy</td>
<td>Training programmes and online courses developed in partnership with Portuguese universities and business schools to help companies acquire knowledge of overseas product certification standards and processes.</td>
</tr>
<tr>
<td></td>
<td>Innovation Scoring Tool</td>
<td>A performance assessment platform that allows companies to measure the degree of innovation of their business activities, receive a score and a set of recommended actions.</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>Chain Acceleration Programme</td>
<td>Tailored support through managerial and technical training to SMEs that have a high potential to become suppliers of export-oriented companies based in Costa Rica.</td>
</tr>
<tr>
<td></td>
<td>Digital Check-up Platform</td>
<td>Providing companies with a diagnosis of their digital maturity in 8 areas, and offering recommendations according to the level of maturity in each area.</td>
</tr>
<tr>
<td>Morocco</td>
<td>Mowakaba programme</td>
<td>Financial and technical support covering domestic companies’ development strategy, financial optimisation, operational resilience, skills as well as product design and development for domestic and international markets.</td>
</tr>
<tr>
<td></td>
<td>Skills Transfer Platform</td>
<td>Matchmaking platform comprising more than 1000 entrepreneurship advisors and technical experts that seek to support SMEs upgrade the managerial skills of their employees.</td>
</tr>
<tr>
<td>Turkey</td>
<td>SME Technology Support Programme</td>
<td>Providing professional services (coaching, consultancy, mentoring) to enterprises through Technology Development Centers (TEKMER).</td>
</tr>
<tr>
<td></td>
<td>KOBIGEL/SME Development Support Programme</td>
<td>Increasing SME productivity and competitiveness with the help of digital technologies, with a focus on the manufacturing sector.</td>
</tr>
</tbody>
</table>

Source: OECD (2021), FDI Qualities Mapping (database).
Box 2.3. Supply chain development programmes in Portugal, Malaysia and Jordan

Portugal

In Portugal, the national investment promotion agency (AICEP) and SME Competitiveness and Innovation Agency (IAPMEI) jointly implement the Supplier Clubs programme, which is a good example of how public policy can mobilise actors across the business ecosystem to help local SMEs collaborate with foreign affiliates (OECD, forthcoming[22]). The programme combines matchmaking services to help foreign and domestic firms identify collaboration opportunities and agree on jointly implemented projects; business consulting and training programmes provided by foreign affiliates to their suppliers based on an assessment of their performance; and financial support through EU-funded incentive schemes to help SMEs upgrade their technological capabilities for the implementation of the agreed joint projects. As part of its aftercare services, AICEP implements two programmes that help foreign investors identify local suppliers, targeting traditional SMEs as well as young innovative start-ups. Several matchmaking platforms and local supplier databases are also in place to bring down information barriers and allow foreign and domestic firms to identify local sourcing and partnership opportunities. For instance, AICEP has developed a new platform, which relies on AI technology to deliver customised matchmaking services, while the National Innovation Agency (ANI) operates the Business and Technology Exchange platform, which serves as a single access point for Portuguese technology offers and requests.

Malaysia

Malaysia offers various incentives to encourage linkages between foreign investors and local SMEs (OECD, 2019[66]). Under the Industrial Linkage Programme, investors can claim tax deductions for costs involved in providing support to local suppliers, including training, product development and testing, and factory auditing to ensure local supplier quality. A Global Supplier Programme offers financial and organisational support to MNEs, if specialists from their foreign affiliates are seconded to local firms (for up to two years) for the purposes of local upgrading. The programmes in Malaysia have influenced Intel in its decision to develop local SMEs as suppliers. Intel is reported to have developed a model for supporting supplier development and upgrading: potential suppliers are selected based on the quality of their management; human resources; technical, materials and process capabilities; and cost competitiveness. They are then provided with training and opportunities to supply the affiliate and ultimately, the global Intel network (Christiansen and Thomsen, 2005[86]).

Jordan

In Jordan, responsibility for supply chain development and MNE-SME linkages lies on the Jordanian Enterprise Development Corporation (JEDCO), which is the country's main government agency responsible for SMEs and entrepreneurship. JEDCO in collaboration with local chambers of commerce and business associations, implements the flagship National Linkages Programme, which connects large manufacturers with local SME suppliers, facilitates their interaction and provides technical and financial support to ensure that locally sourced inputs meet the needs of domestic MNEs. Several other supplier development programmes are also implemented to help SMEs in the industrial, services and agricultural sectors to export and integrate into GVCs. Since 2017, JEDCO and the Jordanian Higher Council for Science and Technology (HCST) have also joined the EU’s Enterprise Europe Network (EEN) and set up a consortium to provide support for companies seeking to collaborate with European firms for the implementation of R&D and technology transfer projects.
Developing network and knowledge infrastructure to promote agglomeration economies and facilitate business-to-business and science-to-business collaboration

The potential for FDI spillovers on the domestic economy is influenced strongly by the local knowledge infrastructure, which may include technology transfer offices, applied research centres, collaborative laboratories, universities and other facilities that contribute to the creation and diffusion of knowledge through synergies. Knowledge co-creation, i.e. the joint production of innovation between industry, research and possibly other stakeholders of the entrepreneurial ecosystem, is increasingly acknowledged as an important mechanism to bring together complementary expertise and facilitate the transfer of tacit knowledge (Kreiling and Paunov, 2021[87]). The establishment of facilities that provide a physical environment for foreign firms to interact, network, exchange knowledge and collaborate with domestic actors can be instrumental for the development of knowledge-intensive partnerships between foreign MNEs and domestic firms. Local SMEs can also gain access to technological premises, equipment, manpower and activities provided by universities and public research institutes that they could not afford independently (OECD, 2019[4]).

Over the past decade, there has been a rapid increase of intermediary technology institutes (ITIs) and technology transfer offices (TTOs) (Rossi et al., 2020[88]). 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.

Moreover, establishing and operating business incubators and accelerators in regions and sectors with high innovation potential allows entrepreneurs and early-stage startups to experiment with new business models, access frontier know how, and technologies that they can use to further develop their innovative ideas, often in collaboration with foreign firms. Business facilities and services supporting the startup ecosystem can also further boost knowledge-intensive FDI by facilitating acquisitions of innovative startups by foreign multinationals. In fact, startup acquisitions are a common practice among MNEs that seek to maintain their position in high-tech sectors by acquiring and exploiting the technological “inventions” and valuable data and information held by young high-growth firms. In Israel, for example, the number and value of M&As and buyouts involving innovative startups has continuously grown over the past decade to reach a total value of USD 21.7 billion in 2019, as local players and multinational corporations expanded open innovation activities in a wide variety of sectors (OECD, 2020[89]).

The development of an effective knowledge infrastructure can also foster the spatial proximity of firms, thereby generating agglomeration externalities that reduce production costs through economies of scale and network effects. Cluster building policies may encourage companies to group together for the development of joint projects, foster industry-science linkages, and enhance cross-sectoral interactions. When foreign direct investors are located in such clusters, they are likely to be more willing to collaborate with other local firms and organisations (Potter, 2001[90]). From a policy perspective, this means that FDI promotion policies, SME policies and cluster development policies could go hand in hand to increase the potential of FDI for domestic productivity growth.

Industrial, science and technology parks can also act 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.

**Facilitating knowledge and technology spillovers from FDI by eliminating information barriers and administrative hurdles**

Providing comprehensive investment facilitation and aftercare services to foster greater embedding of foreign firms in local economies

Investment facilitation and aftercare services can be instrumental in encouraging greater embedding of foreign affiliates in local economies and building relationships that contribute to greater use of local SME suppliers. They often involve accompanying the investor in its project definition and during its establishment phase, ensuring that they identify local suppliers and clients, providing additional assistance once the project is implemented and encouraging expansions and reinvestments through aftercare. The main aim of these services is to maximise the socio-economic benefits from investment, including its impact on domestic productive capacities.

Practically, IPAs have several options to bring down information barriers and help foreign firms identify local suppliers for future collaboration. Matchmaking services and B2B meetings allow representatives of foreign and domestic firms to meet and discuss potential local sourcing and business partnership opportunities. Many IPAs also use local supplier databases to help foreign firms find information on domestically manufactured goods and domestically supplied services. Online 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. Measures to improve the quality of facilitation and aftercare services should, therefore, be at the centre of policy efforts to foster knowledge spillovers from FDI. IPAs should have sufficient resources and dedicated staff that is trained to identify the sourcing needs of foreign investors and steer FDI projects towards locations with the greatest potential for supporting supplier linkages. The development of clear objectives, a strategy and an action programme for embedding foreign investors in the local economy can help create policy momentum and mobilise public resources and relevant government actors.

Investment facilitation and aftercare services should be also aligned with the scope and content of supplier development programmes (see previous section) and combined with other types of support such as capacity building for local firms, training programmes for local staff, and cluster building initiatives. Evidence from OECD and developing economies shows that MNE-SME linkage programmes and other matchmaking services are often combined with policy initiatives aimed at promoting supply chain development and strengthening SME absorptive capacities. This mix of policy instruments allows aligning domestic supplier capabilities with the needs of foreign investors. It is therefore critical that governments increase the focus of FDI policy on its potential for supply chain development by strengthening the IPA’s policy footprint on issues that shape the capacities of domestic firms. This can be done either directly by integrating SME development into the mandate and mission of IPAs – as is the case with many European IPAs such as Enterprise Estonia, Business Finland, SPIRIT Slovenia – or indirectly by strengthening coordination and promoting joint programming between IPAs and government agencies responsible for SME and innovation policy.

MNE-SME linkage programmes and matchmaking services should be also integrated into wider regional development initiatives. Linkages between foreign and domestic firms are often location-specific and therefore depend on the availability of facilitation services at the local level. Recent findings from EU countries show that FDI responds better to the activity of IPAs operating in closer proximity to investors’ operations (Crescenzi, Di Cataldo and Giua, 2019[91]). Similarly, the availability of appropriate business
development services is a local issue because SMEs and entrepreneurs generally access the services within a narrow local area. There are, however, wide cross-country disparities in the way national agencies operate at the subnational level. In some countries where inter-institutional coordination is limited, local presence in the form of secondary offices may be crucial to ensure the effectiveness of aftercare. In some countries, such as France and Canada, investment facilitation and aftercare services are provided by local autonomous agencies such as local regional development agencies, who possess knowledge of the local context. In these cases, coordination and collaboration with subnational governments is necessary to ensure an end-to-end service to foreign investors.

The organisation of networking and knowledge exchange events is a common practice among government agencies responsible for investment promotion, SME and innovation policies. Such events strengthen FDI spillovers arising from the imitation of MNE activities by local firms. The demonstration effect resulting from the improved visibility of foreign firm practices and technologies and the informal sharing of views and ideas during conferences, seminars and site visits involves significant learning opportunities for local SMEs. For instance, Enterprise Ireland, the Irish SME agency, organises Best Practice Study Visits that allow Irish firms to visit the manufacturing plants of foreign firms and get first-hand experience on their business practices and processes. Similarly in Portugal, the national SME agency, IAPMEI, implements the Open Days i4.0 initiative, which aims to present the technological capabilities of innovative companies during stakeholder events and promote the sharing of experiences between market actors operating in the same value chain (OECD, forthcoming[22]). These public events include, in addition to moments of networking and information sharing, visits to the most advanced industrial plants in Portugal, presentations of innovative technologies, exhibitions of technological products and hands-on discussions between business representatives and other market stakeholders.

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OECD (forthcoming), “Enabling FDI diffusion channels to boost SME productivity and innovation in EU countries and regions: Towards a Policy Toolkit”, OECD DAF-CFE concept paper.

OECD (forthcoming), “Harnessing channels of FDI diffusion for SME productivity and innovation in Portugal”.


## Annex 2.A. Core questions to assess the impact of FDI on productivity and innovation

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Structure and characteristics of the economy</strong></td>
<td>Which sectors and value chains are driving growth, productivity and innovation? Is economic activity concentrated in high-technology and/or knowledge-intensive sectors?</td>
</tr>
<tr>
<td></td>
<td>What is the structure of the domestic SME population (e.g. size, economic weight, share in total value added and total employment, sectors)?</td>
</tr>
<tr>
<td></td>
<td>What is the level of GVC integration (both through backward and forward linkages)? Which sectors are better integrated into GVCs? To what extent are SMEs integrated into GVCs?</td>
</tr>
<tr>
<td></td>
<td>How vulnerable is the economy, including SMEs and FDI, to economic shocks?</td>
</tr>
<tr>
<td><strong>FDI characteristics</strong></td>
<td>What is the sectoral composition of FDI? Is FDI concentrated in sectors with higher average productivity levels or technological and R&amp;D intensity?</td>
</tr>
<tr>
<td></td>
<td>What types (greenfield vs. M&amp;A) and motives of FDI are more conducive to positive outcomes on the productivity and innovation of the domestic economy, in particular of SMEs?</td>
</tr>
<tr>
<td></td>
<td>What is the role of FDI in terms of value added and employment? To what extent does FDI drive integration in GVCs?</td>
</tr>
<tr>
<td></td>
<td>What is the ownership structure of foreign MNEs?</td>
</tr>
<tr>
<td></td>
<td>What is the country of origin of FDI?</td>
</tr>
<tr>
<td><strong>Domestic absorptive capacities</strong></td>
<td>Is there a productivity (performance) gap between foreign and domestic firms? In what sectors are these gaps larger?</td>
</tr>
<tr>
<td></td>
<td>How do domestic firms, in particular SMEs, perform in terms of exports, labour productivity and growth?</td>
</tr>
<tr>
<td></td>
<td>How do domestic firms, in particular SMEs, perform in terms of access to skills?</td>
</tr>
<tr>
<td></td>
<td>How do domestic firms, in particular SMEs, perform in terms of access to innovation assets?</td>
</tr>
<tr>
<td></td>
<td>How do domestic firms, in particular SMEs, perform in terms of access to finance?</td>
</tr>
<tr>
<td></td>
<td>How dynamic is the start-up and entrepreneurial ecosystem?</td>
</tr>
<tr>
<td><strong>Economic geography factors</strong></td>
<td>Are there any regional disparities in economic growth, productivity and innovation? What is the industrial structure and specialisation of regions?</td>
</tr>
<tr>
<td></td>
<td>What is the geographic distribution of FDI within the country?</td>
</tr>
<tr>
<td></td>
<td>In what regions are productivity (performance) gaps between foreign and domestic firms more pronounced?</td>
</tr>
<tr>
<td></td>
<td>To what extent does SME performance (in terms of innovation, use of digital assets, access to finance, skill-intensity, etc.) varies across regions?</td>
</tr>
<tr>
<td><strong>FDI transmission channels</strong></td>
<td>Do foreign affiliates source intermediate goods and services from domestic firms, in particular SMEs?</td>
</tr>
<tr>
<td></td>
<td>Do foreign affiliates sell their outputs to domestic firms, in particular SMEs, as an input to their production?</td>
</tr>
<tr>
<td></td>
<td>How common are strategic partnerships between foreign affiliates and local SMEs (e.g. joint ventures, licensing, R&amp;D collaborations, networks)?</td>
</tr>
<tr>
<td></td>
<td>How common and likely is the mobility of workers from foreign affiliates to domestic firms? What is the wage premium of foreign affiliates?</td>
</tr>
<tr>
<td></td>
<td>Is there any evidence of tacit learning/imitation by domestic firms of foreign affiliates operating in the same sector? Does the high level of market competition hamper innovation in SMEs?</td>
</tr>
</tbody>
</table>
Annex 2.B. Core questions to assess policies influencing the impact of FDI on productivity and innovation

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Instrument</th>
<th>Policy questions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Governance</strong></td>
<td>National strategies and action plans</td>
<td>What are the country’s strategic priorities in terms of productivity growth and innovation? Are these priorities aligned with broader development objectives? What is the country’s FDI attraction strategy? Are productivity growth and innovation promotion objectives incorporated in the strategy?</td>
</tr>
<tr>
<td>Policy coordination and coherence</td>
<td>What is the quality of the broader institutional framework that affects productivity and innovation impacts of FDI? Do relevant institutions have enough decisional power and financial resources? Do different institutions (Ministries, investment promotion agencies, SME agencies, innovation agencies) coordinate their policies, activities and strategic priorities to ensure that FDI creates linkages with the domestic economy? Are these coordination mechanisms formal?</td>
<td></td>
</tr>
<tr>
<td>Evaluation of investment impacts and related policies</td>
<td>Do relevant institutions monitor and evaluate the impact of FDI, and relevant policies and programmes, on domestic productivity and innovation, in particular of SMEs? Do relevant institutions consult with foreign firms, local SMEs and other actors of the research and innovation ecosystem to receive feedback on the relevance and effectiveness of their policies and programmes?</td>
<td></td>
</tr>
<tr>
<td><strong>Domestic regulation</strong></td>
<td>FDI and trade openness</td>
<td>Are sectors that drive productivity growth and innovation open to FDI and trade? Are there any regulatory restrictions in downstream sectors? Does the government impose any restrictions or performance requirements (e.g. local content requirements) for foreign investors to gain market access in specific sectors?</td>
</tr>
<tr>
<td>Competition policy</td>
<td>Do competition rules ensure a level playing field for foreign and domestic firms, in particular SMEs?</td>
<td></td>
</tr>
<tr>
<td>Intellectual property rights</td>
<td>Are intellectual property rights (IPR) protected by adequate laws and regulations? Is IPR legislation well implemented?</td>
<td></td>
</tr>
<tr>
<td>Regulatory impact assessments and incentives</td>
<td>Do government institutions conduct regulatory impact assessments (RIA) to ensure that regulation does not stifle productivity growth, innovation and SME competitiveness? Are there regulatory incentives (e.g. eased licensing procedures, SEZs) granted to foreign firms that invest in productive and knowledge-intensive activities? If yes, are there accompanying measures and standards in place to avoid a regulatory “race to the bottom” and mitigate potential socio-economic risks?</td>
<td></td>
</tr>
<tr>
<td>Labour market laws and regulations</td>
<td>Do labour market laws and regulations facilitate the mobility of workers from foreign to domestic firms? Are these regulations aligned with other drivers of labour mobility such as the availability (or lack) of skills in the labour market and the absorptive capacities of domestic firms? Are there any regulatory incentives (e.g. tax relief on training expenses, statutory training leave, entrepreneur visas) to encourage skills development and facilitate the entry of highly skilled workers in the domestic labour market?</td>
<td></td>
</tr>
<tr>
<td>Financial market laws and regulations</td>
<td>Do financial market laws and regulations facilitate access to finance for foreign and domestic firms?</td>
<td></td>
</tr>
<tr>
<td>International agreements &amp; standards</td>
<td>Is the country party of regional trade agreements (RTAs) or bilateral investment treaties (BITs), which incorporate provisions on fostering technology transfers and local sourcing? Is this done through mandatory requirements or voluntary principles? Is the country party to regional trade agreements (RTAs) and bilateral investment treaties (BITs), which incorporate provisions on fostering international cooperation on SMEs and facilitating their internationalisation?</td>
<td></td>
</tr>
<tr>
<td>Investment incentives</td>
<td>Are there investment incentives targeting productive and knowledge-intensive sectors and activities? Are the criteria for the granting of incentives clearly defined, transparent, and rules-based?</td>
<td></td>
</tr>
<tr>
<td>Financial &amp; technical support</td>
<td>Financial support</td>
<td>What type of incentives is provided (e.g. grants, profit-based tax incentives, cost-based tax exemptions) and what eligibility criteria or performance requirements apply (e.g. R&amp;D, supplier linkages, skills development, size)?</td>
</tr>
<tr>
<td>---</td>
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</tr>
</tbody>
</table>
|  | Technical support | Do government institutions provide financial support (e.g. training vouchers, R&D grants, etc.) to strengthen the competitiveness, productivity and innovation of domestic firms, in particular SMEs?  
Do financial support schemes target collaborative business-to-business projects, including with foreign firms? |
|  | Network and knowledge infrastructure | Do government institutions implement supplier development programmes? What is the technical assistance suppliers receive and in which sectors and value chains? What is the scale of these programmes (e.g. number of firms supported)? Are they organised in collaboration with foreign MNEs?  
Are there skill development programmes and/or certification and qualification programmes to facilitate domestic firms’ access to qualified human capital? Do these programmes address potential skill shortages in FDI-intensive sectors?  
Does the country have a well-developed and effective network of knowledge infrastructure such as technology transfer offices, intermediary technology institutes and collaborative laboratories? Do they have sufficient financial and human resources to support FDI-SME collaborations?  
Are there any industrial, technology and science parks in the country? Are they accessible to both foreign and domestic firms? What services do they offer? |
| Information & facilitation services | Investment facilitation and aftercare | Does the investment promotion agency (IPA) provide comprehensive investment facilitation and aftercare services? Does the IPA have sufficient resources and dedicated staff that is trained to identify the sourcing needs of foreign investors and promote linkages with local suppliers?  
Are investment facilitation and aftercare services aligned with the scope and content of supplier development programmes? |
|  | Services to eliminate information barriers | Does the IPA or other government agency provide matchmaking services between foreign and domestic firms?  
Is there a local suppliers database? If so, is it regularly updated? Is it easy to access for interested firms?  
Do government agencies organise networking and knowledge exchange events involving foreign and domestic firms? |
This chapter provides a Policy Toolkit to help governments boost the impacts of foreign direct investment (FDI) 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. It builds on the OECD Policy Framework for Investment and is aligned with other OECD instruments and strategies such as the Guidelines for Multinational Enterprises and the 2018 Jobs Strategy.
Main policy principles

1. Provide strategic directions and promote policy coherence and coordination on investment, employment and skills development

- Ensure that national development or economic plans provide coherent and strategic directions on investment, employment and skills development objectives and that investment considerations are integrated in employment and skills strategies and vice versa.
- Develop a dedicated strategy that articulates the government's vision on the contribution of investment to job quality and skills development. The strategy sets the goals, identifies priority policy actions and clarifies responsibilities of institutions and co-ordinating bodies.
- Strengthen coordination both at strategic and implementing levels by establishing, if inexistent, appropriate coordinating bodies or by considering to expand the mandate and composition of existing ones, such as boards of investment promotion agencies and national skills councils.
- Promote public-private and social dialogue to receive feedback and build consensus around reforms and programmes at the intersection of investment, employment and skills development.
- Involve investment bodies in labour market information and skill needs and anticipation exercises to reduce information gaps and inform the design, implementation, monitoring and evaluation of employment and skills policies that are better focused and targeted.

2. Ensure that regulations support investment and labour market adjustments while promoting high-quality jobs and protecting the most vulnerable

- Promote labour provisions in international investment and trade agreements that raise labour standards, including by referring to ILO’s international conventions and the OECD Guidelines for Multinational Enterprises (MNEs), allow for sufficient domestic policy space and establish institutional mechanisms to promote cooperation and monitoring of labour commitments.
- Ensure adaptability of product and labour markets to foreign investors’ entry and operations, and that the costs and benefits are fairly shared between workers and firms, by fostering competition and labour mobility while providing a level of employment stability that encourages learning in the workplace.
- Periodically assess existing regulatory restrictions on FDI against evolving public policy objectives on job creation and skills development and, where relevant, consider streamlining or removing them. Involve relevant bodies and social partners in such assessments.
- Set and enforce labour standards that support sustainable development to ensure that those practiced by foreign firms are not less favourable than those by domestic firms and are applied with the same level of diligence in all regions, including special economic zones.
- Ensure the right to collective bargaining and workers’ voice arrangements, including within foreign MNEs and in special economic zones, and that these are adapted to a changing world of work and can promote collective solutions to emerging issues and conflicts.

3. Stimulate labour demand and develop skills through higher investment and targeted active labour market policies and programmes

- Financial support, particularly corporate tax relief, that aims at attracting FDI in job-creating or skill-intensive sectors or in regions with low employment rates should be time-limited and subject to regular reviews. If used, favour support that is tied to the performance of firms in terms of jobs created or trained workers, including workers of suppliers, and ensure that it addresses specific market failures and is developed through concerted efforts with all relevant bodies.
Develop training programmes in line with development and investment strategies and in partnership with social partners, and that provide transferable, certifiable skills to facilitate labour mobility and help workers and job seekers move to better jobs, including those adversely affected by changing labour markets, the low-carbon transition and evolving needs of MNEs.

4. **Align investment opportunities with labour market potential by addressing information failures and administrative barriers**

- Adopt investment promotion activities based on the existing skill base and labour market potential that lower information barriers for investors. Support investors in identifying suppliers with high labour standards, and thereby also incentivise other companies to raise theirs.
- Ensure that job information and matching services reduce information gaps and lower search costs in labour and product markets and stimulate internal labour mobility, particularly of job seekers or workers in communities near foreign firms’ activities. Develop these services through concerted efforts or jointly between investment bodies and public employment services.
- Raise awareness about labour standards and incentivise companies to disclose their compliance with them, including local suppliers engaging with foreign buyers that conduct due diligence checks to assess risks in their supply chain.
- Ensure transparency and consistency of procedures and requirements for obtaining permits from labour authorities, including permits for foreign workers.

3.1. **Building more inclusive labour markets in a globalised economy**

Achieving more inclusive labour markets are increasingly key priorities for 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 income losses have been uneven across workers (OECD, 2020[1]).

Policies in favour of job quality and skills development can play a significant role in building forward more inclusive labour markets and ensuring a fair and sustainable recovery. They can help improve well-being of individuals as well as support labour force participation, productivity and 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. Employment creation, social protection, rights at work, and social dialogue – the four pillars of ILO’s Decent Work Agenda – are an integral element of the 2030 Agenda for Sustainable Development. Creating good jobs is also at the core of the OECD 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 (Box 3.1). 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 private investment – a key driver of labour market outcomes – influences job creation and skill upgrading. 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, 2019[2]). 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 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[1]).

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

Jobs created in 1’000 (estimates)

<table>
<thead>
<tr>
<th>OECD</th>
<th>Developing and emerging countries</th>
</tr>
</thead>
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<td></td>
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</table>

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, green 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, 2019[2]). 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.

**Figure 3.2. Conceptual framework: FDI impacts on job quality and skills development**

Source: OECD.
Box 3.1. The OECD Jobs Strategy, Skills Strategy and Job Quality Framework

The key policy recommendations of the 2018 OECD Jobs Strategy are organised around three principles:

i. **Promoting an environment in which high-quality jobs can thrive.** Good labour market performance requires a sound macroeconomic framework, a growth-friendly environment and skills evolving in line with market needs. Adaptability in product and labour markets is also needed, and the costs and benefits of this should be fairly shared between workers and firms, as well as among workers on different contracts by avoiding an over-reliance on temporary (often precarious) contracts through balanced employment protection schemes.

ii. **Preventing labour market exclusion and protecting individuals against labour market risks.** Supporting the quick (re)integration of job seekers in employment is a top priority, but the new strategy also highlights the importance of addressing challenges before they arise by promoting equality of opportunities and preventing the accumulation of disadvantages over the life-course.

iii. **Preparing for future opportunities and challenges in a rapidly changing economy and labour market.** People will need to be equipped with the right skills in a context of rapidly changing skills demands. Workers also need to remain protected against labour market risks in a world where new forms of work may arise.

The OECD also developed a framework for measuring and assessing job quality that guided its 2018 Jobs Strategy. The objective was to revise the 2006 Strategy, which had largely focused its recommendations on the quantity of jobs. The OECD Job Quality Framework measures three aspects of job quality: earning quality (including distributional aspects), labour market security and the quality of the working environment.

The key policy recommendations of the 2019 OECD Skills Strategy are organised around three components:

I. **Developing relevant skills over the life course.** To ensure that countries are able to adapt and thrive in a rapidly changing world, all people need access to opportunities to develop and maintain strong proficiency in a broad set of skills. This process is lifelong, starting in childhood and youth and continuing throughout adulthood. It is also “life-wide”, occurring not only formally in schools and higher education, but also non-formally and informally in the home, community and workplaces.

II. **Using skills effectively in work and society.** Developing a strong and broad set of skills is just the first step. To ensure that countries and people gain the full economic and social value from investments in developing skills, people also need opportunities, encouragement and incentives to use their skills fully and effectively at work and in society.

III. **Strengthening the governance of skills systems.** Success in developing and using relevant skills requires strong governance arrangements to promote co-ordination, co-operation and collaboration across the whole of government; engage stakeholders throughout the policy cycle; build integrated information systems; and align and coordinate financing arrangements.

Source: (Cazes, Hijzen and Saint-Martin, 2015[3]; OECD, 2018[4]; OECD, 2019[5])

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; and (3) labour mobility of workers between foreign and domestic firms.

Value chain relationships or labour mobility between foreign and domestic firms can lead to knowledge sharing, and in turn raise productivity, wages and employment. 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 shocks. For instance, FDI does not increase 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, skill base, 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 outcomes, namely employment, wages and non-wage working conditions and skills. Annex 3.A provides detailed questions for governments to self-assess the impacts of FDI on labour market outcomes.

**FDI creates both direct and indirect job opportunities but not necessarily for all**

FDI affects employment growth or contraction through changes in labour demand. Effects differ by investor entry mode (greenfield project versus M&A) and vary by workforce type (skilled vs. unskilled). Greenfield FDI has 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 can boost employment as acquired firms’ productivity and market share grow (Coniglio, Prota and Seric, 2015[6]; Ragoussis, 2020[7]). In contrast, a divestment by a foreign firm can lead to a drop in employment (Borga, Ibarlucea Flores and Sztajerowska, 2020[8]; Javorcik and Poelhekke, 2017[9]). Irrespective of the entry mode, foreign firms often have a higher demand for skilled workers than domestic firms due to technology advantages (Bandick and Karpayt, 2011[10]; Hijzen et al., 2013[11]).

Whether there will be net employment growth will also depend on FDI spillovers on domestic firms operating in the same value chain, industry or geographical area. 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 (Jude and Silaghi, 2016[12]; Lee and Park, 2020[13]). FDI may also raise employment at domestic firms in the same location, but only for higher-skilled workers (Setzler and Tintelnot, 2021[14]; Steenbergen and Tran, 2020[15]). 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[16]).

Foreign and domestic firms’ adjustments on the labour market are broadly, albeit not totally, comparable (OECD, 2019[2]). During the COVID-19 pandemic, the resulting decline in FDI as well as crippled MNEs operations adversely affected job creation, with knock-on effects on incomes. For instance, the decline in greenfield FDI reduced potential job creation by half in the first five months of 2020 (OECD, 2020[17]). Nonetheless, foreign businesses have cut jobs less than domestic firms, although many still had had to lay off workers or reduce working hours. 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.

**FDI raises wages but can also exacerbate disparities if absorptive capacities are poor**

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 characteristics (Hijzen et al., 2013[11]). Indeed, it is membership in a multinational production network – instead of foreignness – that generates the foreign-firm premium (Setzler and Tintelnot, 2021[14]). Characteristics 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[17]). In developing countries, the foreign wage premium is smaller when institutional quality is higher (Blanas, Seric and Viegelahn, 2019[18]).

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)

Foreign companies do not necessarily lift wages in all sectors and for all workers. The largest wage gains often 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, at least in the short-run (Hijzen et al., 2013[11]). Foreign firms in low-paid activities do not always pay higher salaries than their domestic peers, however (OECD, 2019[2]). 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[19]).

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, Tao and Zhu, 2017[20]). This effect is stronger, and lasts longer, in industries facing skills shortages 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). 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, 2020[21]). In a geographically large country like the United States, foreign firms’ operations substantially increase the wages of higher-earning workers in local domestic firms (Setzler and Tintelnot, 2021[14]). 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, 2019[2]).
If FDI can enhance living standards, it may nonetheless raise 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 work 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. 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, Kim and Wu, 2013).

**FDI in some sectors can improve 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. 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 lead to higher job satisfaction and better health (Bloom and Van Reenen, 2016). FDI effects on 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 standards. Overall, there is little evidence that MNEs transmit their working conditions abroad (Almond and Ferner, 2007).

Evidence on FDI impacts on job security is mixed. The FDI Qualities Indicators suggest that FDI is associated with lower job security. This could be due to the ability of MNEs to rapidly move activities across borders in response to wage movements or changes in regulations (Cuñat and Melitz, 2012). The observed relationship could also reflect foreign firms’ concentration in sectors with more exposure to trade fluctuations, or in areas with more flexible labour rules, such as in some special economic zones. Other findings show that, in the case of Sub-Saharan Africa, foreign firms provide more secure jobs, but not in countries with better governance and social policies (Blanas, Seric and Viegelahn, 2019). The wider empirical literature examining these aspects does not provide a clear-cut response, however (Bernard and Sjoholm, 2005; Bernard and Bradford Jensen, 2007; Hijzen et al., 2013; Javorcik, 2015). 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, Bloom and Canning, 2006) or find a negative effect of FDI on population health (Herzer and Nunnenkamp, 2012). 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 managed better than domestic business to adapt their modus operandi to the new work reality by ramping-up teleworking, potentially reducing workers’ exposure to COVID-19 (OECD, 2020). Fewer workers can telework in poorer economies, however — more skilled workers have higher odds to work remotely. MNEs could accelerate the adoption of new forms of work in host countries through competition and imitation effects, labour mobility, and 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, but not in all sectors (Kucera, 2002; OECD, 2008; Blanton and Blanton, 2012). MNEs may shy away from investing in countries with low labour standards because of reputational risks and to fulfill 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 help
improve working conditions, including in their relationships with local suppliers and buyers. Furthermore, while the positive relationship between FDI and core labour standards holds at the aggregate level, there are significant variation among sectors – mining, oil and gas and services may be important exceptions (Blanton and Blanton, 2012[35]). FDI mode of entry also matters. One study finds that M&As tend to have minimal, or slightly negative, effects on labour rights, whereas joint ventures and greenfield FDI can improve workers’ rights. The sectors and motivations associated with the two modes of entry increase more labour demand, improving the bargaining power of workers (Biglaiser and Lee, 2019[36]).

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, 2019[37]). 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.

**FDI increases the demand for skilled workers but labour adjustments can be costly**

Foreign firms – especially from more advanced economies – often bring new technologies that 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. Many studies have shown that FDI raises the demand for skilled workers. The most 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[38]). Other studies have confirmed since then that FDI has led to an increase in the demand for skilled labour (Bandick and Karpaty, 2011[39]; Peluffo, 2014[40]).

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, 2019[2]). FDI could also affect the demand for specific tasks that parent companies want to offshore (Autor, Levy and Murnane, 2003[41]). 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[42]). They may also induce local firms to invest in upskilling 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, 2002[43]).

Through impact on 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, 2020[21]). 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[44]).
3.3. Policies that influence the impact of FDI on job quality and skills

Policies that are conducive to investment in general influence FDI entering the host country and its labour market implications (OECD, 2015[45]). They are, however, not sufficient to act on the different – direct and indirect – transmission channels of FDI impacts on job quality and skills development. Beyond a conducive investment climate, policymakers must ensure that institutions, strategies and policies that are at the intersection of investment, labour and skills development create the conditions to improve FDI impacts while mitigating potential adverse effects (Table 3.1). These include product and labour market regulations that are adapted to foreign firms’ entry and operations. But flexibility is not sufficient to deliver quality jobs and should be combined with measures that address specific market failures resulting from information failures or externalities resulting from FDI. Such interventions can cushion or amplify the spillover effects of foreign firms on the labour market, including distributional effects. Beyond measures implemented at national level, policymakers need to promote internationally-agreed principles and conventions that can help ensure, inter alia, high labour standards in the operations of foreign firms.

Table 3.1 Policy instruments influencing the impact of FDI on job quality and skills development

<table>
<thead>
<tr>
<th>Principle 1: Provide strategic directions and ensure policy coordination and coherence on investment, labour and skills development</th>
<th>Governance</th>
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<tbody>
<tr>
<td>National strategies and plans</td>
<td>Oversight and coordination bodies</td>
</tr>
<tr>
<td>Public-private and social dialogue</td>
<td>Labour market information and skills needs assessments</td>
</tr>
</tbody>
</table>

| Principle 2: Ensure that regulations and standards support investment and labour market adjustments, create quality jobs and protect the most vulnerable |
| --- | --- |
| Domestic regulations |
| Labour market regulations and standards |
| Collective bargaining rights and workers’ voice |

| Principle 3: Stimulate labour demand and develop workers’ skills through targeted investment and active labour market policies and programmes |
| --- | --- |
| International agreements & standards |
| Labour provisions in investment and trade agreements |
| Adherence to OECD Guidelines on MNEs |
| Global framework agreements |

| Principle 4: Align investment opportunities with labour market needs and skills base by addressing information failures and administrative barriers |
| --- | --- |
| Financial support |
| Corporate tax relief in targeted sectors or regions |
| Corporate tax relief against job or training commitment |
| Employment, wage or training subsidies |

| Technical Support |
| --- | --- |
| General or sectoral certified (re)training programmes |
| Pre-employment training programmes |

| Information & facilitation services |
| --- | --- |
| Job search and matchmaking services |
| Investment promotion and facilitation |
| Awareness raising and corporate disclosure of labour standards |
| Social support services (e.g. transport) |

Source: OECD elaboration.

The majority of policies 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. Policies considered in this Policy Toolkit build and expand on Chapter 8 “Developing human resources for investment” of the OECD Policy Framework for Investment (Box 3.2).Annex 3.B provides detailed questions for governments to self-assess policies influencing the impacts of FDI on job quality and skills development.

**Box 3.2. OECD Policy Framework for Investment: core questions and principles for developing human resources for investment**

1. Has the government established a coherent and comprehensive human resource development policy framework consistent with its broader development and investment strategy and its implementation capacity?
2. Is there an effective system for tackling discrimination that affects labour market outcomes?
3. What steps has the government taken to increase participation in basic schooling and to improve the quality of instruction so as to leverage human resource assets to attract and to seize investment opportunities?
4. Is the economic incentive sufficient to encourage individuals to invest in higher education and life-long learning, supporting improvements in the investment environment through a more qualified skill base?
5. To what extent does the government promote effective training programmes, including through involving the private sector?
6. Does the government have an affordable, effective and efficient overall health system?
7. What mechanisms are being put in place to promote and enforce core labour standards?
8. To what extent do labour market regulations support job creation and the government’s investment attraction strategy?
9. How does the government assist large-scale labour adjustments? What role is business encouraged to play in easing the transition costs associated with labour adjustment?
10. What steps are being taken to ensure that labour market regulations support an adaptable workforce and maintain the ability of firms to modify their operations and investment planning?
11. To what extent does the government allow companies to recruit workers from abroad when they are unable to obtain the skills needed from the domestic labour market?

Source: (OECD, 2015[45])

*Provide strategic direction and ensure policy coordination and coherence on investment, labour and skills development*

FDI that contributes to inclusive labour market outcomes can hardly be achieved through fragmented and isolated policy design, delivery and evaluation. Governments, together with the private sector and social partners, should articulate a clear vision on the contribution of FDI to job quality and skills by ensuring that national strategies provide coherent and interrelated directions on investment, employment and skills development objectives. It is equally important to strengthen co-ordination mechanisms – or establish them if inexisten – that can effectively support social dialogue and collective solutions to emerging labour market issues driven by FDI. Inter-agency collaboration can also improve data collection efforts to better monitor
the impact of FDI and help inform the policy design and evaluation. In particular, involving investment bodies in skill needs assessments can help better anticipate future needs and adapt policies accordingly.

*National strategies and plans can provide coherent and strategic directions by integrating investment considerations in employment and skills strategies and vice versa*

Governments usually have no dedicated strategy relating FDI to job quality and skills, but most, if not all, set priorities and goals on investment, employment and skills development in various strategies and plans. Multi-year national development or growth plans provide overarching directions in a wide range of policy areas and, if well-articulated, a coherent vision to ensure that initiatives and reforms in one area (e.g. investment) support – or do not jeopardise – strategic goals in other areas (e.g. employment). Cross-cutting strategies can also steer policy action towards developing priority activities or value chains that are aligned with the country’s aspirations and labour market realities. These national priorities, goals and policies ultimately affect the FDI transmission channels – the ways in which foreign firms have a direct and indirect impact on labour market outcomes – even when they are not strictly related to investment.

Coherent national development or growth plans also ensure alignment of objectives across specific strategies on investment, employment and skills development. In practice, this entails integrating investment considerations in, *inter alia*, employment and skills strategies and vice versa. This is the case of Rwanda, for instance, where the 2019 National Employment Strategy includes specific goals on investment, such as to support investment with strong linkages in labour-intensive sectors (Table 3.2). The strategy clarifies responsibilities across a wide range of institutions, going well beyond the Ministry of Labour, and provides an estimated budget for each goal. Similarly, the 2011-2020 Jordan National Employment Strategy identifies FDI as a key driver of growth and delivers a diagnosis on its impact, indicating that FDI created mostly short-term job opportunities, often in the construction sector, with few long-term effects (OECD, forthcoming). The strategy provides policy directions on investment, such as to align tax incentives to investors with the country’s ambition of becoming a knowledge-based economy.

<table>
<thead>
<tr>
<th>Table 3.2. Rwanda’s 2019 National Employment Strategy includes specific actions on investment</th>
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<tr>
<td>Strategic goal: extend, prioritise and incentivise investment with strong linkages in employment-intensive sectors</td>
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<table>
<thead>
<tr>
<th>Major Policy Actions</th>
<th>Lead implementing institution</th>
<th>Other implementing institutions</th>
</tr>
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<tbody>
<tr>
<td>Place emphasis on choosing employment-intensive technologies</td>
<td>Ministry of Trade and Industry</td>
<td>Private Sector Federation; Rwanda Development Board</td>
</tr>
<tr>
<td>Consider the impact of investment on the number and quality of jobs created</td>
<td>Rwanda Development Board</td>
<td>Ministry of Trade and Industry; Private Sector Federation</td>
</tr>
<tr>
<td>Carry out comprehensive employment impact assessment of infrastructure investment</td>
<td>Ministry of Infrastructure</td>
<td>Rwanda Development Board; Private Sector Federation</td>
</tr>
<tr>
<td>Link incentive structures for FDI to the number and quality of jobs created and skills upgrading of local labour force</td>
<td>Ministry of Trade and Industry</td>
<td>Rwanda Development Board; Private Sector Federation</td>
</tr>
<tr>
<td>Target policy incentives to employment-intensive sectors and the participation of the poor in high-growth sectors</td>
<td>Ministry of Trade and Industry</td>
<td>Rwanda Development Board; Private Sector Federation</td>
</tr>
</tbody>
</table>

Source: OECD (2021), FDI Qualities Mapping (Database); Rwanda’s Revised 2019 National Employment Policy.

It is equally relevant to incorporate the labour market and skills dimensions into the country’s investment strategy, and in a way that is adapted to the format of such documents. Some countries have comprehensive strategies that outline the government’s objectives and reform plans to foster investment and the roles and responsibilities of all relevant government bodies. Such strategies could provide clear policy directions on labour market reforms adapted to investors’ entry and operations or on promoting high labour standards through international investment and trade agreements. Most investment strategies are narrower in scope and set the government’s FDI attraction targets (e.g. sectors), tools (e.g. fairs, tax
inscentives, aftercare services) and performance indicators (e.g. average wages in foreign firms). They are increasingly taking into consideration quality jobs and skills as outcomes of FDI (OECD, 2020[47]). For instance, the development of Ireland’s 2021-24 investment promotion strategy was informed by Future Jobs Ireland, which itself seeks to address challenges and opportunities for FDI arising from changing skills demand. FDI that support upskilling is a new focus of the strategy and is addressed through various initiatives to promote investments in training.

**Co-ordination bodies with clear mandates and inclusive public-private and social dialogue support policy delivery at the intersection of investment, employment and skills**

The formulation and implementation of strategic objectives at the intersection of investment, employment and skills development are complex, and do not fit neatly within a single governmental department or agency. They require the involvement of several ministries, implementing agencies, social partners, and the private sector, including the foreign firms themselves. Given the multitude of actors with different interests, achieving a consensus between a broad range of stakeholders within and outside government is difficult. It is therefore important that responsibilities are balanced, explicit, sufficiently funded, and mutually understood by all actors. It is also crucial to establish, both at strategic and implementing levels, appropriate coordinating bodies with clear mandates or to adapt the governance structure of existing bodies, such as boards of investment promotion agencies or skills councils, to be more inclusive and support collaborative decision-making, while managing the risk of undue influence from special interests.

In most countries, mandates over investment are separated from employment and skills, which are themselves scattered across various ministries and agencies – yet they are reasonably more integrated than with investment. Mandates are often enshrined in law or spelled-out in national strategies that often also define governance relationships with other bodies. Labour market ministries and agencies often set the country’s labour policy, regulate industrial relations and provide public employment services to individuals. The governance of skills systems entails more collaboration across government departments, including investment bodies. Education ministries and agencies are often in charge of policies related to skills development, whereas labour market ministries and agencies devise policies that maximise the effective use of skills by promoting further training opportunities and labour market activation measures. Ministries of finance are responsible for ensuring that the resources exist and for aligning financial incentives to maximise the effectiveness of employment and skills policies (OECD, 2020[48]).

Bodies mandated with investment policy often include departments in the ministry of economy or industry and investment promotion agencies (IPAs). They can play a key role by developing and promoting policies for regional, sectoral or broad economic development, in which employment and skills occupy a central place. Thus, while investment bodies may not be directly involved in employment or skills policies, they still actively shape impacts of FDI by promoting and facilitating investment in specific job-creating or skill-intensive sectors, granting tax incentives to firms investing in regions with low employment rates or influencing wider reforms through policy advocacy actions. Investment bodies can also be responsible of raising investors’ awareness of labour and other sustainability standards. It is important to align allocated budgets with such responsibilities to ensure effective implementation (OECD, 2021[49]).

The extent to which investment, employment and skills mandates can be integrated – or overlapping if not well-defined – depends on national context and is most likely greater in countries that receive significant FDI. In Rwanda’s 2019 National Employment Strategy, the Ministry of Trade and Industry and the Rwanda Development Board, the country’s IPA, are assigned specific actions to improve the FDI contribution to job quality and skills (Table 3.2). In fact, one mandate of Rwanda’s IPA is to align skills development with labour market demands, including by coordinating and funding training opportunities (Box 3.3). Likewise, the Costa Rican or Thai IPAs have widened their mandates to also support skills development (OECD, 2020[48]).

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5 See OECD’s self-assessment tool to help governments strengthen governance of skills systems (OECD, 2020[48]).
These cases are likely to be the exception rather than the norm, however, and they are not necessarily governance models for other countries with different contexts and priorities. But they illustrate how mandates can be partly integrated to leverage FDI for more inclusive labour markets, as long as responsibilities are clear, mutually understood by all and grounded in sound and coherent strategies.

**Box 3.3. Promoting FDI, employment and skills under one umbrella agency: the case of Rwanda**

Rwanda Development Board (RDB) is a government institution whose mandate is to accelerate Rwanda's economic development by enabling private sector growth. It is principally responsible for promoting domestic and foreign investments, but other key services include skills development and improving workers' employability.

The 2019 *National Employment Strategy* indicates that while promoting exports to regional and international markets of goods and services, the opportunities for labour mobility should also be given much consideration by RDB. In its mandate to provide guidelines, analyse project proposals and follow up on the implementation of Government decisions in line with public and private investment, RDB should mainstream employment opportunities in project proposals.

RDB vision is skilling Rwanda for economic transformation. The Chief Skills Office was established under the RDB in 2018 to align skills development with labour market demands. The Chief Skills Office, together with key stakeholders in the skills development and employment promotion ecosystem, developed the National Skills Development and Employment Promotion Strategy (NSDEPS).

The Chief Skills Office is composed of two departments: the strategic development capacity department and the targeted labour market interventions department. It is mandated to provide effective oversight and coordination in the skills development and employment promotion ecosystem. Goals include promoting and coordinating sector skills, capacity development strategies and actions to respond to private sector needs; conducting labour market analysis to identify current and future skills needs in priority sectors and for key investment projects; and facilitating labour market integration through innovative partnerships and interventions.

Source: OECD based on [https://rdb.rw/](https://rdb.rw/).

Effective horizontal coordination also can help achieve a better alignment across investment, employment and skills policies. In general, governments have no committees (or similar structures) exclusively dedicated to coordination between ministries, agencies and social partners dealing with labour and skills development and those responsible for investment. If they are to be created, such inter-governmental committees need clear and strong internal governance structures, and decision-making processes should be agreed on to maximise the commitment and involvement of all stakeholders, including technical agencies, the private sector and social partners. Establishing such dedicated committees may not be necessary, however, and could be even counter-productive, if other, narrower, coordinating mechanisms that already exist could be realistically adapted to help ensure some alignment across investment, employment and skills policies.

On the investment side, existing coordinating committees such as boards of IPAs could consider involving the labour and skills communities to help them voice their concerns with regards to FDI, better coordinate on specific measures and build consensus around future reforms that are of relevance to them (e.g. to introduce tax incentives for firms that provide training). In Jordan, for instance, the Minister of Labour sits in the Investment Council, a high-level coordinating body headed by the Prime Minister that sets the country’s investment strategy and oversees the work of the IPA (OECD, forthcoming[46]). In general, the presence of representatives from the labour or skills communities is not widespread across IPAs’ boards.
(or similar structures). The status of such boards and the breadth of their coordinating role can strongly vary across agencies (OECD, 2018[51]). In many countries, boards of IPAs have solely an advisory role that is confined to investment promotion and facilitation activities.

It is equally relevant to envisage including representatives of investment bodies in committees coordinating employment or skills policies. They can, for instance, provide feedback on labour market reforms under discussion or voice the concerns of foreign investors in terms of training needs. In Ireland, the National Skills Council provides advice on skills needs and secures delivery of the identified needs, as well as bringing together a wide range of actors, including the CEO of IDA Ireland, the Irish IPA. The CEO is charged with providing regular updates on sectoral opportunities and potential target areas for increased FDI and advise on issues associated with the availability of skills to support employment. Respectively, the 2021-2024 investment promotion strategy indicates that the IPA will collaborate with the Department of Education and Skills, the National Skills Council, or the Expert Group on Future Skills Needs.

**FDI can be a forward-looking indicator of what jobs and skills will be in demand in the future and could therefore be integrated into skills anticipation systems**

FDI is a key driver of GVCs and technological changes (e.g. automation and digitalisation) that influence the kind of jobs that are available, the skills needed to perform them and related working conditions (e.g. new working arrangements on teleworking). The costs and benefits of these megatrends are complex and increase the uncertainty surrounding the future of work. In this context, it is of paramount importance to build responsive skill assessment and anticipation systems that enable countries to react to changing labour market and skills demands (OECD, 2019[56]). FDI decisions can constitute a forward-looking indicator of what jobs and skills will be in demand in the near future, rather than trade flows that reflect past investment decisions (Hallward-Driemeier and Nayyar, 2019[52]). Collecting information on foreign firms’ operations and skills needs will help governments developing adequate policies, such as training programmes, that can prevent skills mismatches and shortages as well as reduce retraining costs. For instance, ILO’s “Skills for Trade and Economic Diversification” guide recommends disaggregating data between foreign and domestic businesses when FDI accounts for a significant part of a sector.

Many countries have put in place labour market information 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 policymaking (OECD, 2016[53]). Ministries of Labour and Education, the statistical offices and employer organisations are the actors most frequently involved in skills assessment and foresight exercises. Involving the investment community, including the IPA and the foreign firms, in such foresight exercises could help reduce the gap between the information produced and the skills needs driven by FDI. IPAs have often access to unique information on MNEs’ operations and run surveys to identify their challenges and skills needs (OECD, 2018[54]). Furthermore, IPAs are increasingly tracking FDI impact by setting key performance indicators (KPIs), including on employment, wages and skills (OECD, 2021[55]). Such data could be shared or even automatically connected to skills assessment and anticipation systems to ensure that policy responses are timely, coherent and well-targeted.

**Ensure that regulations support investment and labour market adjustments that create good job opportunities for all and are adapted to a changing world of work**

Product and labour market regulations affect FDI location choice, characteristics and, in turn, labour market impacts. They also affect how labour markets adjust in response to FDI entry and spillovers – impact is likely to be greater in settings with more efficient resource reallocation. Solid collective bargaining institutions and high labour standards are however fundamental to ensure that FDI creates opportunities for all. Regulations also include internationally-agreed principles that can be instigated by governments, such as by joining international conventions or including labour provisions in investment agreements. They can also consist of non-binding recommendations addressed directly to business, such as the OECD
Guidelines for MNEs, or agreements between MNEs and global union federations to ensure common labour standards across an MNE global operation.

*Openness to foreign investment and wider pro-competition policies can help ensure that expected labour market gains from FDI materialise and are fairly shared.*

Governments should periodically assess existing regulatory restrictions on FDI against evolving public policy objectives on job quality and skills development and, where relevant, consider streamlining or removing them. Discriminatory measures on foreign investors’ entry and operations deter 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[56]). In Jordan, for instance, restrictions on full foreign ownership exist in business services, transport and tourism, while greenfield FDI has a strong job creation potential in these sectors, including for the many unemployed young graduates (Figure 3.4).

**Figure 3.4. FDI regulatory restrictions and job-creating potential of greenfield FDI in Jordan**

FDI restrictions: a value higher than zero indicates that restrictions in Jordan are higher than the OECD average

![Graph showing FDI regulatory restrictions and job-creating potential of greenfield FDI in Jordan](source: OECD FDI Regulatory Restrictiveness Index and Financial Times fDi Markets).

Governments often introduce FDI restrictions with the stated objective of protecting 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[57]). 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-paid jobs (Chapter 2). It is therefore essential to involve labour market bodies and social partners when assessing the costs and benefits of FDI restrictions as it can help promote collective solutions and build consensus around meaningful liberalisation reforms.

Whether openness leads to positive impacts of FDI on labour market outcomes also depends on the time horizon. For instance, liberalisation can crowd out domestic competitors and increase wage inequality in the short-term, particularly in non-tradable services where foreign firms are more likely to capture market
shares such as in the construction sector. Indeed, FDI in services is often associated with the largest increases in wage inequality because lower-skilled workers can be displaced in favour of higher-skilled workers. In the longer-term, services liberalisation improves productivity in other sectors and can generate significant labour market gains, although not necessarily for all segments of the labour force. Governments could prioritise the tradable services sectors with solid comparative advantages to limit the transitory labour market losses from liberalising other services FDI (Steenbergen and Tran, 2020). Together with FDI restrictions, other regulations affect the degree of product market competition, including state control of business enterprises and barriers to trade, innovation and entrepreneurship. 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). For instance, research on the role of product market regulations for the employment dynamics of entering and incumbent firms suggests that, in sectors that are more risky or financially dependent, more stringent product market regulation is negatively associated with the net job contribution of firms (Calvino, Criscuolo and Menon, 2016)

Pro-competitive product market reforms and competition policy enforcement can also help achieve fairer sharing of productivity gains by foreign firms. As restrictions on FDI decrease, countries need to adopt and enforce sound measures to control anti-competitive practices (OECD, 2018). Enhanced competition can help reduce rents of firms active in highly concentrated markets, and to share more fairly these gains with workers. In particular, strengthened competition could contain rents in “superstar” or “winner-take-most” MNEs operating in markets with high mark-ups and low labour shares (e.g. ICT services) because of large product market concentration (Autor et al., 2020; Criscuolo et al., 2020). Such rents could also be contained by levelling the playing field through tax policies, as MNEs are often better able than other companies to reduce their tax burden through tax optimisation measures (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 intuition behind is that, with less flexible labour markets, employment will be further away from its full employment level. This example shows that policymakers should take into consideration product and labour policy interactions when collectively thinking about ways to introduce reforms that can positively affect FDI impacts on labour market outcomes.

**Balanced labour market regulations can support foreign firms’ adjustments while providing a level of employment stability that encourages learning in the workplace**

Stringent employment protection can increase firms’ labour adjustment costs but also improves job quality. Greater flexibility of the host country’s labour market matters for the location choice of investors and affects FDI volumes – and thus job creation – as well as their skill intensity. For instance, stringent legislation can deter FDI in the services sector more than in manufacturing (Javorcik and Spatareanu, 2005). It may also dissuade R&D firms from locating their core innovation projects, as these need drastic employment adjustment because many workers with new skills are needed (Griffith and Macartney, 2014). Impact can differ across contracts and, for instance, stringent legislation on regular contracts may affect FDI-related employment more adversely than rules on temporary work (Gross and Ryan, 2008). At the same time, job security protects workers from being fired in response to small business fluctuations, encourages them to invest in long-term training and is often associated with better (mental) health (OECD, 2018).

Once established, foreign firms do not appear to be more constrained by labour regulations than domestic firms, although they can be in some countries – including those with high FDI stocks (Figure 3.5). Employment protection legislation may matter less for foreign firms that can move production across subsidiaries located in different countries or that are attracted by markets with low production costs (Leibrecht and Scharler, 2009; Cuñat and Melitz, 2012). These firms may be able to bargain from a
privileged position with host governments and unions, thus obtaining exceptions on hiring and firing practices (Navaretti, Checchi and Turrini, 2003[69]). Notwithstanding the additional leeway MNEs 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.

Figure 3.5. Per cent of firms identifying labour regulations as a major constraint, by ownership

Employment protection legislation also affects how the wider 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, at least in the short term (Hijzen et al., 2013[11]). However, it may protect vulnerable workers that otherwise would have been displaced and lose out via long unemployment spells or lower wages in post-displacement jobs. When local absorptive capacities are sufficiently high, i.e. when skills in demand by foreign firms are available, more flexible labour markets can host FDI without necessarily reducing employment or increasing wage disparities between foreign and domestic firms (Becker et al., 2020[44]).

Other regulations include working-time arrangements, minimum wages, occupational health and safety at work, or legislation on foreign workers – foreign firms tend to rely more often on foreign workers than their domestic peers do. Minimum labour standards ensure that those practiced by foreign firms are not less favourable than those by domestic firms. This helps to ensure that FDI is not worsening working conditions in the host country. Labour standards can be established through legislation, collective agreements or both. Core labour standards of 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 (see next sections).

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[34]; OECD, 2008[19]). This holds equally 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, 2008[19]). 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 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 MNEs than in domestic firms, and good management can be a critical component of a good job. Foreign affiliates of more gender-inclusive countries also tend to have higher shares of female workers (see Chapter 4). Furthermore, foreign firms have relied significantly more than domestic firms on teleworking during the COVID-19 pandemic (OECD, 2020[11]). With support from labour unions and employers’ associations, they could play a 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.

The right to collectively bargain and workers’ representations can support better working conditions in MNEs but they must be adapted to a changing world of work

FDI – combined with trade, innovation, climate change and other factors – transforms the world of work and creates uncertainties on related labour market gains and losses. Collective bargaining systems and workers’ voice arrangements help ensure that all workers benefit from these transformations by supporting solutions to emerging issues (e.g. automation, digitalisation, teleworking, protecting biodiversity), complement policies to anticipate skills needs, or support to displaced workers in new forms of work (OECD, 2019[37]). Collective bargaining can also support a fairer sharing of productivity gains by influencing the wage formation process. This is relevant in the context of foreign firms that poorly translate productivity-related rents into wage benefits, particularly for less skilled workers with lower bargaining power (OECD, 2019[37]; Criscuolo et al., 2020[63]). Indeed, sector-level collective bargaining is associated with lower wage inequality while bargaining and workers’ representation at the firm-level can increase wages, productivity and job satisfaction (OECD, 2019[37]; Blanchflower and Bryson, 2020[70]).

Collective bargaining systems are generally based on a complex set of rules and practices, partly written in national laws and partly based on longstanding traditions. They can strongly differ across both developing and developed countries (Lamarche, 2015[71]; OECD, 2019[37]). The two main aspects of collective bargaining are the level at which bargaining occurs (national or multi-sector level, sectoral level, or firm level) and the coverage rate. Governments should ensure the freedom of association and the right to collective bargaining for all workers and across the country, including in free or special economic zones where foreign firms often operate. In some countries, specific sectors or geographical areas are excluded from the right to organise and bargain collectively. In some other countries, laws can prohibit union pluralism or prevent foreign workers from forming unions (OECD, forthcoming[46]).

A challenge for collective bargaining is to remain relevant in a globalised and rapidly changing world of work (OECD, 2019[37]). Technological and organisational changes are encouraging new forms of employment, blurring traditional categories, such as ‘employer’, ‘employee’ and ‘place of work’. Employers' organisations, which are part of the collective bargaining system, are also being put to the test by changes to the world of work. They have an interest in ensuring a level-playing field for their members in the face of new competitors, who may circumvent existing labour regulations – for instance, digital platforms often consider themselves as matchmakers rather than employers (OECD, 2019[37]). As to FDI, existing, albeit limited, evidence indicates that foreign firms may not have sufficient incentives to join collective bargaining agreements or employers’ associations (Jirjahn, 2021[72]).

Collective bargaining coverage has declined in most OECD countries, a trend accelerated by outward FDI to countries where industrial relations and collective bargaining are weaker (OECD, 2018[63]; Duval and Loungani, 2019[73]). In the absence of broad membership, one way to maintain high coverage is to extend the coverage of collective agreements beyond the signatory unions and employer organisations to all workers and firms in a sector (OECD, 2018[61]). In some countries, extensions are issued to ensure the same treatment and standards to all workers in the same sector, in particular for workers of foreign firms
(Hayter and Visser, 2018). On the other side, extensions may have a negative impact when the terms set in the agreement do not account for the economic situation of a majority of firms in the sector. In order to alleviate these concerns, extension requests could be subjected to reasonable representativeness criteria, in line with the ILO Recommendation on collective agreements No. 91 (OECD, 2019).

It is an open question how the decentralisation of collective bargaining affects MNEs’ industrial relations. 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 (OECD, 2008). 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 GVCs. The OECD Guidelines for MNEs (OECD Guidelines) indicate that, in the context of negotiations with workers’ representatives, or while workers are exercising a right to organise, MNEs should not threaten to transfer activity to other countries in order to influence unfairly negotiations or to hinder the exercise of a right to organise (Box 3.4).

One concrete consequence of the bargaining imbalance in foreign firms at the national level has been the development of transnational workers’ representations to better coordinate workers’ bargaining policies. 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, Schüßler and Stevis, 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 the ILO and the European Commission. In the EU, for instance, European Works Councils are consulted by MNE management on decisions at European level that affect workers’ employment or working conditions. They can be established, as per EU directives, in companies or groups of companies with at least 1000 employees in the EU and the other countries of the European Economic Area, when there are at least 150 employees in each of two Member States. The majority of GFAs make reference to ILO Conventions, and an increasing number are also referring to the OECD Guidelines for MNEs and the ILO MNE Declaration. Most GFAs make reference to supply chain due diligence, 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, Schüßler and Stevis, 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 potentially help address such challenges by serving as a basis for MNEs to promote global standards across their subsidiaries. This could also explain why foreign firms can be less interested in joining national employers’ associations than in interacting with other subsidiaries of the parent company (Jirjahn, 2021).

ILO’s labour conventions and OECD’s Guidelines for Multinational Enterprises can help raise labour standards of MNEs and their domestic partners along the supply chain

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 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 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. Poor labour practices in the operations of businesses can reflect weak enforcement of national and international labour provisions. Indeed, non-compliance with international labour provisions continues to be a concern in many countries with weak rule of law.

The OECD Guidelines and ILO’s Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy are international instruments rooted in the ILO Declaration on Fundamental Principles and Rights at Work. They are voluntary recommendations by adhering governments, supported by employer and worker organisations, which are directly addressed to MNEs. The OECD Guidelines come with binding commitments and have a unique implementation mechanism called National Contact Points (NCPs), which are agencies established by governments to promote the Guidelines and related due diligence guidance, and to handle cases (referred to as “specific instances”) as a non-judicial grievance mechanism. The Employment and Industrial Relations chapter of the OECD Guidelines covers the fields of employment, training, working conditions, and industrial relations (Box 3.4).

Box 3.4. OECD Guidelines for Multinational Enterprises: Employment and Industrial Relations

MNEs should, within the framework of applicable law, regulations and prevailing labour relations and employment practices and applicable international labour standards:

- Respect the right of workers employed by the MNE 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. Where comparable employers may not exist, provide the best possible wages and conditions of work, within the framework of government policies.
- To the greatest extent practicable, employ local workers and provide training, 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, provide reasonable notice of such changes to representatives of the workers, and, where appropriate, to the relevant governmental authorities, and co-operate to mitigate 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 activity in order to influence unfairly those negotiations or to hinder the exercise of a right to organise.

The OECD Guidelines recommend MNEs to carry out due diligence through their value chain relationships to address existing or potential adverse impacts on various aspects related to labour. Overall, countries are increasingly adopting due diligence legislation that covers various labour standards and that applies to MNEs supply chain operations. To support the implementation of the Guidelines, the OECD Due Diligence Guidance for RBC provides practical support to firms on implementation (OECD, 2018[78]). Implementing these recommendations can help companies avoid and address adverse impacts related to labour, industrial relations and human rights that may be associated with their operations, supply chains and other business relationships. The OECD has also developed practical actions in specific sectors. For instance, the due diligence guidance on child labour in minerals supply chains helps companies identify, mitigate and account for the risks of child labour in their mineral supply chains (OECD, 2017[79]).

**International investment and trade agreements can seek to raise labour standards and support monitoring of commitments**

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 international agreements address labour regulations and standards**

<table>
<thead>
<tr>
<th>Policy objective</th>
<th>Type of reference</th>
<th>Examples of treaties</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Encourage international cooperation</strong></td>
<td>General promotion of progress in labour standards and cooperation</td>
<td>Armenia-EU Comprehensive and Enhanced Partnership Agreement (2017), Chapter 85-86.</td>
</tr>
<tr>
<td></td>
<td>Commitment to cooperate on labour matters</td>
<td>EC-Uzbekistan Cooperation Agreement (1996), Art. 43.</td>
</tr>
<tr>
<td><strong>Reinforce domestic law</strong></td>
<td>Explicit safeguards or enhancements of labour standards</td>
<td>US-Mexico-Canada Agreement (USMCA) (2018), Chapter 23</td>
</tr>
<tr>
<td></td>
<td>Non-lowering of labour standards for the purpose of attracting investment</td>
<td>Japan-Jordan BIT (2018), Chapter 20</td>
</tr>
<tr>
<td><strong>Preserve domestic policy space</strong></td>
<td>Explicit affirmation of labour regulatory power of host state</td>
<td>Canada-EU Comprehensive Economic and Trade Agreement (CETA), Chapter 23</td>
</tr>
<tr>
<td></td>
<td>Carve-out clauses for labour measures with respect to certain treaty provisions</td>
<td>US-Rwanda BIT (2008), Art. 13.</td>
</tr>
<tr>
<td></td>
<td>Exclusion of non-discriminatory labour measures from ISDS</td>
<td>Canada - Mongolia BIT (2016), Art. 20</td>
</tr>
<tr>
<td><strong>Influence investor conduct</strong></td>
<td>Investor obligations related to labour standards</td>
<td>CARIFORUM-EU FTA (2008), Art 72.</td>
</tr>
</tbody>
</table>

Source: OECD (2021), FDI Qualities Mapping (database).

International agreements addressing investment can promote better labour practices by strengthening the incentives of governments to transpose international labour standards into national law. Some IIAs contain government commitments to maintain, implement or strive to implement internationally recognised labour standards, most prominently ILO’s 1998 Declaration and related Conventions (ILO, 2016[80]). Labour provisions in IIAs can also refer to government commitments on minimum wages, working hours or occupational safety and health. Some IIAs include non-binding language, often in the preamble of the treaty, on the importance of sustainable development and the implementation of the treaty in a way that is
consistent with national and international commitments on labour. Others go further and explicitly require
treaty parties not to lower labour standards. Some treaties prohibit governments from imposing
performance requirements on covered investors to meet certain quotas of local employees or managers;
but exceptions to these rules in some IIAs can allow governments to require investors to employ or train
local workers under certain conditions. A few treaties contain more specific commitments. For example,
the labour chapter of the United States–Mexico–Canada Agreement (USMCA) requires Mexico to
strengthen protection for collective bargaining and related enforcement tools. The ASEAN Economic
Community Agreement has provisions to facilitate labour mobility in specific high-skilled occupations.

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, 2008[19]). 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 USD 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 agreements condition 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 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[80]). 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.

6 By contrast, some trade agreements seek to use positive incentives. For example, the Cambodia–US Bilateral Textile
Agreement (CUSBTA) made the extension of quota limits conditional on compliance with international and national
labour laws. It is not clear if this go against the principles of the WTO (OECD, 2008[19]), but it induced Cambodia to
accept ILO’s support to enhance compliance, leading to a substantial increase in the possibility of forming trade unions.
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.

**Stimulate labour demand and develop workers’ skills through targeted investment and active labour market policies and programmes**

Active 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 FDI in specific sectors or locations. Other policies aim at increasing the supply of adequate skills or mitigate potential adverse effects of FDI by supporting displaced or vulnerable workers. Such mutually-reinforcing policy interventions are warranted as FDI 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 and low-carbon transition – all accelerated by FDI – impose on the labour market.

Qualified tax incentives, based on the labour market outcomes of firms, can help address specific market failures but they must be transitory and properly evaluated.

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. Incentives usually do not differentiate between foreign and domestic investors but some tend to target implicitly foreign firms – for instance through eligibility conditions on the minimum number of jobs. Incentives can distort competition, however, and are not always cost-effective in inducing firms to create quality jobs, although this can depend on the instrument and the targeting strategy. Governments should ensure that incentives address a well-identified labour market failure such as the existence of skills gaps or labour immobility (i.e. labour does not move to where it is in demand). Incentives must be time-bound, their appropriateness evaluated periodically to ensure that benefits materialise and outweigh the costs, and developed through concerted efforts across relevant agencies (such incentives could be as much seen as investment policies as active labour market policies).

There are a variety of tax and financial incentives, each targeting directly or indirectly a specific labour outcome and influencing a specific transmission channel of FDI. Some incentives – often tax holidays – do not explicitly target labour market outcomes but can be conceived with the goal of attracting investment that stimulates labour demand in labour or skill-intensive sectors or in regions with low employment shares. Governments also often design incentives that target explicitly specific labour market outcomes. For instance 12 of the 36 countries included in the OECD Investment Tax Incentive Database use incentives to promote job creation and quality while 6 countries grant incentives to support skills (Celani, Dressler and Wermelinger, forthcoming[2]). These incentives are based on eligibility conditions that define who qualifies for tax relief (e.g. a firm that creates a minimum number of workers) and can include design features that describe how relief from taxation applies (e.g. spending on training) (Table 3.4).

### Table 3.4. Targeting specific labour market outcomes through investment tax incentives

<table>
<thead>
<tr>
<th>Type of incentive</th>
<th>Examples of criteria</th>
<th>Country examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligibility conditions related to outcomes</td>
<td>- Employ a minimum number of workers</td>
<td>- Jordan provides CIT reduction to manufacturers that raise employment from a defined baseline.</td>
</tr>
<tr>
<td></td>
<td>- Create a minimum number of new jobs</td>
<td>- Viet Nam provides reduced CIT rate for 10 years if the project has more than 3000 employees.</td>
</tr>
<tr>
<td></td>
<td>- Pay an average wage at a certain level</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Reach a minimum level of spending on training</td>
<td></td>
</tr>
<tr>
<td>Design Features</td>
<td>- Wages of newly created employment</td>
<td>- Thailand allows expenditures on employee training to be deducted at 200% of the actual cost for tax purposes.</td>
</tr>
<tr>
<td></td>
<td>- Wages of trainees and apprentices</td>
<td>- Armenia provides enhanced deductions for new jobs created within the business plan.</td>
</tr>
<tr>
<td></td>
<td>- Expenditure on training and education of employees</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Expenditures related to building training facilities</td>
<td></td>
</tr>
</tbody>
</table>

Tax exemptions are the most typical instrument governments use to attract FDI that directly relates to specific labour market outcomes (OECD, 2021[82]). For instance, Jordan provides CIT reduction to manufacturing firms that raise the employment of Jordanian citizens from a pre-defined threshold (OECD, forthcoming[48]). Such eligibility conditions related to outcome require careful monitoring to ensure that the outcome has been met and to avoid fraudulent behaviour; for example, to ensure that a required number of jobs were effectively created. Such monitoring requires resources and administrative capacity, which may be scarce in developing countries. In some countries, the IPA can access social security data to calculate the number of jobs created or wages in foreign firms and whether they deliver on their promises.

Tax allowances, credits or subsidies are other instruments that can be directly tied to the performance of firms in terms of employment, the wage bill, or trained workers. They can target specific groups that the government supports as part of a national plan, such as R&D workers, youth transitioning from school to work or women (see Chapter 4). They can also influence transmission channels of FDI spillovers, such as support to firms that train workers of their domestic suppliers. Likewise, tax allowances, credits or subsidies may benefit domestic firms that want to upgrade their workers’ skills in response to foreign competitive pressure. Evidence on the effectiveness of incentives that are directly tied to objectives such as increasing employment or wages is mixed in both developed and developing countries (McKenzie, 2017[83]; Bown and Freund, 2019[84]). When they are not well targeted, incentives might benefit firms that did not need support to hire or train workers in the first place. Some evidence shows that interventions targeting geographical or sectoral labour mobility may work better than others (Duval and Loungani, 2019[73]).

Some governments, including local authorities, make special deals (or mega deals) with large companies, typically MNEs, operating in innovative or strategic sectors, and offer them upfront discretionary incentives packages against commitments to create a certain number of jobs. Such packages are not always cost effective and, while they may improve direct and indirect labour market outcomes, their impact from both a local or national welfare perspective is uncertain (Bartik, 2018[85]; Slattery and Zidar, 2020[86]). Furthermore, large firms receiving upfront tax incentives could fail to fulfil employment requirements predicated on ex-ante contractibility because of rapidly changing or uncertain environments (Rodrik and Sabel, 2020[87]). In the United States, such discretionary deals are negotiated at the local level, more often in declining regions, and one quarter of them go to large foreign firms (Setzler and Tintelnot, 2021[14]). If they are to be negotiated, firm-specific deals may be more effective if they include design features that describe how tax relief can apply ex post, i.e. depending on the actual performance of the firm.

Some incentives have a countercyclical nature and can mitigate the adverse effects of downturns on labour market by supporting firms, including foreign business. 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 3.6). This corroborates the possibility that foreign firms find it costly to reduce their workforce during a crisis: higher skilled staff are typically harder to find (OECD, 2020[11]). They may also be more resilient to crises due to their ability to shift temporarily production to other subsidiaries.
Skills development features prominently among the active labour market policies affecting a country’s enabling environment for investment and inclusive growth (OECD, 2015[45]). Skills imbalances lead to higher risk of unemployment, lower wages and lower job satisfaction. They are also associated with lower labour productivity through a misallocation of workers to jobs (Adalet McGowan and Andrews, 2015[88]). By reducing skills mismatches and shortages, training programmes can help increase labour mobility and raise the share of skilled workers following a surge in labour demand from FDI entry, including in domestic firms that will be more able to absorb potential spillover benefits (Becker et al., 2020[44]).

Vocational training programmes can be very different in nature and may differ in their cost and duration, in their curricular content, and in whether or not, and how, the private sector participates, and may address a diverse public, from engineers in the ICT sector to disadvantaged youth in poor regions. Effectiveness largely depends on how these programmes are designed, on the quality of implementation, on the context in which they were developed, and on target population (Levy-Yeyati, Montané and Sartorio, 2019[89]). It is therefore crucial that skills development programmes are developed in line with national economic and investment plans, in consultation with workers, the private sector and relevant investment bodies.

Existing variations in skills shortages and training provision by firms across countries and between foreign and domestic firms suggest that there is ample room for policy intervention. Four patterns can be identified based on the World Bank Enterprise Survey. First, levels of skills inadequacy and training provision of foreign and domestic firms are largely driven by national factors, although ownership matters (Figure 3.7). Second, skills inadequacy is a major constraint for firms in the OECD area more than in developing economies. This could reflect more severe skills shortages in OECD countries, even if this observation may be driven by better business climates – corruption is more likely to be a major constraint in developing economies. Third, foreign firms in the OECD area suffer from skills inadequacy less than domestic business while the reverse is often observed in non-OECD countries. Different sectoral concentrations of the two groups of firms and higher cross-border labour mobility in OECD countries could explain such pattern. Fourth, foreign firms systematically provide more training than domestic firms, including in countries where they report being relatively less constrained by skills availability. This reflects MNEs’ permanent need to adapt to competitive international pressure through reskilling and upskilling.
Firms may provide training on their own costs but skills policies targeted at employers can also be covered by government subsidies (see previous section). In general, training support provided or subsidised by government agencies, though costly, have shown some success when well-designed and targeting the right beneficiaries (Bown and Freund, 2019[84]). For instance, sectoral training or re-training programmes in transferable and certifiable skills can facilitate labour mobility and help workers move to better-paid jobs (Katz et al., 2020[90]). They can reduce skills shortages in high-growth sectors where FDI may crowd out competitors unable to retain their talented staff. Sectoral training could be equally helpful to help mitigate the potential adverse impacts of FDI by retraining displaced or vulnerable workers affected by rapidly changing labour markets due to, inter alia, evolving needs of MNEs or because of the low-carbon transition (see also Chapter 5). On-the-job training support contribute to a more flexible workforce and, in turn, to higher wages; and foreign firms tend to strongly rely on them (Almeida and Faria, 2014[91]; Konings and Vanormelingen, 2019[92]). Providing all firms with financial support for training can, however, lead to deadweight losses. Companies that compete in high-productivity environments, such as foreign firms, need to provide training in any case because it is critical to their productivity and survival (Saraf, 2017[93]).

While reskilling and upskilling support is essential, pre-employment training programmes can help host countries prepare future workers, particularly youth transitioning from school to work, with relevant skills. In countries or regions that are large recipient of FDI, pre-employment training programmes could be even designed specifically to quickly respond to the needs of foreign firms considering to invest. One example is Assured Skills, a state programme in Northern Ireland, introduced by the Department for the Economy and Northern Ireland’s investment promotion agency Invest NI, that prepares and trains workers for guaranteed jobs in new foreign firms (OECD, 2020[94]). Overall, governments must ensure that, in light of the different training programmes (sectoral, on-the-job, pre-employment trainings) and providers (public, private, NGOs) that could exist, that there is a solid accreditation and skills certification system.

The investment community can play an important role by participating in skills development initiatives. As illustrated by the example of Assured skills, training programmes are sometimes developed and implemented by IPAs in cooperation with relevant partners. For instance, the Costa Rican IPA established the Skills4Life Program, in partnership with the Ministry of Labour and the Ministry of Education, and as part of the National Employment Programme, to retrain students and provide an accompaniment plan to help recipients find work afterwards (Box 3.5). IPAs could also cooperate with the relevant agencies to identify and support existing or potential local suppliers of foreign firms with relevant training options (see...
also Chapter 2). Sometimes, the foreign firms create their own training centres that serve beyond the company's needs. IPAs could support them in such undertakings and ensure that trainings are recognised by the relevant authority. In Jordan, for instance, Orange established a Coding Academy that offers a free training programme, accredited by the competent public authority, to young job seekers interested in digital technology who were unable to complete their university education (OECD, forthcoming[46]).

### Box 3.5. IPAs as key partners in skills development: the case of CINDE in Costa Rica

Costa Rica is one country in which the IPA, CINDE, plays a particularly significant role in skills, through partnerships, studies and advocacy. Education and human talent is one of CINDE’s identified strategic pillars. According to the IPA’s 2019-22 strategy, the organisation identifies itself as a key player in supporting skills development for jobs of the future, and in the transitioning towards a knowledge economy. CINDE is fulfilling the strategy to boosting skills in Costa Rica in partnership with ministries, other agencies, universities, technical institutions and the foreign MNEs themselves, allowing the IPA to closely track patterns in emerging human talent.

In 2018, CINDE launched a partnership with the Ministry of Labour and the Ministry of Education, to create the Skills4Life Program, as part of the National Employment Program. Skills4Life rettrains over 2000 students per year in the English language, social skills in the workplace and also provides an accompaniment plan to help recipients find work afterwards. A 2020 initiative saw CINDE, in collaboration with Coursera, an online education platform, along with the Ministry of Labour, come together to launch an industry 4.0 train program designed to benefit 50,000 recipients. CINDE is also part of a strategic partnership to boost education and skills development, with two key Costa Rican sustainable development NGOs, Crusa and Aliarse, as well as the Inter-American Development Bank.

CINDE also contributes to an overall understanding of the labour market and education outlook of Costa Rica, including skills needs, which encourages programmes that further boost the country’s attractiveness as an FDI destination. One of these programs was launched in September 2021, Technological Seedlings, in which CINDE has partnered with Microsoft to boost the talent pool in certain high-tech sectors identified in CINDE’s studies as needing the most new entrants. The training of these students has been relegated to the INA, Costa Rica’s primary agency for learning and skills development, showing a strategic positioning of an IPA to actively shape skills development at home.

CINDE also incorporates digital tools in their talent development initiatives, such as their Crystal Ball programme that is directed at matching the supply of knowledge economy jobs with the demand. The programme uses an AI-based digital employment orientation platform that predicts and recommends learning paths to ensure users’ employability opportunities, personalised based on experience, capabilities and interests, with the aim of impacting over 30’000 people.

Source: OECD (2021), FDI Qualities Mapping (Database); CINDE 2019-22 Strategy.

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**Align investment opportunities with labour market needs by addressing information failures on the product and labour markets and reducing administrative barriers**

Together with financial and technical support, information and facilitation services can help address market failures that are preventing FDI from realising its labour market potential. Some policies such as linkages programmes can help connect foreign firms with the relevant skills while job search programmes help match job seekers with existing opportunities in MNEs. Other policies aim at raising awareness about labour standards and helping companies disclose their compliance with them. This increases suppliers' prospects to engage with foreign buyers that conduct due diligence checks in their supply chain.
**Investment promotion and facilitation activities that reduce information barriers for foreign investors must be based on the existing skill base and labour market potential**

Through their activities, IPAs can help address specific market failure (e.g. low labour mobility) by reducing information barriers for foreign investors (e.g. existing skill base) and, thus, improve labour outcomes of FDI. In coherence with existing strategies, IPAs could adopt activities and tools providing information on the national skill base or on local labour market conditions. They can also ensure that material on labour regulations, skills support programmes or employment incentives are visible and easily accessible online. Importantly, IPAs can provide targeted facilitation and aftercare services, such as guiding existing foreign investors that are looking to hire workers with specific skills or in identifying domestic suppliers disclosing high labour standards, and thereby also incentivise other firms to raise theirs.

The relevance of IPAs is stronger when information asymmetries are more severe, markets less transparent and institutional conditions generally weaker. They can be particularly effective if governments’ efforts also include attracting FDI to regions with low employment rates. Co-operation between the national IPA and regional development agencies or the existence of regional IPAs can contribute to higher inflows of FDI at the local level and to increased number of jobs directly created by the foreign firm (Crescenzi, Di Cataldo and Giua, 2021[95]). IPAs’ activities in the region can cut operational or search costs of foreign investors (for example when setting up a training centre or contributing to its creation), reducing transaction costs when interacting with local actors. This can ensure that the distribution of FDI across regions is also governed by local labour market potential and not information asymmetries or transaction costs.

Another, albeit related, way through which IPA influence the impact of FDI on quality job creation and skills is through prioritisation – IPAs can prioritise FDI in labour- or skill-intensive sectors, target countries with better records of human rights or RBC or focus on foreign investors’ size. An increasing number of IPAs are using project evaluation and prioritisation tools that allow them to focus their limited resources on the most valuable deals. For instance, the Lithuanian IPA only treats potential projects that are expected to create a minimum number of jobs – 5 for an R&D project and 20 for other projects. It also scores projects based on the expected wage firms’ will pay to workers. Overall, job quality and skills are important goals for IPAs when setting their prioritisation strategy, although there can be large differences across agencies (OECD, 2021[55]). IPAs set key KPIs to help them identify investments of higher job quality and that can contribute to upskilling. Targets and promotion activities should be coherent with national strategies and reasonably reflect the country’s skill base and labour market conditions.

IPAs are also increasingly taking into consideration the global race for attracting talent into their activities. The mobility of human resources has become a central aspect of globalisation, alongside FDI, trade and R&D internationalisation (OECD, 2008[96]). Attracting talent, including foreign, and facilitating workers’ entry and establishment is becoming intrinsically connected with FDI attraction, and thus becoming an activity of some IPAs. Agencies can help ensure transparency and consistency of procedures and requirements for obtaining permits from labour authorities, including permits for foreign workers. Notwithstanding the relevance or not of regulating the entry of foreign workers, it is crucial to simplify their entry procedures. Countries like Thailand, for instance, impose restrictions on the entry of foreign workers. To remain attractive to investors, the government established a Strategic Talent Centre to facilitate the admission of skilled foreign workers. The Centre provides a mechanism that recognises the qualifications of foreign experts interested to work in Thailand. Once their qualifications are recognised, the Centre, together with the national IPA, assist foreign job seekers with their visas and work permits (OECD, 2021[56]).

**Public employment services can assist vulnerable communities adversely affected by FDI by reducing job search costs and stimulating labour mobility near MNE activity**

While investment promotion and facilitation activities lower information barriers for investors, public or private employment services reduce search costs in the labour market for job seekers. Such support is particularly important to mitigate possible adverse effects of FDI on vulnerable communities such as the
less educated, youth and women (Steenbergen and Tran, 2020[15])(Chapter 4). Indeed, some workers can lose out following FDI entry and spillovers via long unemployment durations or displacement to lower-paid jobs. Supporting job seekers or low-wage workers with job search assistance, certification of their skills, matchmaking services (e.g. MNEs secondment programmes), and advice on available training support can help them adjust to changes in the marketplace and find better job opportunities. Overall, active labour market policies have a stronger impact when they are offered in an integrated manner – for example, when employment services are combined with training support (Angel-Urdinola, Kuddo and Semlali, 2013[97]).

Search and matching 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[83]). 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[15]). Programmes providing information about job opportunities in a different location or subsidising job search in different parts of the city by covering transportation costs has been found to be effective (Jensen, 2012[98]; Abebe et al., 2016[99]; Franklin, 2018[100]). In Jordan, for instance, the IPA itself, in partnership with the Industrial Estate Company, recently launched an initiative – the Gold Professions Initiative – to rehabilitate the skills of the local communities surrounding the industrial estates and match them with job opportunities at employers operating there (OECD, forthcoming[46]).

Raising awareness on labour standards and supporting companies disclose their compliance with them can facilitate MNEs’ due diligence checks and responsible sourcing

Policies supporting supply chain linkages between foreign and domestic firms typically aim at upgrading local suppliers’ capabilities, but those helping companies improve and disclose their labour standards compliance can be equally relevant. Effective corporate disclosure, both by foreign and domestic firms, is crucial in integrating them into more inclusive, albeit complex, supply chains. Businesses have a responsibility to prevent and address negative impacts of their actions on the labour market, including by conducting due diligence checks. Policies that raise awareness on labour standards and encourage corporate disclosure can act as an incentive for firms to improve working conditions. In particular, transparency on labour standards of suppliers reduce information costs for foreign investors, encouraging them to pursue partnerships, thus boosting the standing of these companies and their suppliers.

Initiatives aiming at raising awareness of labour standards and helping companies disclose compliance are diverse and implemented by a variety of actors, including IPAs and civil society. In some OECD countries, corporate disclosure is a requirement; such as in France, where very large companies must establish, implement and publish their due diligence plans to prevent human rights’ abuses in supply chains, or in the UK, where companies with a turnover of over GBP 36 million annually must disclose their approach in preventing modern slavery in their supply chains. In most countries, however, initiatives to raise awareness on labour standards and supporting companies disclose their compliance with them often rely on international donors’ support. One relevant initiative is ILO’s Better Work (BW) programme, which engages MNEs, local governments, business, and labour in social dialogue around compliance and competitiveness (Box 3.6). BW created a transparency portal which discloses the names of registered businesses and their compliance with key labour standards, such as payment for overtime work, the conditions of migrant workers, implementation of collective agreements, and health and safety conditions.

The OECD Due Diligence Guidance for RBC is another relevant tool for governments and enterprises seeking to implement the OECD Guidelines. The NCPs operating under the OECD Guidelines – sometimes hosted by the IPA – are requested to promote the Guidelines and related due diligence guidance. The OECD Due Diligence Guidance helps companies implement the due diligence recommendations for risk areas such as child and forced labour, working time, occupational health and safety, trade union and collective bargaining, and wages. While it is central for companies to assess due
diligence risks from an issue-specific perspective (e.g. labour), risk assessment across sustainability areas can be equally important. For instance, companies’ taking action to reduce carbon emissions in order to address and adapt to the transition risks of climate change on their direct operations and supply chains should also consider potential adverse impacts on workers and local communities to ensure a just transition (see also Chapter 5). In some countries, the NCP has been largely inactive due to limited financial resources and institutional clarity about their role (OECD, 2021[49]).

Box 3.6. Better Work: an initiative that supports corporate disclosure and due diligence

Better Work (BW) is a partnership between the ILO and the International Finance Corporation (IFC), as an initiative to improve labour standards and competitiveness in the garment sector across developing economies. One of their motivations comes from a noticed correlation between compliance with labour laws and increased productivity, profitability and resilience for enterprises. Workers in factories who enjoy a clean, safe and equitable working environment are also more motivated and less likely to leave their jobs – all of which can improve business performance. BW is an example of the benefits of cooperative initiatives to boost corporate disclosure and compliance, which has the potential to create a more competitive environment that not only strives to meet international labour standards, but also one which has an increased ability to attract MNEs and seek deeper linkages with the supply chain.

BW includes labour actors at all levels of programme design, adoption, implementation, monitoring, and evaluation. This includes global union federations in the global advisory committee, trade unions at the national level, and the provision of an institutionalised form of collective worker voice at the factory level. This approach holds the prospect of better enforcement outcomes by bringing labour to the table in an active role and by fostering worker voice through interpersonal interactions between workers and managers.

In Jordan, for instance, the BW programme has been active since 2008, in coordination with the Ministry of Labour, where it works to improve working conditions and competitiveness in the garment industry and other exporting sectors. It is active on both the factory-level and institutional-level, and not only provides frequent reporting and advice on conditions in factories, but also encourages a dialogue between industry, government and international stakeholders, and also participates in the training of trainers, in order to create a more safe and productive Jordanian workforce.

BW includes a Transparency Portal which “discloses the names of the apparel factories registered with Better Work country programmes and their compliance with key national and international labour standards,” which according BW, “transparency has the potential to stimulate factory progress, improve working conditions, bolster the competitiveness of the sector and encourage ethical sourcing.” For example, in the case of Jordan, publicly reported issues have included those such as payment for overtime, the conditions of migrant workers, implementation issues of collective agreements, and health and safety resources and infrastructure. Importantly, BW’s direct advisory role provides resources for these same factories, such as a Compliance Assessment Tool, to ensure that once disclosure comes, the garment sector, and often other sectors such as chemicals and light manufacturing are in compliance with Jordanian laws and international labour standards as much as possible.

Source: OECD (2021), FDI Qualities Mapping (database); (Pike, 2020[101])
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### Annex 3.A. Core questions to assess the impact of FDI on job quality and skills

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<tr>
<th>Dimension</th>
<th>Questions</th>
<th>Potential data sources</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Structure of the economy</strong></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>
</tr>
<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><strong>Labour market characteristics</strong></td>
<td>What are the rates of employment and unemployment in the economy?</td>
<td>OECD and ILO statistics</td>
</tr>
<tr>
<td></td>
<td>What is the percentage of child and forced labour?</td>
<td>ILO statistics</td>
</tr>
<tr>
<td></td>
<td>What is the percentage of informal employment in the economy?</td>
<td>ILO statistics</td>
</tr>
<tr>
<td></td>
<td>What is the percentage of skilled workers in the economy?</td>
<td>OECD and ILO statistics</td>
</tr>
<tr>
<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 imbalances 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 trade union density?</td>
<td>OECD and ILO statistics</td>
</tr>
<tr>
<td><strong>FDI characteristics</strong></td>
<td>What types (greenfield vs. M&amp;A) and motives of FDI are more conducive to positive labour outcomes in the economy?</td>
<td>Refinitiv; Financial Times’ fDi Markets; World Bank Enterprise Surveys</td>
</tr>
<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 that have adhered to the OECD Guidelines?</td>
<td>National statistics and empirical research</td>
</tr>
<tr>
<td><strong>FDI transmission channels</strong></td>
<td>Are average wages higher in foreign firms relative to domestic firms?</td>
<td>OECD FDI Qualities Indicators</td>
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<tr>
<td></td>
<td>Do foreign firms train more theirs workers than domestic firms do? To which extent foreign they also train workers of their suppliers?</td>
<td>OECD FDI Qualities Indicators; National statistics and empirical research</td>
</tr>
<tr>
<td></td>
<td>Is job security higher in foreign firms relative to domestic firms?</td>
<td>OECD FDI Qualities Indicators</td>
</tr>
<tr>
<td></td>
<td>Is labour mobility between foreign and domestic firms happening and does it contribute to skills transfers and wage growth?</td>
<td>National statistics and empirical research</td>
</tr>
<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>
## Annex 3.B. Core questions to assess policies influence the impact of FDI on job quality and skills

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Instrument</th>
<th>Policy questions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Governance</strong></td>
<td>National strategies and plans</td>
<td>Are the country's priorities in terms of labour market outcomes (e.g. create more jobs, increase the share of skilled workers, etc.) clearly defined? Is the country's FDI attraction strategy? Are these strategies aligned with broader development objectives? Do national development or economic plans provide coherent and strategic directions on investment, employment and skills development objectives? Are investment considerations integrated in employment and skills strategies and vice versa? Is there a dedicated strategy that articulates the government's vision on the contribution of investment to job quality and skills development? If yes, does the strategy set the goals, identifies priority policy actions and clarifies responsibilities of institutions and co-ordinating bodies?</td>
</tr>
<tr>
<td></td>
<td>Policy coherence and coordination</td>
<td>Are responsibilities across government ministries and agencies on investment, employment and skills development clearly defined, balanced, sufficiently funded, mutually understood by all actors and grounded in sound and coherent strategies? Is there a centralised mapping of all institutions involved in developing and delivering policies at the intersection of investment, employment and skills development? Do actors involved in governance decisions know about it and use it as a point of reference? Is there horizontal coordination between stakeholders at the same level of governance, i.e. strategic coordination between different ministries via inter-ministerial bodies and operational coordination between implementing agencies via working groups (e.g. skills councils), boards of directors (IPA's boards), etc.? Are the mandates and internal governance structures of the coordinating bodies clearly defined? Are there formal coordination mechanisms with social partners to receive feedback and build consensus around reforms at the intersection of investment, employment and skills development?</td>
</tr>
<tr>
<td></td>
<td>Labour market information and skills assessment</td>
<td>Do relevant institutions systematically undertake labour market impact assessment of their policies and programmes? Do they run skills assessment and anticipation exercises? Are investment bodies such as IPAs involved in labour market information and skills assessment and anticipation exercises? Are information on inward FDI characteristics and MNEs' activity used as forward-looking indicators of what jobs and skills will be in demand in the future in skills anticipation systems?</td>
</tr>
<tr>
<td>and anticipation systems</td>
<td>International labour standards</td>
<td>Has the country 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? Are there measures in place to ensure and promote the effective implementation of these conventions?</td>
</tr>
<tr>
<td></td>
<td>OECD Guidelines for MNEs</td>
<td>Has the country adhered to the OECD Guidelines for MNEs and related OECD Due Diligence Guidance for RBC? If yes, to what extent do governments align their laws, regulations and labour relations with the Employment and Industrial Relations chapter of the Guidelines?</td>
</tr>
<tr>
<td></td>
<td>International investment and trade agreements</td>
<td>Does the country promote the inclusion of provisions in international investment and trade agreements that raise labour standards, including by referring to ILO’s conventions and the OECD Guidelines? Do agreements allow for sufficient domestic policy space and commit the parties to establish institutional mechanisms to monitor implementation of labour commitments?</td>
</tr>
<tr>
<td>Domestic regulations</td>
<td>FDI restrictions and wider product market</td>
<td>Are existing regulatory restrictions on FDI periodically reassessed against evolving public policy objectives on job creation and skills development and, where relevant, streamlined or removed? Are relevant labour bodies and social partners involved in such assessments, and are potential liberalisation reforms designed in cooperation with them? Does the government ensure that wider product market regulations and competition policy are adapted to foreign investors’ entry and operations and that they promote a fair sharing of benefits between firms and workers through fostered competition?</td>
</tr>
<tr>
<td></td>
<td>market regulations</td>
<td>Does the employment protection legislation provide a level of employment stability that encourages learning in the workplace while allowing for enhanced labour mobility? Does the government take into account how labour market regulations affect foreign firms’ entry and operations? Are labour market reforms discussed with public and private bodies in charge of investment?</td>
</tr>
<tr>
<td>Financial &amp; technical support</td>
<td>Is the right to collective bargaining ensured by the law and workers' voice arrangements promoted by the government? Does the right to collective bargaining exclude specific sectors or workers (e.g. foreign workers)? Are existing collective bargaining systems are adapted to a changing world of work and to MNEs' supranational activities? Does the government support global framework agreements between MNEs and global union federations? Are other labour regulations (e.g. minimum wage, temporary work, occupational health and safety, child and forced labour, etc.) aligned with international standards? Does the government ensure nation-wide implementation of these regulations, including in special economic zones?</td>
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</tr>
<tr>
<td>Investment and employment incentives</td>
<td>If provided, is financial support, particularly corporate tax relief, which aims at attracting FDI in job-creating or skill-intensive sectors or in regions with low employment rates time-limited and subject to regular impact assessments? If provided, do incentives tied to the performance of firms in terms of jobs created, wages or trained workers, including workers of suppliers, aim at addressing specific market failures (e.g. labour immobility)? Are they developed through concerted efforts with all relevant bodies?</td>
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<tr>
<td>Training and skills development</td>
<td>Are vocational training and skills development programmes developed in line with national development and investment strategies and in partnership with businesses and workers? Is there a unified accreditation system that certifies all programmes? Are training centres established by foreign firms regularly subject to accreditation? Do IPAs work with skills development agencies to identify and support local suppliers of foreign firms with relevant training options? Are vocational training and skills development programmes adapted to MNEs' changing skills needs and to rapidly evolving labour markets (e.g. green transition)? Do sectoral training programmes provide transferable and certifiable skills? Are there retraining programmes for displaced workers adversely affected by FDI? If they exist, do pre-employment training programmes help prepare future workers, particularly youth transitioning from school to work, with relevant skills?</td>
<td></td>
</tr>
<tr>
<td>Investment promotion and facilitation services</td>
<td>Do investment promotion and facilitation activities information barriers for foreign investors based on the country’s skill base and labour market potential? Do they support investors in identifying suppliers with high labour standards? Do they ensure transparency and consistency of procedures for obtaining permits from labour authorities, including permits for foreign workers?</td>
<td></td>
</tr>
<tr>
<td>Public employment services</td>
<td>Do job search programmes and matching services reduce information gaps and lower search costs in labour markets and stimulate labour mobility, particularly of job seekers or workers in communities near foreign firms’ activities? Do they support job seekers or workers in vulnerable communities such as lower-skilled workers or youth? Are there mechanisms to support coordination between investment and public employment services?</td>
<td></td>
</tr>
<tr>
<td>Awareness raising and corporate disclosure of labour standards</td>
<td>If the country is an adherent to the OECD Guidelines, does the government raise awareness on the recommendations of the Employment and Industrial Relations Chapter and is the National Contact Point sufficiently active and adequately staffed? Does the country raise awareness about the content of the ILO’s Tripartite Declaration of Principles Concerning MNEs and Social Policy? Does the government incentivise companies to disclose their compliance with labour standards, including local suppliers, to facilitate due diligence checks and assess labour risks in supply chain? Does the government also encourages companies to assess risks not only from an issue-specific perspective (e.g. labour), but also across sustainability areas (for instance, do companies’ that reducing carbon emissions in order to address the transition risks of climate change also consider potential impacts on workers and local communities to ensure a just transition?).</td>
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</table>
This chapter presents a Policy Toolkit that can help countries improve the impacts of FDI on gender equality. It describes the channels through which FDI can affect gender and shows what policies and institutional arrangements can enhance its contribution to SDG 5. It builds on existing OECD instruments related to investment and gender equality, notably the Policy Framework for Investment, the Guidelines for Multinational Enterprises, and the Council Recommendations on Gender Equality in Education, Employment and Entrepreneurship, and on Gender Equality in Public Life.
Main policy principles

1. Provide coherent strategic direction on investment and gender equality and ensure policy coordination and effective implementation

- Align strategic objectives in the areas of investment, gender equality, labour markets, small and medium enterprises (SMEs), entrepreneurship and human resource development. Develop a national strategy for gender equality, clearly defining priorities, actors involved and budget.
- Improve policy coherence and coordination between actors responsible for gender and investment policies, as well as other relevant policies, through existing or new coordination mechanisms, including by establishing a focal point for responsible business conduct (RBC) (i.e. a National Contact Point for RBC) for countries adhering to the OECD Guidelines for MNEs.
- Conduct regular gender impact assessment of investment and relevant policies to improve policy design and implementation. Systematically collect gender-disaggregated data in areas such as investment, labour markets, entrepreneurship and human resource development.

2. Ensure that domestic regulation is aligned with international standards and supports the positive impact of FDI on gender equality

- Adhere to key international agreements that promote gender equality and integrate a gender perspective to identify and assess risks in supply chains and ensure that access to remedy considers a gendered perspective, as highlighted in the OECD Guidelines for Multinational Enterprises and the OECD Due Diligence Guidance for Responsible Business Conduct. Consider including gender provisions in regional trade agreements and bilateral investment treaties and provide mechanisms for their implementation.
- Remove regulatory restrictions on FDI and trade in sectors that employ or have the potential to employ many women, such as the service sectors.
- Ensure that internal regulations on employment (e.g. minimum wage), social protection, and the workplace (e.g. sexual harassment) support the creation of good quality jobs for women by MNEs.
- Remove regulatory barriers that hold back women entrepreneurs and prevent them from taking advantage of the presence of foreign MNEs, such as businesses opportunities generated along MNE value chains and technology and productivity spillovers.
- Ensure equal access for women and men to a gender-equitable education system and to quality and affordable health care.

3. Stimulation investment, particularly international investment, that promotes gender equality, and strengthen the capacities of female entrepreneurs and the skills of female workers

- Design transparent investment incentive systems that promote gender equality, or that do not exacerbate existing gender inequalities, and regularly assess the benefits and costs of such schemes.
- Provide financial and technical support to help women entrepreneurs access the capital and skills they need to develop business linkages with foreign MNEs and benefit from foreign spillovers.
- Offer training and skills development programmes to women, particularly those at the bottom of the productivity ladder and those returning to the workforce, to prepare them to work for foreign MNEs and for their local suppliers.
4. Eliminate information barriers and gender stereotypes that penalise women in the labour market; and provide social support services to enable women to work

- Help women entrepreneurs overcome information asymmetries caused by gender stereotypes and connect with foreign investors and business partners.
- Eliminate gender stereotypes on traditional gender roles that inhibit women’s participation in the labour force and prevent them from taking advantage of jobs created by MNEs.
- Provide good quality social support services such as childcare and elderly care services and safe transport to enable women to work, including for foreign MNEs.

4.1. Continued pressures on gender equality at the workplace

Achieving gender equality in the labour market can bring significant benefits to countries. Greater inclusion and empowerment of women in the labour market is related to lower income inequality and greater economic diversification (Kazandjian et al., 2016[1]), and contributes to more resilient economies (OECD, 2017[2]) (Box 4.1). OECD estimates 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[2]). In the Nordics, increasing employment of women accounted for 3-20% of per capita GDP growth over the past 50 years (OECD, 2018[3]).

Participation of women in the labour market remains low in many countries, however, with a global average at less than 50% in 2019, compared to 75% for men (ILO, 2019[4]). 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, 2019[5]). Women are also more likely to work part-time, in lower paid, less secure 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[6]). A lower gender wage gap is observed in the OECD area, at around 13%, but with a large variation between countries (OECD, 2019[5]).

Women are also less likely to reach the highest levels of management, in both the private and public sectors. In the OECD area, only about one third of managers are women. Women are also much less likely than men to become Chief Executive Officers (CEOs), sit on the boards of private companies or hold public leadership positions (OECD, 2020[7]). Similarly, in developing countries few women reach high-level, well-paid positions such as legislators, senior officials and managers (ILO, 2016[8]). 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[2]).

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 indicates that the impact of the COVID-19 outbreak has been particularly hard on women (OECD, 2020[9]). 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 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 services sectors such as air travel, tourism, retail, accommodation services (e.g. hotels), but also manufacturing industries such as clothing.
4.2. The impact of FDI on gender equality

**FDI can affect gender equality in the labour market through several channels**

FDI generates multiple gender-specific effects in the labour market of host countries. It influences the relative demand and prices of factors of production, including labour. Since women and men have different preferences and skillsets due to policy and non-policy factors (taxation, social and cultural norms, etc.), and employment intensities of female and male labour varies across industries, FDI generates shifts in the relative demand for labour by gender and affects the employment and wages of women and men differently. FDI can also influence other dimensions of gender equality and the empowerment of women 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 (e.g. training and promotion) (Chapter 3). The operations of affiliates of foreign multinational enterprises (MNEs) (hereafter referred to as foreign MNEs or foreign firms) can also have significant implications for local women entrepreneurs (Figure 4.1, green box).
FDI can influence gender outcomes through the direct operations of foreign MNEs or indirectly through business linkages and other market interactions with domestic firms (Figure 4.1, yellow box):

- **Activities of MNEs**: FDI affects women in host countries mainly through the direct employment activities and practices of foreign affiliates of MNEs (e.g. recruitment, remuneration, training, promotion, benefits). These, in turn, are influenced by the MNE corporate culture\(^7\), which is highly dependent on the country of origin.

- **Value chain relationships**: FDI can create jobs for local women not only in affiliates of foreign MNEs, but also in domestic companies through value chain relationships with local suppliers and buyers. Value chain relationships can be a channel for the transfer of gender practices and values from foreign MNEs to domestic companies (UNCTAD, 2021\(^{[10]}\)). Through value chain relationships, FDI can also support local women entrepreneurs.

- **Competition and imitation effects**: Foreign MNEs compete with local firms in both product markets (i.e. crowding-out) and 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\(^{[2]}\); OECD/European Union, 2019\(^{[11]}\)) 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 respond by improving wages and working conditions of women (Aguayo-Tellez, 2012\(^{[12]}\)). Imitation effects occur when domestic firms imitate the business practices of the multinational firm, including human resources management (HRM) activities related to gender. Through imitation, foreign MNEs can have an impact on women in domestic firms or on women-owned businesses.

- **Labour mobility**: This channel concerns the movement of women workers from foreign MNEs to domestic enterprises or the start-up of enterprises by women previously employed by foreign MNEs. Previous work experience with the MNE can help women get better jobs in domestic enterprises. While working for the MNE, women can acquire new skills through on-the-job training and learning, which can give them better prospects for career development in future jobs. Labour mobility can also contribute to the transfer of information on gender practices from foreign to

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\(^7\) Evidence shows that the corporate culture of the MNE is influenced by the home country's policy context as well as its social and cultural norms (Kodama, Javorcik and Abe, 2016\(^{[14]}\); Tang, 2017\(^{[15]}\)). While the Policy Toolkit focuses on host country policies, home country policies also play an important role through their effect on the MNE corporate culture.
domestic companies (UNCTAD, 2021[19]; Davis A., 2020[13]). Women can also use the knowledge gained at the foreign MNE to set up their own company.

The direction and magnitude of gender-specific impacts of FDI depend on several policy and non-policy factors (Figure 4.1, blue box). Policy framework conditions include a broad set of policies that will be discussed in Section 4.3. Non-policy factors comprise:

- **Sector, entry mode, and motive of FDI:** In general, the impacts on gender equality are expected to be greater when investment takes place in sectors with higher proportions of women than men. The choice of entry mode by foreign investors is also an important factor. For example, the creation of a new affiliate (greenfield FDI) is likely to have a greater effect on employment than a merger or acquisition (M&A) of an existing company, at least in the short term. Moreover, the motives that drive investors can vary widely. FDI driven by efficiency-seeking motives (e.g. the search for cheap labour and inputs) may lead to the creation of more (low-wage) jobs in the local economy, as opposed to FDI driven by the search for new markets.

- **MNE corporate culture:** Evidence points to the corporate culture of the MNE as an important factor governing gender equality in the workplace. Foreign affiliates in more gender-inclusive countries tend to have higher proportions of female employees, including in management positions, to have smaller gender pay gaps and to offer more family-friendly ways of working (e.g. teleworking) (Kodama, Javorcik and Abe, 2018[14]; Tang, 2017[15]).

- **Socio-economic development of the host country:** The characteristics of the host country, such as the structure of its economy, endowment of natural resources, comparative advantage, level of specialisation, explain the types of FDI attracted. Different types of FDI, in turn, are likely to have differentiated impacts on gender outcomes in the local economy. Social and cultural norms also play a crucial role as they influence women and men's roles in society and at work and affects women's decisions, aspirations and opportunities in relation to job opportunities.

An extensive review of the literature about the channels and non-policy determinants of gender-specific FDI impacts is discussed in Montinari and Wermelinger (2020[16]). Annex 4.A provides detailed questions for governments to self-assess the impact of FDI on gender equality.

**The impact of FDI on gender equality varies greatly**

FDI has varying effects on the employment and wage dimensions of gender equality. For example, in less developed countries, FDI in labour-intensive industries (e.g. clothing, electronics, toys, tourism) generates significant employment for women. However, these are generally low-skilled and low-paying jobs and offer limited career prospects (UNCTAD, 2014[17]; Chen and Carr, 2004[18]). In countries with a more advanced industrial structure, the inverse relationship tends to be observed: FDI is directed towards more productive and technology-intensive sectors (Benfratello and Sembenelli, 2006[19]; Criscuolo and Martin, 2003[20]), which on average have smaller shares of women, but with jobs that are on average well paid, and with a smaller wage gap compared to men (OECD, 2019[21]) (Figure 4.2).
Figure 4.2. Contribution of FDI to gender equality in wages and employment

Note: See OECD (2019[21]) for a description of the methodology and data.
Source: OECD based on Financial Times’ fDi Markets database, ILO and UN National Accounts

There is limited evidence on the contribution of FDI to non-wage working conditions of women 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, 2004[22]; Ver Beek, 2001[23]). On the other hand, other studies indicate that women working for MNEs are more likely to have precarious contracts than their male co-workers (Chen and Carr, 2004[18]; Ghosh, 2002[24]). Regarding practices that empower women in the workplace and allow them to grow professionally, evidence for some countries indicate that foreign firms offer better opportunities for career advancement than domestic firms, as evidenced by their higher shares of women in top-management positions (Kodama, Javorcik and Abe, 2018[14]; Olcott, 2014[25]; Ono, 2004[26]). Yet, even if employed by foreign MNEs, women are not immune to the discriminatory barriers that prevent them from advancing in their professional career. Women remain largely under-represented in the top management and boards of MNEs (UNCTAD, 2020[27]).

Corporate culture is a key factor governing the gender employment practices of MNEs, and is strongly influenced by the values and norms in place in the country of origin. Affiliates of MNEs from more gender-equal countries tend to be 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, Javorcik and Abe, 2018[14]; Tang, 2017[15]). With respect to entrepreneurship, some evidence points to a negative competition effect of foreign firms on women-owned businesses, possibly due to the fact that women-owned businesses tend to be smaller and less productive than men-owned businesses (OECD, 2017[2]). At the same time, the FDI Qualities Indicators show that, in countries with a less developed industrial structure, FDI tends to prevail in sectors with larger shares of businesses owned by women. These are typically female-dominated industries, which are labour-intensive and low-skilled (e.g. garment) (OECD, 2019[21]).

Economic and other disruptions can further affect the impact of FDI on gender equality, as the recent COVID-19 pandemic and related economic crisis has shown. Measures introduced by governments to contain the pandemic have generated significant disruptions in MNE activities and their value chains, and has put employment of women at risk, particularly in sectors where women are over-represented such as
healthcare, tourism, accommodation, but also in 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. Similar disruptions in MNE activities could also be caused by environmental disasters (e.g. floods, wild fires) and other events (e.g. economic and financial crisis).

4.3. Policies that influence FDI impacts on gender equality

Policies that influence the impact of FDI on gender equality pertain to different areas, from investment to labour markets, small and medium sized enterprises (SMEs), entrepreneurship and human resource development. This Policy Toolkit aims to provide a comprehensive policy framework for countries to maximise positive impacts of FDI on gender equality. It builds on existing OECD instruments related to investment and gender equality, notably the Policy Framework for Investment, the Guidelines for Multinational Enterprises, and the Council Recommendations on Gender Equality in Education, Employment and Entrepreneurship, and on Gender Equality in Public Life. It complements these instruments by offering a comprehensive mapping of policies and institutional settings that influence the impacts of FDI on gender equality across selected OECD and developing countries (Chapter 1). The Policy Toolkit is structured around four principles and the policy instruments that support these principles (Figure 4.3). It provides detailed questions for governments to self-assess policies influencing the impacts of FDI on gender equality, while Annex 4.C classifies policy instruments by policy area.

**Figure 4.3. Overview of FDI Qualities Policy Toolkit for enhancing FDI impact on gender equality**

<table>
<thead>
<tr>
<th>Principle 1: Provide coherent strategic direction on investment and gender equality and ensure policy coordination and effective implementation</th>
<th>Governance</th>
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</thead>
<tbody>
<tr>
<td>National strategies and plans on gender equality</td>
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<tr>
<td>Policy coherence and coordination</td>
<td></td>
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<tr>
<td>Gender impact assessment and data collection</td>
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</tbody>
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<table>
<thead>
<tr>
<th>Principle 2: Ensure that domestic regulation is aligned with international standards and supports the positive impact of FDI on gender equality</th>
<th>International agreements &amp; standards</th>
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<tbody>
<tr>
<td>International agreements promoting gender equality</td>
<td></td>
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<tr>
<td>OECD Guidelines for MNEs and sectoral Guidance for RBC</td>
<td></td>
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<tr>
<td>Gender provisions in RTAs and BITs</td>
<td></td>
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</tbody>
</table>

| Domestic regulation |
| Regulatory restrictions on FDI and trade in female-dominated sectors |
| Labour market regulations, social protection, labour income taxation |
| Regulatory barriers to women entrepreneurship |
| Education and health care systems |

<table>
<thead>
<tr>
<th>Principles 3: Stimulate investment, particularly international investment, that promotes gender equality, and strengthen the capacities of female entrepreneurs and the skills of female workers</th>
<th>Financial and technical support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment incentives to attract FDI in female-dominated sectors and to promote gender equality</td>
<td></td>
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<tr>
<td>Financial and technical assistance to women entrepreneurs</td>
<td></td>
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<tr>
<td>Training and skills development programmes for women</td>
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</tbody>
</table>

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<tr>
<th>Principle 4: Eliminate information barriers and gender stereotypes that penalise women in the labour market; and provide social support services to enable women to work</th>
<th>Information &amp; facilitation services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information services and matchmaking programmes to link women entrepreneurs with foreign MNEs</td>
<td></td>
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<tr>
<td>Public information campaigns to eliminate gender stereotypes</td>
<td></td>
</tr>
<tr>
<td>Social support services (e.g. childcare services, safe transport)</td>
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</table>
Providing coherent strategic direction on investment and gender equality and ensuring policy coordination and effective implementation

Aligning strategic objectives in the areas of investment, particularly international investment, gender equality, labour market, entrepreneurship/SMEs and human resources development

Policy priorities and objectives in the area of investment and gender equality can vary considerably depending on a country's stage of socio-economic development. At the same time, the institutional framework governing the policy areas of investment and gender equality may also differ from country to country. For example, some countries may have a more centralised policy system, while others may give more power and responsibility to sub-national levels of government. Regardless of the institutional set-up, it is important that different institutions and levels of government have clear responsibilities and that their actions are aligned. National strategies and plans are an important tool for ensuring policy coherence between relevant institutions, as they can help identify potential trade-offs between different strategic development objectives and encourage coordinated policy responses between the actors involved. The alignment of national strategies and plans implies that they are made available to all stakeholders, including international donors, and that they are regularly updated.

Maximising the impact of FDI on gender equality requires coherence between policy objectives and actions in several policy areas, including investment, gender equality, labour markets, entrepreneurship and SMEs, and human resource development. Establishing a comprehensive policy framework for investment promotion with a clear link to sustainable development goals, including in the area of gender equality, is important to raise awareness of the impact of FDI and sustainable development and to encourage targeted and coordinated policy actions. This would ensure that attracting FDI to specific sectors or regions does not exacerbate existing gender inequalities, but rather supports gender equality goals. At the same time, gender equality priorities, as well as the actors and budget needed to achieve them, should be clearly defined in the national gender equality strategy. The 2015 OECD Recommendation on Gender Equality in Public Life provides guidelines for the development of an effective gender equality strategy. According to the guidelines, the gender equality strategy should follow a whole-of-government approach to ensure coordination and coherence between relevant actors and gender initiatives.

Promoting policy coordination among relevant actors

The governance framework for gender and investment policies can vary considerably from one country to another. Especially in developed countries, gender policies are highly integrated into the activities of all government ministries and agencies, which ensures a more comprehensive approach. In less developed countries, which rely more on private investment, there is often more limited government intervention and gender equality initiatives depend largely on dedicated ministries and institutions supporting women and gender equality, including private actors and the donor community. Nonetheless, institutional arrangements and programmes can change significantly even among countries with similar levels of development and gender equality performance (Box 4.2). Improving policy coherence and coordination among actors responsible for gender and investment policies, as well as other relevant policies, is key to improving the impact of FDI. Coordination mechanisms can take different forms, from gender focal points in relevant ministries and agencies to inter-ministerial committees. In countries that have adhered to the OECD Guidelines, an important role can be played by the National Contact Point for Responsible Business Conduct (NCP for RBC), which provides an important link between investment and other sustainable development areas, including gender equality.
Conducting systematic gender impact assessments of investment and relevant policies; and collecting data disaggregated by gender

Determining the impact of FDI on gender equality outcomes is important to identify areas where policy intervention might be most needed. The first part of this chapter provides a conceptual framework for analysing the impact of FDI on gender equality by identifying the main transmission channels. Moreover, Annex 4.A offers a set of questions and indicators that can guide policy-makers in assessing the link between FDI and gender equality in their country. In addition to evaluating the impact of FDI on gender equality, assessing the impact of policies, including investment policies, on gender equality is important for...
improving policy design and implementation. On the one hand, this helps to ensure that policies are effective in promoting gender equality. On the other hand, policy evaluation helps prevent unintended negative impacts of policies on women more generally.

Gender impact assessment, however, is not possible without adequate data. The FDI Qualities Indicators (OECD, 2019[21]) are an important effort insofar as they shed light on the link between FDI and gender equality in the labour market and allow for comparative analysis across countries and over time. In an effort to improve the measurement of gender impacts and policies, the government should also prioritise the collection of timely and internationally comparable data and indicators disaggregated by gender in areas such as investment, entrepreneurship and SMEs, labour markets and human resource development. The use of quantitative methodologies (e.g. analysis of data collected through surveys) should be accompanied by the use of qualitative tools (e.g. interviews or consultations). For example, consultations with foreign investors can help to improve the completeness and reliability of the data collected. In addition, collaboration between institutions responsible for investment promotion, gender equality, labour markets, entrepreneurship and SMEs, including the department of statistics, can facilitate the exchange of information, experience and expertise.

**Ensuring that domestic regulation is aligned with international standards and supports the positive impact of FDI on gender equality**

*Joining and implementing major international agreements on gender equality*

Gender equality and non-discrimination based on sex are fundamental rights enshrined in numerous international human rights instruments (Table 4.1). Although not all of these agreements are legally binding, they are important insofar as they contribute to the integration of gender equality principles into national law. The UN Charter of 1945 is the first international instrument binding on signatory countries to establish the principle of equality between men and women. Since then, numerous international instruments have promoted women's rights. After the UN Charter, an important milestone is the UN Convention on the Elimination of All Forms of Discrimination against Women (CEDAW) in 1979. The CEDAW Convention defines gender discrimination for the first time and provides the basis for achieving gender equality in many areas. Countries that have ratified the convention are legally bound by its provisions and must report regularly on the measures they take. Other key treaties are the Beijing Declaration and Platform for Action, adopted in 1995, and a number of ILO conventions dealing with gender-specific issues such as the Equal Remuneration Convention, the Discrimination (Employment and Occupation) Convention, the Workers with Family Responsibilities Convention and the Maternity Protection Convention. The adoption of the 2030 Agenda for Sustainable Development and the 17 Sustainable Development Goals (SDGs) by UN members in 2015 is another important step towards achieving gender equality. Gender equality and women's empowerment are reflected in SDG 5 and integrated into many of the other SDGs (e.g. good health and well-being, quality education, decent work and economic growth). Although the 2030 Agenda for Sustainable Development is not in itself a legally binding international agreement, it has the merit of having increased the transparency and measurability of countries' efforts in the area of gender equality. Companies operating in countries adhering to and implementing these international agreements must take these standards into account in their operations.
Table 4.1. Major international agreements on women’s human rights and gender equality

<table>
<thead>
<tr>
<th>International agreement</th>
<th>Year</th>
<th>Legally binding on signatory countries</th>
<th>Number of countries that have joined</th>
</tr>
</thead>
<tbody>
<tr>
<td>UN Charter</td>
<td>1945</td>
<td>yes</td>
<td>193</td>
</tr>
<tr>
<td>UN Convention on the Elimination of All Forms of Discrimination against Women (CEDAW)</td>
<td>1979</td>
<td>yes</td>
<td>189</td>
</tr>
<tr>
<td>Beijing Declaration and Platform for Action</td>
<td>1995</td>
<td>no</td>
<td>189</td>
</tr>
<tr>
<td>ILO’s Equal Remuneration Convention (n100)</td>
<td>1951</td>
<td>yes</td>
<td>173</td>
</tr>
<tr>
<td>ILO’s Discrimination (Employment and Occupation) Convention (n 111)</td>
<td>1958</td>
<td>yes</td>
<td>175</td>
</tr>
<tr>
<td>ILO’s Workers with Family Responsibilities Convention (n 156)</td>
<td>1981</td>
<td>yes</td>
<td>44</td>
</tr>
<tr>
<td>ILO’s Maternity Protection Convention (n 183)</td>
<td>2000</td>
<td>yes</td>
<td>38</td>
</tr>
<tr>
<td>2030 Agenda for Sustainable Development and the 17 Sustainable Development Goals</td>
<td>2012</td>
<td>no</td>
<td>193</td>
</tr>
<tr>
<td>Buenos Aires Declaration on Women and Trade</td>
<td>2017</td>
<td>no</td>
<td>118</td>
</tr>
</tbody>
</table>

Source: OECD elaboration

Adhering to the OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises are recommendations made by governments to companies to prevent and address the negative impacts of business operations on the economy, society, and the environment (OECD, 2011[29]). The Guidelines are not legally binding on companies, but they are legally binding on signatory governments, which are required to ensure that the Guidelines are implemented and observed. Coverage of gender issues in the Guidelines is limited though (Box 4.3). Only Chapter V on "Employment and Industrial Relations" contains an explicit reference to gender, particularly to the principle of equal treatment in employment and non-discrimination on the grounds of sex. Other explicit references can be found in the commentaries of Chapters V and IV on "Human Rights". The OECD Due Diligence Guidance for Responsible Business Conduct (RBC) (OECD, 2018[30]) and Sectoral Guidance provide additional tools to help companies identify and address potential negative impacts on women in their operations and value chains. Other multilateral instruments that promote responsible business practices contain references to gender equality, such as the ILO Tripartite Declaration of Principles on Multinational Enterprises (ILO, 2017[31]) and the United Nations Norms on the Responsibilities of Transnational Corporations. Like the OECD Guidelines for MNEs, these instruments do not impose any legal obligations on companies.
Mainstreaming gender in international trade and investment agreements

The inclusion of gender provisions in regional trade agreements (RTAs) and bilateral investment treaties (BITs) has increasingly been seen as a means to make trade and investment more gender inclusive. Currently, 80 out of 350 regional trade agreements, 69 of which are in force and notified to the WTO, contain specific gender provisions. While gender provisions have evolved over time, they remain general in nature. Korinek, Moïsé and Tange (2021[32]) classifies them into three main categories, ordered from most to least ambitious: (i) provisions that reaffirm parties’ existing commitments to gender equality; (ii) “safeguard” provisions designed to ensure that the RTA will not adversely affect gender equality; and (iii) provisions that actively promote gender equality and women’s economic empowerment by incorporating gender-sensitive policies or cooperation on gender equality issues between countries. The provisions in these three categories rarely contain binding obligations.

Mechanisms to implement gender provisions are also important, e.g. budgetary commitments for implementation or provisions for consequences of non-compliance. Presently, 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[33]). An interesting example 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, Moïsé and Tange, 2021[32]). Gender provisions in bilateral investment treaties (BITs) are scarce and rarely impose concrete obligations on investors (Dubin, 2018[34]). One notable exception is provided by the 2019 model BIT of the Netherlands, 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.

Box 4.3. Gender issues in the OECD Guidelines for MNEs

Two chapters of the OECD Guidelines for MNEs are more closely related to gender issues: 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. The OECD Due Diligence Guidance helps companies to become aware of actual and potential risks across GVCs 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 on women 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 Garment and Footwear Sector" explains how companies along these value chains can identify and address gender-specific risks, such as sexual harassment and discrimination. Similarly, the OECD-FAO Due Diligence Guidance for Responsible Agricultural Supply Chains integrates gender as a cross-cutting theme in supply chain due diligence to support companies in taking a proactive and systematic approach to risk management while ensuring that actions do not undermine gender equality.
Eliminating regulatory restrictions on FDI and trade in sectors that employ or have the potential to employ many women

Restrictions on FDI inflows can take different forms. Some restrictions directly affect FDI flows, such as limits on foreign ownership, a screening and approval process, and constraints on foreign personnel. These restrictions tend to be justified by national policy objectives, such as the desire to protect domestic firms and workers from foreign competition. Other impediments stem from national policies regulating product and labour markets (e.g. competition policy), intellectual property rights, infrastructure, state-owned enterprises (SOEs), and public procurement and tend to have a negative impact not only on foreign but also on domestic firms.

These restrictions and barriers increase uncertainty for investors and may divert investment to less risky locations, and thus undermine the potential benefits associated with FDI, such as job creation, productivity spillovers and the transfer of skills and technology (Chapters 2 and 3). These restrictions also have implications on gender equality when they affect sectors where many women work or have the potential to work (e.g. services sectors). Trade restrictions both at the border (e.g. tariffs and quotas) and behind the border (e.g. technical and sanitary barriers, migration barriers) also reduce the expected returns on investment projects and limit the positive spillover effects of FDI on women, especially when they concern female-dominated sectors. Furthermore, trade barriers tend to have a negative impact especially on women-owned/led businesses due to their more limited financial, managerial and time resources (Korinek, Moïsé and Tange, 2021[32]).

Ensuring that domestic regulation supports the creation of good quality jobs for women by foreign MNEs

Foreign MNEs can create employment opportunities for women in host countries, both within their affiliates and in domestic companies through supply chain relationships. The ‘quality’ of these jobs, as well as the ability of women to take advantage of these opportunities, is influenced by domestic regulation related to employment (e.g. minimum wage, employment protection, Chapter 3), social protection (e.g. length of maternity leave), the workplace (e.g. sexual harassment law, flexible working arrangements), and taxation of labour income (e.g. taxation of secondary workers). Employment and social protection policies are found to be more impactful in countries with less advanced legal and regulatory frameworks and tend to be more effective when negotiated with trade unions and workers' representatives (Chapter 3). On the other hand, policies that address gender inequalities in the workplace, such as policies in favour of teleworking, are found to be more effective in developed countries (IMF, 2018[35]).

While labour market regulations are important for setting minimum standards and protecting women from gender discrimination and life cycle risks, they can also perpetuate patterns of gender inequality. For example, regulations prohibiting women from working in certain sectors, which are not imposed on men, can reinforce gender inequality gaps. Similarly, taxation of labour income that disproportionately penalises secondary income earners, who are often women, is likely to discourage female labour participation. These regulatory barriers are likely to prevent women from benefiting from the employment opportunities created by foreign multinationals or to make such opportunities more attractive to men than to women.

Removing regulatory barriers that prevent women entrepreneurs from taking advantage of the business opportunities created by FDI

FDI can have a beneficial effect on local women’s entrepreneurship. For example, linkages with foreign MNEs can help women-owned enterprises become more productive and expand their business in domestic and international markets (Chapter 2). Regulatory barriers, however, can hold back women entrepreneurs and reduce their ability to profit from the presence of foreign MNEs. Regulatory procedures such as business registration and licensing, worker registration, and reporting requirements can be more
burdensome for women entrepreneurs, especially when they are complex and non-transparent. This is
due to the fact that female entrepreneurs tend to have fewer resources, time and skills to deal with these
complex procedures than male entrepreneurs (OECD/European Union, 2019[11]).

In addition, in some countries, regulations and laws may explicitly prevent women from registering a
business, signing contracts, owning a bank account and using formal credit services. In several countries,
women also face discrimination in relation to property and inheritance rights (World Bank, 2021[36]). This
makes starting and running a business even more difficult, as property can be sold and used as collateral
for loans that finance the start-up and growth of the business. Furthermore, if women do not have equal
inheritance rights, they are less able than men to accumulate property and wealth that could be used for
the enterprise.

Improving women’s access to quality education and health systems

A well-educated and productive female workforce is an important prerequisite for improving the impact of
FDI on gender equality. It can attract technology-intensive FDI, which creates better jobs for women. In
countries with a comparative advantage in low-value-added production, it can help women move to
alternative or better job opportunities when technology improves and wages rise. In some developing
countries, women do not have the same access to education as men. Even in advanced countries,
stereotypes about gender roles underlie inequalities between girls and boys in performance and career
choices (OECD, 2018[37]).

The 2013 OECD Council Recommendation on Gender Equality in Education, Employment and
Entrepreneurship provides principles for a gender-equal education system (OECD, 2017[38]). These include
ensuring equal access to quality education for both boys and girls, eliminating gender discrimination and
stereotypes in curricula and teaching practices, making science, technology, engineering and mathematics
(STEM) subjects as well as financial and entrepreneurial issues more attractive to girls, and raising
awareness among parents and teachers about gender stereotypical attitudes on school performance. In
some countries, women also have limited access to health services due to their more precarious economic
status and various cultural and social barriers. This can have a negative impact on their health and further
hinder their participation in the labour market (OECD, 2017[3]). A universally accessible health care system
is an important condition for developing a productive workforce and enabling women to benefit from
economic prospects brought by FDI.

Stimulating investment, particularly international investment, that promotes gender
equality, and strengthening the capacities of female entrepreneurs and the skills of
female workers

Designing investment incentive systems that promote gender equality

Fiscal and financial investment incentives can support gender equality objectives. Incentives used by
countries to attract FDI in specific sectors can boost women’s employment and wages when used in
sectors that employ many women. Fiscal and financial incentives can also be used to directly promote
gender equality goals. For example, tax exemptions can be given to companies that encourage the hiring
of women or their training, or that provide services such as childcare. Similarly, subsidies and grants can
be given to companies to help offset the higher costs companies may face in hiring, promoting and training
women. Currently, the use of incentives to promote gender inclusive practices in the workplace remains
limited (Kronfol, Nichols and Thu Tran, 2019[39]). An interesting example is Jordan, which provides
incentives to companies that hire a certain percentage of women in specific sectors (Box 4.4).

Incentives, however, have distorting effects as they can divert resources from more efficient to less efficient
activities and entail an economic cost both in terms of expenditure in the case of financial incentives and
in terms of lost revenue in the case of tax incentives (OECD, 2021[40]). The use of investment incentives may therefore reduce the fiscal space for other policies that are important for achieving gender equality. For this reason, it is important that investment incentive schemes are designed in a transparent way and regularly assessed.

**Box 4.4. Investment incentives and gender equality in Jordan**

There are several investment incentives in Jordan that can have a positive effect on gender equality, including a direct tax incentive for employing Jordanian women, as well as incentives in special economic zones (SEZs) and satellite production units that employ many women:

- **Corporate tax incentive to hire women**: In 2020, the Government of Jordan adopted Regulation No. 18, introducing corporate income tax (CITs) incentives. According to this regulation, companies receive a CIT reduction if the share of Jordanian women and workers with disabilities is not less than 15% of the total workforce, with the exception of companies in the textile and garment sector that are located in QIZs, for which the share must not be less than 25%. Although this is a low percentage, it is a rare example of a corporate tax incentive directly linked to the achievement of a gender equality objective. The tax incentive, however, discriminates against foreign women, who represent an important share of workers especially in industries such as textiles and clothing.

- **Investment incentives in SEZs**: Jordan has numerous SEZs that enjoy investment incentives, including a series of exemptions from income tax, export taxes and customs duties. These incentives have attracted many foreign companies since the 1990s. As many of these zones are dominated by female-intensive sectors, especially textiles and garments (73% women in 2021), these incentives have significant potential to boost local women’s employment and wages.

- **Investment incentives in satellite production units**: As of 2017, incentives for satellite production units, outside the defined SEZs, have also encouraged the integration of women into the workforce. Satellite production units, created to stimulate female employment in rural areas, provide a range of incentives to companies in terms of land, rent exemptions and subsidised wages, transport, social security and utilities for companies. Currently about 85% of the workforce in satellite units are women.

*Sources: OECD (2021[28]), OECD (2021[41])*

**Providing financial and technical assistance to women entrepreneurs**

Due to various economic, social and cultural barriers, including the fact that women spend more time than men on family care and domestic work, women entrepreneurs tend to have fewer entrepreneurial and managerial skills and have more difficulty accessing formal credit than male entrepreneurs (OECD/European Union, 2019[11]). Lack of skills and capital can affect the capacity of women entrepreneurs to develop linkages with foreign firms and benefit from related technology and productivity spillovers. The 2013 OECD Council Recommendation on Gender Equality in Education, Employment and Entrepreneurship encourages countries to design policy instruments to help female entrepreneurs overcome barriers related to lack of skills and credit (OECD, 2017[38]). Financial support can take the form of soft loans or microcredit, or tax benefits. Technical support can help women entrepreneurs strengthen their skills and grow their business. This can include training programmes to develop skills in business, management and digitisation, professional advice on legal and tax issues and other business development services.
Offering training and skills development programmes to female workers

Skills development and upgrading is key to increasing women’s employability and career prospects, including within foreign companies. This is particularly important for women at the bottom of the productivity ladder and those re-entering the workforce. Especially in developing countries, investing in women’s skills minimises the risk of women remaining in low-skilled jobs or moving into informal employment when wages rise (Braunstein, 2009[42]). In addition to ensuring equal access to a quality education system, governments can support women’s skills development through training programmes that take into account the needs of domestic and foreign companies (Chapters 2 and 3). These programmes can be organised in collaboration with companies, training centres or universities. Governments can also provide incentives to companies to train their female employees, for example through training grants. Offering training incentives to companies may be preferable when they have a better understanding of the skills that are lacking in the local labour market. In addition, governments can also provide certification and qualification programmes to help women obtain a standardised accreditation that they can use to signal their skills to companies (Kronfol, Nichols and Thu Tran, 2019[39]).

Eliminating information barriers and gender stereotypes that penalise women in the labour market; and providing social support services to enable women to work

Helping women entrepreneurs overcome information barriers and develop linkages with foreign MNEs

Women entrepreneurs have more limited access to information due to a lack of time and resources and their smaller professional networks (OECD, 2017[2]). In addition, gender stereotypes can influence potential business partners and investors’ perceptions (Kronfol, Nichols and Thu Tran, 2019[39]). These information asymmetries hold back women entrepreneurs and can hinder the development of business linkages with foreign firms.

Several information and facilitation measures can help women entrepreneurs overcome these information barriers. For example, programmes such as mentoring, coaching or trade fairs and events aimed primarily at women-owned businesses can help women entrepreneurs acquire relevant information about their business and expand their professional network. Matchmaking events, supplier diversity programmes and supplier databases identifying women-owned enterprises can enable women entrepreneurs to connect with potential business partners and investors (Box 4.5). In addition, especially in developing countries, women entrepreneurs tend to have limited access to the internet and digital platforms (OECD/European Union, 2019[11]). Improving women’s access to affordable digital technologies, particularly mobile technology, could help them more easily obtain information and develop business connections.
Women in host countries may not be able to benefit from the job opportunities generated by foreign MNEs due to various social and cultural barriers. Social norms shape the acceptable roles for women and men in society and influence women's aspirations and opportunities. In most developed and developing countries, men are still seen as breadwinners, while unpaid care work is considered a women's prerogative (OECD, 2017). Even at school age, girls have different aspirations from boys and show less interest in some professional careers (e.g. STEM) (Mostafa, 2019). These gender stereotypes are at the root of patterns of gender inequality in the labour market, e.g. the fact that women tend to be concentrated in low-value-added sectors (e.g. labour intensive manufacturing, education, health, social services) and in part-time jobs. Because of these social barriers, women may not be able to take advantage of job opportunities brought by foreign multinationals. Transforming these social gender norms is therefore key to increasing female labour force participation and maximising the positive impact of FDI on employment. This can be achieved through public information and awareness-raising campaigns that aim to change traditional gender roles and patterns in society and at work. In schools, programmes targeting female students and their teachers can eliminate differences in approaches to learning and teaching. For example, mentoring programmes can help girls expand their networks, influence their career aspirations and raise awareness of different educational and professional careers.
Providing good quality social support services to enable women to work

The provision of public social support services such as childcare, elderly care and transport are crucial to enable women to benefit from the employment opportunities created by foreign MNEs. The opportunity cost of entering the labour market is higher for women than for men. This is due to an unequal distribution of unpaid care responsibilities between men and women (OECD, 2017[2]). The disproportionate share of care work for which women are responsible has a negative impact on their labour force participation and affects the types of job opportunities available to them (e.g. more women work part-time than men) (OECD, 2019[5]). The provision of public childcare and elderly care services is therefore important for increasing women’s labour force participation. The ability of women to travel to work by safe and affordable means of transport is also an important factor influencing their decision to work and the quality of employment opportunities available to them (Livingston, 2004[44]; UNACTD, 2014[17]).

References


Braunstein, E. (2009), Making policy work for women: gender, foreign direct investment and development.[42]


IMF (2018), *Pursuing Women’s Economic Empowerment*,

Javorcik, B. (2020), “Global supply chains will not be the same in the post-COVID-19 world”,


OECD (2021), *FDI Qualities Assessment: Improving the sustainable development impacts of investment in Jordan (draft for consultation)*.

OECD (2021), *FDI Qualities Policy Mapping (database)*.


Annex 4.A. Core questions to assess the impact of FDI on gender equality

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Policy questions</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gender equality in the labour market</strong></td>
<td>What is the gender employment gap in the country? How does it vary across sectors? Has it increased (or decreased) over time?</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? Has it increased (or decreased) over time?</td>
<td>OECD’s Employment Outlook Equal Pay Legal Database - EPIC</td>
</tr>
<tr>
<td></td>
<td>How many women reach the top levels of management in private and public companies? Is this share increased (or decreased) over time?</td>
<td>OECD’s Employment Outlook</td>
</tr>
<tr>
<td></td>
<td>What is the share of women-owned/led businesses and how it varies across sectors? Has this share increased (or decreased) over time?</td>
<td>OECD Entrepreneurship Database Global Entrepreneurship Monitor</td>
</tr>
<tr>
<td></td>
<td>What is the level of discrimination against women in social institutions (formal and informal laws, social norms, and practices)?</td>
<td>OECD SIGI</td>
</tr>
<tr>
<td><strong>Structure of the economy</strong></td>
<td>In which sectors and value chains do women work? Have these changed over time?</td>
<td>ILO’s databases on labour market statistics</td>
</tr>
<tr>
<td></td>
<td>In which sectors and value chains are women-owned/led businesses concentrated? Have these changed over time?</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? How has this changed over time?</td>
<td>UN Comtrade Database</td>
</tr>
<tr>
<td><strong>FDI characteristics</strong></td>
<td>Is FDI concentrated in sectors that employ many women?</td>
<td>OECD FDI Qualities Indicators</td>
</tr>
<tr>
<td></td>
<td>How has the gender employment/wage gap shifted, if at all, in sectors that have seen FDI growth?</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 OECD Development Centre</td>
</tr>
<tr>
<td><strong>FDI transmission channels</strong></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 database)</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>
## Annex 4.B. Core questions to assess policies influencing the impact of FDI on gender equality

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Instrument</th>
<th>Policy questions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Governance</strong></td>
<td>National strategies and plans</td>
<td>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?</td>
</tr>
<tr>
<td></td>
<td>Policy coherence and coordination</td>
<td>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?</td>
</tr>
<tr>
<td></td>
<td>Gender impact assessment and collection of data</td>
<td>Do relevant institutions systematically undertake gender impact assessment of their policies and programmes? Do institutions regularly collect gender-disaggregated data in areas such investment/FDI, labour market, SMEs/entrepreneurship and human resource development?</td>
</tr>
<tr>
<td><strong>International agreements</strong></td>
<td>International standards on gender equality</td>
<td>Has the country ratified major international instruments promoting gender equality (e.g. CEDAW)? Has the country placed reservations on specific articles?</td>
</tr>
<tr>
<td></td>
<td>OECD Guidelines on MNEs and Sectoral Guidance on RBC</td>
<td>Has the country adhered to the OECD Guidelines for MNEs and to any of the OECD Due Diligence Guidance for RBCs? Does the country allocate sufficient resources to the National Contact Point for RBC?</td>
</tr>
<tr>
<td></td>
<td>RTAs and BITs</td>
<td>Is the country party of RTAs or BITs that incorporate gender provisions? How strong are the mechanisms to enforce these provisions? Is market access granted in partner countries in sectors where women work and own businesses?</td>
</tr>
<tr>
<td><strong>Regulation</strong></td>
<td>FDI and trade openness</td>
<td>Are there restrictions on FDI and trade in sectors that employ or have the potential to employ many women?</td>
</tr>
<tr>
<td></td>
<td>Labour market regulations</td>
<td>Does the country have a law on minimum wage? Does the country have a law demanding equal pay between women and men? Does the country have a well-designed and implemented social protection system that addresses women’s specific life-cycle transitions and risks (e.g. maternity paid leave of at least 14 weeks)? Are there restrictions for women to work in certain jobs and/or sectors? Is there a legislation on sexual harassment in employment? Does the country have gender-neutral labour income taxation?</td>
</tr>
<tr>
<td></td>
<td>Regulatory barriers to women entrepreneurship</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? Can a woman inherit property in the same way as a man?</td>
</tr>
<tr>
<td></td>
<td>Education and health care systems</td>
<td>Is there universal access to education and health care in the country? Does the education system provide equal opportunities for girls and boys (e.g. what is the share of girls in STEM subjects)?</td>
</tr>
<tr>
<td><strong>Financial &amp; technical support</strong></td>
<td>Investment incentives</td>
<td>Are there investment incentives in sectors where many women work? Are there incentives for companies that promote gender-inclusive business practices (e.g. tax incentives to hire women; wage/training subsidies for women)?</td>
</tr>
<tr>
<td></td>
<td>Financial and technical support to women entrepreneurs</td>
<td>Are there financial programmes to support women entrepreneurs (e.g. soft loans, microcredit, tax incentives)? Are there training programmes and business support services (e.g. advice on legal and tax issues) for women entrepreneurs?</td>
</tr>
<tr>
<td></td>
<td>Training and skills development programmes for women workers</td>
<td>Are there skill development programmes and/or certification and qualification programmes targeting women? Are they organised in collaboration with foreign MNEs?</td>
</tr>
<tr>
<td>Information &amp; facilitation services</td>
<td>Information and facilitation services for women entrepreneurs</td>
<td>Are there programmes to help women overcome information barriers and link to foreign MNEs (e.g. matchmaking events, supplier diversity programmes)?</td>
</tr>
<tr>
<td>Initatives to eliminate gender bias and stereotypes</td>
<td>Are there initiatives in place to eliminate stereotypes about gender roles (e.g. public information campaign)?</td>
<td></td>
</tr>
<tr>
<td>Social support services</td>
<td>Is safe public transport available to women, particularly in areas where foreign MNEs are located? Are there affordable childcare and elderly care services for families?</td>
<td></td>
</tr>
</tbody>
</table>
### Annex 4.C. Policies for positive FDI impacts on gender equality by policy area

<table>
<thead>
<tr>
<th>Policy area</th>
<th>Policy dimension</th>
<th>Institutions and policies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment policy</strong></td>
<td>FDI/trade openness</td>
<td>Gender equality strategy encompassing all relevant policy areas; Systematic gender impact assessment; Gender provisions in BITs and RTAs; WTO Joint Declaration on Trade and Women's Economic Empowerment</td>
</tr>
<tr>
<td>Investment promotion &amp; facilitation</td>
<td>Business linkages</td>
<td>Tax and financial incentives to attract FDI in female-dominated sectors; Information and facilitation programmes to link women-owned/led businesses to foreign MNEs; OECD MNE Guidelines for MNEs; OECD Due Diligence Sectoral Guidance on RBC;</td>
</tr>
<tr>
<td>Labour market policy</td>
<td>Employment and job quality</td>
<td>Labour market regulation (e.g. minimum wage, employment protection, sexual harassment) Tax and financial incentives to hire and train women; Information services to reduce gender bias in the workplace; ILO Conventions on gender equality; Convention on the Elimination of All Forms of Discrimination against Women (CEDAW); Beijing Declaration and Platform for Action; 2030 Sustainable Development Goal Agenda (SDG 5: Achieve</td>
</tr>
<tr>
<td></td>
<td>Social protection</td>
<td>Affordable quality childcare and elderly care services</td>
</tr>
<tr>
<td></td>
<td>Taxes on labour income</td>
<td>Labour income taxes that affect male and female labour demand</td>
</tr>
<tr>
<td>Private sector development</td>
<td>Transport to work</td>
<td>differently (e.g., taxation on secondary earners);</td>
</tr>
<tr>
<td>---------------------------</td>
<td>------------------</td>
<td>-------------------------------------------------</td>
</tr>
<tr>
<td>Entrepreneurship/SMEs</td>
<td>Safe public transport</td>
<td>Safe public transport</td>
</tr>
<tr>
<td>Property</td>
<td>Regulation affecting women's ability to start and run a business</td>
<td>Tax and financial incentives to support women entrepreneurs; Business development support for women entrepreneurs;</td>
</tr>
<tr>
<td>Human resources development</td>
<td>Education</td>
<td>Regulation on the education system</td>
</tr>
<tr>
<td>Health</td>
<td>Regulation on the health system</td>
<td>Regulation on the health system</td>
</tr>
</tbody>
</table>
This chapter presents a Policy Toolkit to help governments attract foreign direct investment (FDI) that contributes to decarbonisation, both by reducing the emissions associated with foreign investments and inducing low-carbon spillovers to domestic firms. The chapter describes the channels through which FDI affects carbon emissions and the contextual factors determining the magnitude and direction of such impacts. The objective of the Policy Toolkit is to provide an overview of the policy choices that can improve the impacts of FDI on decarbonisation.
Main policy principles

1. Provide strategic direction and promote policy coherence and coordination on investment and climate action.
   - Ensure a coherent, long-term strategic framework to mainstream decarbonisation across economic sectors that is linked to the national vision or goals for growth and development, with clear climate goals (e.g. emissions reductions, renewable energy) that are translated to science-based targets for the private sector.
   - Develop a dedicated strategy that articulates the government’s vision on the contribution of investment, including foreign direct investment, to decarbonisation. The strategy sets the goals, identifies priority policy actions and clarifies responsibilities of institutions and co-ordinating bodies.
   - Strengthen coordination both at strategic and implementing levels by establishing appropriate coordinating bodies or by considering to expand the mandate and composition of existing ones, such as boards of investment promotion agencies and higher councils for green growth.
   - Encourage public consultations and stakeholder engagement to receive feedback and build consensus around policy reforms and programmes to decarbonise investments.
   - Design and implement effective monitoring and evaluation frameworks to assess the impact of FDI and related policies on decarbonisation, and to identify bottlenecks in policy implementation, including strategic environmental assessment (SEA) and environmental impact assessment (EIA) systems. Build capacity at national and subnational levels to review environmental assessments, reduce delays in the process, and improve transparency and information systems supporting the review process.

2. Ensure that domestic and international investment regulations are aligned with and reinforce national climate objectives.
   - Ensure that international investment and trade agreements reinforce climate objectives and allow for sufficient domestic policy space to achieve these objectives.
   - Endeavour to join major international agreements and conventions promoting decarbonisation and set domestic environmental standards for investments (e.g. on emissions, fuel economy, appliances) that are aligned with climate objectives and that support climate-friendly business conduct.
   - Develop laws and regulations that level the playing field for climate-friendly investment, including by ensuring an open and non-discriminatory environment for foreign investors in low-carbon technologies, strengthening competition in electricity markets, and ensuring intellectual property protection for low-carbon innovations.

3. Stimulate investment and build technical capabilities related to low-carbon technologies, services and infrastructure.
   - Phase out subsidies for investments that distort price signals and reduce the competitiveness of low-carbon technologies and consider introducing carbon pricing measures. Address any effects on jobs with appropriate measures to compensate and retrain workers so as to ensure a just transition.
   - Ensure that financial support to stimulate low-carbon investment addresses market failures that reduce the competitiveness of low-carbon investments, and is transparent, time-limited and subjective to regular reviews.
• Use financial and technical support to build domestic low-carbon supply chains and capable low-carbon workforces, and to support the flow of knowledge and technology from foreign to domestic firms.

4. Address information failures and administrative barriers that reduce the competitiveness of low-carbon investments.

• Raise public awareness on climate priorities and individual actions for investors and consumers to reduce carbon footprint.

• Encourage corporate disclosure of carbon emissions embodied in products and services (e.g., carbon labelling), and facilitate reporting of suspected violations of environmental regulations, or risks of violations, related to their business operations.

• Tailor investment promotion activities and tools raise visibility of low-carbon investment opportunities. Facilitate compliance with environmental permitting. Support foreign investors in identifying domestic suppliers and partners with complementary capabilities. Use IPAs as intermediaries to make policy makers aware of the regulatory needs of low-carbon investors.

5.1. The urgency of reducing CO\(_2\) 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\(\text{[1]}\)). To address these mounting challenges, on 12 December 2015, 190 countries signed the Paris Agreement to combat climate change, pledging to achieve carbon neutrality by 2050 (UNFCCC, 2015\(\text{[2]}\)). This landmark agreement was discussed at the 26th Conference of the Parties (COP26) of the United Nations Framework Convention on Climate Change (UNFCCC) with new impetus and more ambitious pledges to accelerate actions and investments needed for a sustainable low-carbon future.

**Figure 5.1. Global annual CO\(_2\) emissions**

![Graph showing annual CO\(_2\) emissions from 1900 to 2020.](source)

Source: International Energy Agency’s World Energy Statistics
The climate crisis has serious financial repercussions, including disaster-related damage costs that amount to hundreds of billions of dollars, annually (IPCC, 2018[3]); adaptation costs associated with protection and reinforcement; and mitigation costs associated with decarbonisation. Climate change mitigation and adaptation will require an estimated USD 7 trillion per year worth of public and private investments alone to meet global infrastructure development needs and climate objectives through 2030 (OECD, 2017[4]). Of these, USD 4 trillion per year are needed across emerging economies, and USD 1.7 trillion per year in emerging Asia (OECD, 2020[5]). In the wake of the COVID-19 pandemic, government efforts to support economic recovery are essential but should not undermine actions to limit the climate crisis. Stimulus measures and policy responses must be aligned with ambitions on climate change, biodiversity and wider environmental protection (OECD, 2020[6]; OECD, 2020[7]). 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[8]). This chapter focuses on the potential contribution of FDI to climate change mitigation. Box 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. This Policy Toolkit focuses primarily on CO₂ because it is generated by all economic activities, but its implications can be extended to cover other GHGs. 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. Clean energy and renewable energy are used interchangeably for the purpose of this report.


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8 Climate change adaptation will also become increasingly relevant in the discussion on understanding and improving the contribution of FDI to achieving the SDGs in face of the climate crisis, but is not addressed in this Policy Toolkit.
5.2. The impact of FDI on carbon emissions

Evidence stemming from the traditional literature on the trade-FDI-environment nexus 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 (Grossman and Kruger, 1991; Copeland and Taylor, 1994; Porter and van der Linde, 1995). In isolation, the *scale effect* is 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*, which refers to a change in production methods resulting from FDI inflows and the transfer of technology from foreign to domestic firms, is expected to reduce emissions by helping diffuse less emitting technologies (Pazienza, 2015). 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 channels through which FDI influences carbon emissions (Figure 5.2, yellow box). Specifically, FDI generates emissions from production processes, energy use, product end use and product disposal that reflect investor characteristics (e.g. sector, technology, motive). The supply chain relationships that foreign investors forge affect the emissions embodied in the intermediate goods they use, and the emissions generated from the distribution of goods to market. Market interaction with local firms can influence the emissions of domestic business through competition and imitation effects. Similarly, mobility of workers from foreign to domestic firms can influence the business practices and resulting emissions-intensity of domestic firms.

**Figure 5.2. Conceptual framework: FDI impacts on carbon emissions**

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. 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. Resulting benefits for host countries include (Figure 5.2, green box):

- improving energy security, diversifying energy sources, reducing reliance on energy imports and electrifying remote rural areas (SDG7);
- fostering innovation, creating new industries and jobs, and gaining an edge over competitors and attendant export opportunities in key industries (SDG9);
The manner in which FDI affects carbon emissions and the extent to which it can contribute to decarbonisation depend on a number of contextual factors that are the focus of this chapter, including FDI characteristics and spillover potential, socio-economic factors, and the policy environments of home and host countries. Targeted policy interventions can level the playing field for more climate-friendly FDI, and influence spillovers to domestic firms. The next section will look closely at framework conditions and policies that affect the impact of FDI on emissions (Figure 5.2, blue box).

**FDI characteristics and 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, and their corporate cultures and environmental policies. Annex 5.A provides the core questions of the Policy Toolkit for governments to self-assess the impacts of FDI on decarbonisation, including through spillovers.

**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. Broadly speaking, low-carbon technologies reduce CO₂ emissions by (1) reducing energy use (e.g. energy-saving); (2) generating zero carbon emissions from use (e.g. renewable energy, electric vehicles); (3) removing carbon from the atmosphere (e.g. carbon capture); or (4) conserving resources (e.g. recycling).

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, multinational enterprises (MNEs) are key players in the deployment of capital- and R&D-intensive clean energy technologies across borders, accounting for 30% of global new investments in renewable energy (Figure 5.3, Panel A). FDI in the energy sector has also shifted considerably away from fossil fuels and into renewables, particularly in advanced countries, but increasingly also in developing countries (Figure 5.3, Panel B). The contribution of FDI to the energy transition may become increasingly relevant in developing countries, where demand for energy is expected to grow most rapidly in the coming decades.

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), as well as integrating climate action into their risk management processes, business models and supply chains.
Investor attributes

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 (e.g. labour), 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.

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.

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]).

FDI spillovers on carbon emissions

The premise behind FDI spillovers is that multinational firms have access to innovative technologies and operating procedures, which, if applied, could help raise environmental performance overall and induce the broader uptake of low-carbon technologies. The realisation of these spillovers hinges on the transfer of knowledge from foreign to domestic firms, through their market interactions and through the mobility of workers. The spillover potential varies across technology and spillover channels. FDI spillovers on carbon...
emissions are likely to be negative, 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.

The OECD FDI Qualities Indicators, developed using the green economy module of the EBRD-EIB-World Bank Enterprise Surveys, suggest that foreign manufacturing companies outperform domestic peers in terms of green business practices, and indeed have the potential to contribute to greening the business practices of domestic businesses. This potential may be especially large in developing countries. According to the surveys, a minority of manufacturing firms incorporate environmental or climate change issues into their strategic objectives (5-18%), and even fewer employ a manager responsible for environmental issues (4-12%). More substantial shares of companies monitor energy consumption and introduce measures to save energy (20-40%), and over 50% of companies seek measures to control pollution, while still few companies specifically monitor or seek to reduce carbon emissions (0-5%). In general, companies in OECD countries tend to outperform companies in non-OECD countries (Figure 5.4, Panel A), and foreign firms perform at least as well as domestic firms across all environmental dimensions (Figure 5.4, Panel B). The gap between foreign and domestic firms is often wider in non-OECD countries than in OECD countries, particularly when it comes to addressing carbon emissions.

Figure 5.4. Green performance of foreign and domestic firms

A. Share of manufacturing firms that adopt green business practices

B. Foreign firms perform better than domestic firms if value > 0

Note: The OECD and non-OECD averages are based on a subset of countries from Europe, Middle East, North Africa and Central Asia. Source: OECD based on EBRD-EIB-World Bank Enterprise Surveys (2020)
Value chain spillovers

The supply chain decisions of foreign investors influence the emissions embodied in the intermediates they use in production; similarly, their choices of distributors will influence the emissions associated with the delivery of goods to market. In practice, there is evidence that very few firms monitor carbon emissions along their supply chains, even though the practice is more common among foreign firms, suggesting that these emissions are rarely internalised by investors (Figure 5.4). At the same time, the bulk of MNE impacts on emissions originates from their supply chains in many industries. For instance, in the garment industry the supply chains of global leaders in the garment industry account for 70% of emissions in the sector (McKinsey-GFA, 2020[18]). Encouraging foreign investors to engage with sustainable suppliers and partners, both locally and in their foreign operations, can further support emissions reductions objectives.

Moreover, advancing the low-carbon transition and maximising its contribution to employment generation depends on countries’ abilities to build and strengthen domestic supply chains (IRENA, 2013[19]). Linkages with local suppliers and buyers are an important channel of knowledge and technology diffusion. 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, which also helps ensure a just transition (OECD, 2015[20]).

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.

Other spillover 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. As noted previously, foreign multinationals may be particularly successful in catering to end users that are responsive to environmental performance and green branding. As companies compete to serve growing consumer demands for low-carbon products and services, foreign competition can catalyse low-carbon innovation across domestic businesses in their efforts to retain customers or tap into new markets. Thanks to these competitive pressures, low-carbon technologies and operating procedures can disseminate to the wider business sector and make a significant contribution to reducing its environmental and carbon footprint.

A special case in which monopolistic markets can inhibit decarbonisation is the energy sector, traditionally dominated by incumbent utilities that control power generation, transmission and distribution, and have little incentive to diversify energy sources. Unbundling the power sector by separating power generation, transmission and distribution functions can help create more space for foreign investment in renewable power, which in turn can exert competitive pressures toward conventional power generators, and spur the wider diffusion of renewable power investments across domestic actors.

Movement of workers between foreign and domestic firms and corporate spin-offs originating from foreign MNEs can further propagate knowledge spillovers from foreign to domestic firms. The low-carbon transition creates many new jobs related to low-carbon technologies (IRENA-ILO, 2021[11]). Foreign MNEs play an important role as employers in developing skills related to these new technologies and in creating a capable low-carbon workforce (Chapter 3). As such, labour mobility is a key conduit for the diffusion of these skills.
and low-carbon operating procedures more broadly to domestic companies. Labour mobility also allows new foreign entrants to seek out talent and hire the skilled workers needed to run their businesses, and can therefore contribute to additional low-carbon FDI attraction.

**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. Though exceptions exist, 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[22]; Pao and Tsai, 2010[23]; Behera and Dash, 2017[24]).

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 5.5). This is likely because extraction and energy transformation offer lucrative investment opportunities for large multinationals with the requisite capacity for these heavily capital- and energy-intensive activities.

**Figure 5.5. FDI and CO₂ emissions**

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

![Graph](image)

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

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[25]; Hanni et al., 2011[26]).

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 carbon emissions, and facilitate low-carbon FDI and its knowledge and technology spillovers (OECD, 2015[27]).

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 framework for green growth” of the OECD Policy Framework for Investment, and on the OECD Policy Guidance for Investment in Clean Energy Infrastructure, and complements 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). The Toolkit is structured around four broad principles and the policy instruments that support these principles (Figure 5.6). Annex 5.B provides the core questions of the Policy Toolkit for governments to self-assess policies that influences the impacts of FDI on decarbonisation.

Figure 5.6. Overview of FDI Qualities Policy Toolkit for reducing FDI impact on carbon emissions

<table>
<thead>
<tr>
<th>Principle 1: Provide strategic direction and promote policy coordination and coherence on investment and climate action</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>National strategies and plans</td>
<td>National strategies and plans</td>
</tr>
<tr>
<td>Oversight and coordination bodies</td>
<td>Oversight and coordination bodies</td>
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<tr>
<td>Public consultation, data, M&amp;E</td>
<td>Public consultation, data, M&amp;E</td>
</tr>
</tbody>
</table>

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<tr>
<th>Principle 2: Ensure that domestic and international investment regulations and standards reinforce climate objectives</th>
<th>International agreements &amp; standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>International agreements on climate change</td>
<td>International agreements on climate change</td>
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<tr>
<td>International agreements on RBC</td>
<td>International agreements on RBC</td>
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<tr>
<td>Environmental provisions BITs &amp; RTAs</td>
<td>Environmental provisions BITs &amp; RTAs</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Principles 3: Stimulate investment and build technical capabilities related to low-carbon technologies, services and infrastructure</th>
<th>Domestic regulations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental standards &amp; requirements</td>
<td>Environmental standards &amp; requirements</td>
</tr>
<tr>
<td>Regulatory incentives</td>
<td>Regulatory incentives</td>
</tr>
<tr>
<td>Carbon pricing instruments</td>
<td>Carbon pricing instruments</td>
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<tr>
<td>Subsidies and tax relief for green investments</td>
<td>Subsidies and tax relief for green investments</td>
</tr>
<tr>
<td>Public procurement of green investments</td>
<td>Public procurement of green investments</td>
</tr>
<tr>
<td>Business &amp; supplier development services</td>
<td>Business &amp; supplier development services</td>
</tr>
<tr>
<td>Green technology parks</td>
<td>Green technology parks</td>
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<tr>
<td>Training and skills development services</td>
<td>Training and skills development services</td>
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<tr>
<th>Principle 4: Address information failures and administrative barriers to level the playing field for low-carbon investors</th>
<th>Financial support</th>
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<tbody>
<tr>
<td>Green investment promotion &amp; facilitation</td>
<td>Green investment promotion &amp; facilitation</td>
</tr>
<tr>
<td>Public awareness campaigns</td>
<td>Public awareness campaigns</td>
</tr>
<tr>
<td>Corporate environmental disclosure</td>
<td>Corporate environmental disclosure</td>
</tr>
</tbody>
</table>
Providing strategic direction and promoting policy coherence on investment and climate

Ensuring coherence across climate, sectoral and investment strategies and plans

Strong government commitment to combat climate change and to support low-carbon growth, underpinned by a coherent policy framework and clear decarbonisation targets, provides investors with encouraging signals regarding the government’s climate ambitions. Setting a clear, long-term transition trajectory that is linked to the national vision or goals for growth and development is critically important to build capacity for investors to understand transition risks, and to attracting foreign investment that contributes to the country’s climate agenda (Box 5.2). Given the cross-cutting nature of climate change, a strategic framework for addressing climate change should include a comprehensive and coherent multi-sector approach, integrating environmental targets and ambitions into sector strategies and plans. For instance, incorporating climate considerations in national infrastructure development plans and priorities can help avoid locking-in environmentally unsustainable infrastructure for decades. This may require the establishment of new connections between national sectoral planning processes in order to avoid repackaging existing sectoral plans into a climate strategy.

Box 5.2. The EU Green Deal’s integrated framework for the climate transition

The European Green Deal sets out a detailed vision to make Europe the first climate-neutral continent by 2050, safeguard biodiversity, establish a circular economy and eliminate pollution, while boosting the competitiveness of European industry and ensuring a just transition for affected regions and workers. Under the EU Green Deal, the European Commission pledged to raise the GHG emissions reduction targets to 55% by 2030, compared to the previous target of 40%. To implement the increased ambition, on 14 July 2021 the Commission presented the ‘Fit for 55’ package, which contains legislative proposals to revise the entire EU 2030 climate and energy framework, including the legislation on effort sharing, land use and forestry, renewable energy, energy efficiency, emission standards for new cars and vans, and the Energy Taxation Directive. The Commission proposes to strengthen the emissions trading system, extend it to the maritime sector, and reduce over time the free allowances allocated to airlines. A proposed new emissions trading system for road transport and buildings should start in 2025, complemented by a new social climate fund with a financial envelope of €72.2 billion to address its social impacts. New legislation is proposed on clean maritime and aviation fuels. To ensure fair pricing of GHG emissions associated with imported goods, the Commission proposes a new carbon border adjustment mechanism.

By offering a holistic and integrated approach to mainstream decarbonisation across a multi-sector regulatory framework, the Green Deal provides investors with a clear long-term trajectory for Europe’s climate transition. This long-term commitment and direction reduces uncertainty about regulation and taxation to advance the transition, and allows investors to better understand the transition risks associated with their operations going forward, and to take steps to mitigate these risks.


The investment promotion strategy must also reflect national climate objectives across priority sectors in alignment with the multi-sector strategic framework for addressing climate change. Concretely, it should translate national level emissions targets to science-based targets for the private sector in order to drive responsible climate action by business. In this regard, it is important that the investment promotion strategy and its main features are developed in co-ordination with other key ministries, including for instance the ministry of environment and the ministry of energy. The investment promotion strategy should be very clear and specific about targets, tools to reach the set targets, and performance indicators to measure progress.
It should provide clear indications on its implementation, including how staff should be organised internally, what the main activities are that it should focus on, what the key performance indicators to measure outputs and outcomes are, and what procedures are in place to collaborate effectively with other relevant public agencies and stakeholders (e.g. the private sector). Clearly delineating the role of private investors, both domestic and foreign, in achieving climate objectives can help adequately tailor investment promotion efforts to target investors that help further these objectives. The government should consult with the private sector and other local stakeholders in the design and implementation of strategies and plans that are relevant for low-carbon investment, and regularly evaluate their effectiveness.

**Ensuring inter-ministerial and inter-agency coordination and alignment**

As is the case for other policy areas covered by the Policy Toolkit, a complex system of institutions design and implement investment, climate and sectoral strategies, and it is important for coordination mechanisms to be in place to ensure their coherence and consistency, and to achieve desired outcomes related to FDI and carbon emissions. Overlapping and sometimes conflicting rules, procedures and regulations across ministries and levels of government, including between the central and provincial levels can create administrative burdens on investors (OECD, 2015[27]). Although coordination is a fundamental and longstanding problem for public administrations, there is still no standardised method for approaching coordination issues, and much of the success or failure of attempts to coordinate appear to depend upon context. Overall, coordination approaches and instruments should be matched to circumstances and policy areas. Instruments of co-ordination can be based on regulation, incentives, norms and information sharing. They can be top-down and rely upon the authority of a lead actor or bottom-up and emergent (Peters, 2018[28]). Common approaches for co-ordination are summarised in Box 5.3.

**Box 5.3. Examples inter-agency co-ordination approaches and instruments**

**National strategies and action plans** typically involve wide consultation and deliberation, and provide diagnostic overviews of the strengths, weaknesses, opportunities, and threats associated with their stated objectives. If properly designed, national strategies and plans can set a shared vision of the goals pursued across climate and investment policy domains, and how one can contribute to the other. Costa Rica’s National Decarbonisation Plan, for instance, explicitly states that the priorities related to FDI attraction for decarbonisation will be addressed in cooperation with the Ministry of Trade and Commerce (COMEX), the investment promotion agency (CINDE) and the export promotion agency (PROCOMER).

**Dedicated agencies or ministries** assume the leadership of the national policy agenda in some policy domains (e.g. environment, energy, investment) and often responsibility of coordination. At the same time, inter-agency joint programming can draw together a number of interested agencies and facilitate co-ordination and other aspects of governance as agencies share agenda and action.

The **Centre of government** (e.g. the President’s or Prime Minister’s Office) can bridge political interests and bureaucratic boundaries. **High-level policy councils** can also deal with aspects of policy coordination although they have variable roles and composition across countries. In Jordan, for instance, the higher steering committee for green growth, responsible for the overall strategic framework for green growth, reports directly to the prime minister, who also sits in the high-level investment council, responsible for the country’s investment strategy, ensuring that the strategic directions of the two are aligned.

**Informal channels of communication** between officials or job circulation (of civil servants, but also experts and stakeholders) can play a role and suggest a relatively well-developed culture of inter-agency trust and communication. Such arrangements tend to work best where there already exists a relatively well-developed culture of inter-agency trust and communication.
Designing and implementing effective environmental assessment processes and ensuring stakeholder involvement and consultation

Environmental assessment processes, including Strategic Environmental Assessment (SEA) and Environmental Impact Assessment (EIA), are structured analytical and participatory approaches for obtaining and evaluating environmental information prior to its use in decision-making. This information consists of assessments of how the environment will be affected if certain alternative actions are implemented and advise on how best to manage environmental implications if one alternative is selected and implemented. SEA focuses on strategic and policy actions such as new or amended laws, policies, programmes and plans. EIA focuses on proposed investment projects such as highways, power stations, water resource projects and large-scale industrial facilities, which are sometimes linked to the implementation of a policy or plan (e.g. extended highway network may be an outcome of a new transport policy). Environmental assessment systems are fundamental to ensure that international investments contribute to sustainable development, and in particular to climate and environmental goals. As an integral part of the policy programme and plan life-cycle, SEAs guarantee that the policies, regulations and standards that influence the attraction and environmental performance of investments are aligned with national climate objectives. In Senegal, for instance, to ensure the success of the new energy policy, the Government has set up a monitoring and evaluation system for major energy projects through an inter-ministerial committee chaired by the Prime Minister. EIA systems, additionally support investors in minimising environmental risks associated with their investment projects.

Strong political will is important for the effectiveness of EIA systems in mitigating potential adverse environmental impacts of FDI. When the EIA authority is under financial pressure or politically inferior to other government institutions that support the investment project, EIAs may be used to rationalise predetermined outcomes, rather than to provide independent and rigorous analysis, upon which the approval is based. In such cases underestimation of the role and impact of EIA can negatively influence the impact of foreign investments on the host country’s environment (Dung, 2019[29]). Strengthening the implementation of EIA systems is essential for their effectiveness in greening FDI and reducing its carbon impacts. In some countries investment proponents face major delays in the review and approval of EIAs due to lack of human and financial resources. Another factor exacerbating delays may be the lack of quality of EIA documents submitted to the authority, as a result of lack of capacity in the environmental assessment industry. Relevant authorities at national and subnational levels may also lack the capacity to monitor and audit implementation of investments to ensure compliance with EIA results (OECD, 2020[30]). Building capacity at national and subnational levels to review EIAs and reduce delays in this process, and improving the transparency and information systems supporting EIAs can significantly improve the environmental impacts of foreign investments.

Public consultation is a vital component of successful EIA/SEA systems and specific EIA/SEA studies. Timely and well-planned public consultation programmes will contribute to the successful design, implementation, operation and management of proposal actions. Stakeholder engagement also enhances the effectiveness of the EIA/SEA process. Stakeholders, including foreign multinationals, provide a valuable source of information on key impacts, potential mitigation measures and the identification and selection of alternatives. Their consultation further ensures the EIA/SEA process is open, transparent, and robust, and also that individual EIAs/SEAs are founded on justifiable and defensible analyses.

Collecting data to monitor the impact of FDI on carbon emissions

Measuring and tracking the impact of FDI on carbon emissions, and its potential contribution to decarbonisation can help identify appropriate policy responses. The first section of this chapter presents a framework for understanding FDI impacts on emissions, and factors that may influence these impacts. The collection and production of timely and internationally comparable data on FDI by sector, is important for monitoring its contribution to decarbonisation. Supplementing this with firm-level surveys that capture
different aspects of their environmental practices can provide policymakers with a valuable tool for self-assessment of FDI impacts on carbon emissions, and green growth more generally. Annex 5A provides a set of core questions and indicators that can guide policy-makers in this self-assessment.

**Adhering to international agreements and standards that reinforce climate objectives**

**Ratifying major international agreements promoting climate action**

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[20]). The international agreements that directly or indirectly influence carbon emissions and the economic activities that generate them include multilateral environmental agreements (MEAs) negotiated at the global level, under the auspices of the UN. These MEAs span several environmental fields, including GHG emissions reductions, cross-border air pollution, soil and desertification, and environmental governance (Table 5.1).

The UNFCCC is the central forum for global negotiations on climate change and for international co-ordination of climate policies, and plays a crucial 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 parties 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, but are required to report emissions, with progress reviewed by an independent review system. 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.

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. The Paris Agreement also 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.
Table 5.1. Summary of MEAs that influence GHG emissions

<table>
<thead>
<tr>
<th>Year</th>
<th>Title</th>
<th>Theme</th>
<th>Objective</th>
<th>Parties</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>Geneva Convention on Long-Range Transboundary Air Pollution (CLRTAP)</td>
<td>Air pollution</td>
<td>To protect human health and the environment against air pollution and to limit and, as far as possible, gradually reduce and prevent air pollution including long-range transboundary air pollution.</td>
<td>51</td>
</tr>
<tr>
<td>1991</td>
<td>Espoo Convention on EIA</td>
<td>Governance</td>
<td>To prevent, reduce and control significant adverse transboundary environmental impact from proposed activities.</td>
<td>44</td>
</tr>
<tr>
<td>1992</td>
<td>Framework Convention on Climate Change (UNFCCC)</td>
<td>Climate change</td>
<td>To achieve stabilisation of greenhouse gas concentrations in the atmosphere at a level that prevents dangerous anthropogenic interference with the climate system.</td>
<td>197</td>
</tr>
<tr>
<td>1994</td>
<td>Convention to Combat Desertification (UNCCD)</td>
<td>Soil</td>
<td>To combat desertification and mitigate the effects of drought, particularly in Africa, with a view to contributing to the achievement of sustainable development in affected areas.</td>
<td>196</td>
</tr>
<tr>
<td>1994</td>
<td>International Tropical Timber Agreement (ITTA)</td>
<td>Nature and biodiversity</td>
<td>To promote and apply comparable and appropriate guidelines and criteria for the management, conservation and sustainable development of timber-producing forests.</td>
<td>74</td>
</tr>
<tr>
<td>1997</td>
<td>Kyoto Protocol</td>
<td>Climate change</td>
<td>To ensure that greenhouse gas emission do not exceed the assigned amounts, with a view to reducing overall emissions of such gases by at least 5 per cent below 1990 levels in the commitment period 2008 to 2012.</td>
<td>192</td>
</tr>
<tr>
<td>1998</td>
<td>Aarhus Convention on Access to Information</td>
<td>Governance</td>
<td>To guarantee the rights of access to information, public participation in decision-making, and access to justice in environmental matters.</td>
<td>47</td>
</tr>
<tr>
<td>2015</td>
<td>Paris Agreement</td>
<td>Climate change</td>
<td>The Paris Agreement builds upon the UNFCCC Kyoto Protocol and commits all to undertake ambitious efforts to combat climate change and adapt to its effects, with enhanced support to assist developing countries to do so.</td>
<td>192</td>
</tr>
</tbody>
</table>

Source: OECD elaboration

Adhering to international agreements on RBC and promoting environmental due diligence

Home country governments can also influence the impacts of outward FDI on global emissions by implementing international agreements on responsible business conduct (RBC), and encouraging environmental due diligence across supply chains. The OECD’s Guidelines for Multinational Enterprises (OECD Guidelines) recommends that businesses take due account of the need to protect the environment, including improving environmental performance in their own operations and supply chain and addressing any adverse environmental impacts of their own operations and their supply chains, 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. Adherence to the Guidelines and efforts to facilitate corporate compliance with the Guidelines is therefore instrumental in minimising any adverse environmental impacts associated with FDI, and increasing its contribution to climate and environmental objectives.

The OECD Due Diligence Guidance for Responsible Business Conduct provides practical support to enterprises on the implementation of the OECD Guidelines for Multinational Enterprises, by providing plain language explanations of its due diligence recommendations and associated provisions (OECD, 2018[31]). Implementing these recommendations helps enterprises avoid and address adverse impacts related to workers, human rights, the environment, bribery, consumers and corporate governance that may be associated with their operations, supply chains and other business relationships. Further tailored guidance for businesses on addressing climate risks in sector supply chains is included in the OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector (OECD Garment Guidance), which has a risk module dedicated to GHG emissions, and the OECD-FAO Guidance for Responsible Agricultural Supply Chains. These guidance advocates a risk-based approach to addressing GHG emissions in a company’s supply chain, using leverage with suppliers to encourage suppliers to reduce emissions and to support suppliers directly in implementing measures to reduce GHG emissions.
Growing demands to hold corporations accountable for their climate impacts are leading some courthouses to draw heavily on international instruments like the OECD Guidelines and order multinational giants to cut GHG emissions of their operations and those of their supply chains independently of their home and host country regulations (Box 5.4). Such rulings raise questions on the need for mandatory due diligence legislation that defines the obligations of companies to prevent environmental damage, and enables public regulators and judges to enforce such legislation.

Box 5.4. The Shell climate ruling

Basing its verdict on the United Nations Guiding Principles on Business and Human Rights (UNGPs) and OECD Guidelines for Multinational Enterprises (OECD Guidelines), in May 2021, a Dutch court ruled that Royal Dutch Shell (Shell) must reduce its CO₂ emissions by 45% by 2030 (compared to 2019), regardless of the policies of the Dutch government. The ruling asserts that Shell’s total CO₂ emission levels, from its own operations and from those of its supply chain and end users, present a breach of the company’s legal obligation to prevent climate change, explicitly linking climate change to human rights. It also emphasises the responsibility Shell headquarters has over the entire Shell group, thereby acknowledging the parent companies’ responsibility for subsidiaries. The ruling makes clear that the severity of the impact of climate change on human rights justifies the economic sacrifices Shell will be required to make. This historic ruling is the first to impose a clear and measurable emissions reduction target on a company and its value chain, making clear that preventing climate change harm is an essential element of responsible business conduct as defined by the UNGPs and the OECD Guidelines.


Ensuring that investment and trade agreements allow for sufficient domestic policy space to achieve climate objectives

Depending on the way in which international investment and trade agreements address environmental concerns, or fail to address them, these treaties may in some cases be perceived to conflict with climate objectives and with the measures taken by states to implement the Paris Agreement. Investment agreements may limit the ability of governments to restrict new fossil fuel investment 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. WTO rules may prevent states from regulating traded goods on the basis of the climate impacts of their production (OECD, 2020[9]). 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 investment and trade negotiations are in an important position to ensure alignment and mutual reinforcement across climate, trade and investment regimes.

International investment agreements (IIAs) – including bilateral investment treaties and regional trade agreements with investment chapters – 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[32]; Yamaguchi, 2020[33]). These references vary in specificity, objective and in their use across different types of agreements (Table 5.2 and Box 5.5.)
Table 5.2. Illustration of how IIAs explicitly address environmental protection and climate action

<table>
<thead>
<tr>
<th>Policy objective</th>
<th>Type of reference</th>
<th>Example</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</td>
</tr>
<tr>
<td></td>
<td>Commitment to cooperate on environmental matters</td>
<td>ASEAN- Japan Economic Partnership Agreement, Art. 53</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</td>
</tr>
<tr>
<td></td>
<td>Non-lowering of environmental standards for the purpose of attracting investment</td>
<td>Japan - Jordan BIT (2018), Art. 20</td>
</tr>
<tr>
<td>Preserve domestic policy space</td>
<td>Explicit affirmation of environmental regulatory power of host state</td>
<td>Korea – Uzbekistan (2019), Art. 17</td>
</tr>
<tr>
<td></td>
<td>Carve-out clauses for environmental measures with respect to treaty provisions</td>
<td>Russia - Sweden BIT (1995), Art. 3</td>
</tr>
<tr>
<td></td>
<td>Exclusion of non-discriminatory environmental measures from ISDS</td>
<td>Canada - Mongolia BIT (2016), Art. 20</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 (not in force)</td>
</tr>
</tbody>
</table>

Note: This table contains selected examples of treaty provisions that fall into the identified categories, based on the OECD FDI Qualities Mapping.

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. 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). 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).

IIAs can also help to reinforce laws and regulations related to the climate and strengthen environmental governance. 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 multilateral environmental agreements (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 UNFCCC and the Paris Agreement. 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.

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. 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). 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). 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).

In rare cases IIAs take a more proactive stance on environmental and climate concerns by seeking to influence investor conduct. 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). While still rare in IIAs to date, such provisions may become more common 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 on the future of investment treaties, the results of which will be reflected in future iterations of this Policy Toolkit.
Box 5.5. IIA and environmental provisions

According to the OECD FDI Qualities Mapping, there is wide variation across countries in the extent of referencing of environmental concerns in investment and trade agreements. Canada’s BITs and RTAs contain 75 explicit references to preserve domestic policy space for environmental regulation, or to prevent the lowering of environmental standards for the purpose of investment attraction, or both. Significantly fewer treaties present such safeguards in other countries covered by the mapping, with explicit environmental references ranging from 15-20 in Morocco, Thailand and Sweden, to 4-5 in Uzbekistan, Tunisia and Jordan.

The types of references also vary across types of treaties. BITs contain relatively more provisions on the right to regulate, and carve-out clauses for key investment treaty provisions, while RTAs contain significantly more references to commitments to cooperate on environmental matters. The types of references that seek to reinforce domestic law, also very across instrument, with a great focus on non-lowering of standards in BITs, and greater reference to multilateral investment agreements and commitments in RTAs.

Source: OECD FDI Qualities Mapping
Ensuring that domestic regulations reinforce climate objectives

Ensuring transparency, openness and non-discrimination

A fair, transparent, clear and predictable regulatory framework for investment is a critical determinant of investment decisions and their contribution to decarbonisation (OECD, 2015[27]). 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[20]). 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.

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[34]). 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. 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[27]).

The opportunities presented by international investment can sometimes 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[35]). 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[36]); 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. While scrutiny of investment in sensitive sectors is necessary and legitimate, governments should ensure that such screening remains closely tailored to risk and that it is guided by the principles of transparency, predictability, proportionality, and accountability as described in the OECD Guidelines for Recipient Country Investment Policies relating to National Security (OECD, 2009[37]).
Strengthening competition and property rights

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 power sector, which is traditionally characterised by vertically integrated monopolies. Unbundling the power sector by separating power generation, transmission and distribution functions can help create more space for foreign investment. Moreover, by opening competition in power generation, unbundling provides more space for clean energy technologies to enter the market and can therefore stimulate changes in the national energy mix. The decentralised nature and the smaller generation capacity of clean energy projects compared to their fossil fuel counterparts, makes independent power production well-suited for mainstreaming clean energy technologies. In the areas of transmission and distribution, increased competition can also render the national energy network more flexible, increasing its capacity to accommodate both on- and off-grid renewable energy (OECD, 2015[38]). Even where structural separation has been implemented, dominant incumbent enterprises may deter independent renewable power producers from entering a market through tender procedures (Ang, Röttgers and Burli, 2017[11]). Therefore, countries in which regulators 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. In general, 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[20]).

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[19]). 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[39]). 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[38]).
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 large-scale 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[38]). 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.

Setting environmental standards that are aligned with national climate objectives

Environmental performance standards, such as emissions 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[40]). Counter to the pollution haven hypothesis, there is little and often conflicting empirical evidence that investors locational decisions are driven by differences in stringency of environmental standards and regulations. Indeed adopting regulations and standards that reinforce climate goals can help level the playing field for foreign investments in low-carbon technologies, services and infrastructure. Countries should indeed regularly assess whether their technology and performance standards are in line with long-term climate goals, as strong vested interested may result in targets set at the most feasible level rather than the optimal level necessary to meet objective (OECD, 2015[20]).

Environmental screening and approvals regulation refers to all government environmental regulation that companies need to comply with before they can gain environmental approval for a new, or expanded, investment project. This includes legislation and policy in the areas of environmental impact assessment (EIA) and environmental licensing and permitting, typically applied to investments with potentially significant environmental impacts. These regulations can help mitigate any adverse effects of FDI on emissions, and the environment more broadly, although there is some disagreement on how these regulations affect the attractiveness of a country to foreign investors. The environmental approvals process for proposed investments is considered by some industry representatives and academics to be burdensome because it is perceived as causing delays and increased uncertainty, and therefore likely to discourage FDI. At the same time, empirical evidence on international mining companies in Canada and Australia suggests that investors tend to see EIA as a catalyst for integrating environmental design into the early planning of an investment project, thereby alleviating the need to spend money on overcoming environmental problems once a poorly designed project has been commissioned (Annandale and Taplin, 2003[41]).
Stimulating investment and building technical capabilities related to green technologies, services and infrastructure

Ensuring that price signals reflect environmental costs of emissions

Carbon pricing mechanisms are gaining popularity as an effective way to address over-investment in carbon-intensive activities. Price-based instruments 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 (Box 5.6). 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[42]). At the same time, carbon pricing policies are, by design, intended to reduce the competitiveness of carbon-intensive industries, and ultimately downsize these industries. While many new jobs are created, this can result in job destruction as some jobs cease to exist, and workers may struggle to find alternative employment opportunities. Appropriate measures to mitigate these adverse social effects, including direct compensation or retraining of workers, are necessary to ensure a just transition (Chapter 3).

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[40]). 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. ⁹

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. CO₂) over a set time period. Emitters are required to hold permits in amount 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

⁹ See OECD (2019[40]) for a detailed analysis of carbon pricing instruments, and their use in OECD and G20 countries.
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 world. 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[43]). 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[44]). BCA regimes have long been discussed, 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 (OECD, 2020[9]). Potential conflicts between climate, trade and investment objectives must be taken into consideration in designing a suitable policy mix to promote low-carbon FDI.

Box 5.6. Subsidies for fossil fuel consumption far exceed carbon pricing

Consumer subsidies for fossil fuels remain pervasive despite their negative environmental, social, fiscal and economic costs. In 2019, cumulative consumer subsidies on all fossil fuel products amounted to double the spending on development aid, seven times the combined global carbon prices, and thirty-three times the pledges made to the Green Climate Fund, to assist developing countries in climate change mitigation and adaptation practices. Gradually phasing out these distortionary price signals is essential to channel FDI toward low-carbon energy alternatives.

Ensuring that financial support is transparent, time-limited and subject to regular reviews

Private investors do not internalise the positive spillovers of low-carbon investments and are likely to under-invest in related technologies and skills. Targeted financial and technical support by the government is therefore warranted, but must be, transparent time-limited and subject to regular review. 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 general, government support should decrease over time as the renewable energy sector matures (Box 5.7). In certain countries foreign investors need to limit their equity in clean energy projects to certain thresholds in order to benefit from financial support, which may limit the potential for FDI to contribute to decarbonising the energy sector. Minimum investment size thresholds for securing financial support can also discourage investment by smaller foreign and domestic enterprises, despite their high innovation potential (OECD, 2015[38]).
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, reducing costs associated with certain expenses or exempting recipients from indirect taxes. Different instruments present advantages and disadvantages related to their fiscal and administrative costs, and their effectiveness in promoting the desired investment. Profit-based incentives are often used to promote the development of strategic sectors. For instance, Rwanda offers a 50% corporate income tax (CIT) reduction on investments in renewable energy. The main drawback of these incentives is that they are very costly in terms of forgone public revenues, and that by reducing (or eliminating) the CIT rate on any amount of profit earned by the investor, they incentivise investments that would have materialised anyway. Costs-based incentives that target low-carbon investments are instead linked to specific expenses and lower the cost of related inputs. For instance, Mauritius and South Africa offer accelerated depreciation allowances on machinery used to generate renewable energy. By lowering the cost of capital they are expected to facilitate investment that would otherwise not be made and have the potential to mobilise more investment per dollar of forgone tax revenue (Clark and Skrok, 2019). A downside of targeted cost-based incentives is that they require greater tax administration capacities and are associated with higher compliance costs in terms of qualifying and reporting requirements. Exemptions from indirect taxes paid by businesses, such as value added tax (VAT) on machinery and equipment, land tax, property tax, and customs duties on imported and exported goods, allow investors to avoid contact with tax and customs administration, lowering their cost of paying taxes. In the case of renewables, these fiscal measures tend to reward installation of capacity rather than production, which does not encourage investors to locate clean electricity generation in the most optimal geographical locations (according to resource availability and grid location).

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. 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[45]; Kathuria, 2015[46]; Zhang, 2013[47]). At the same time, feed-in-tariffs come with some important drawbacks. 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.

 Tradable renewable energy 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. Investors may additionally require capacity building before engaging in such markets.

Public procurement is a useful tool to decarbonise infrastructure investment. Beyond bringing existing low-carbon solutions to market today, it can create ‘lead’ markets where government demand is significant (e.g. transport, construction), and can spur innovation without engaging new spending (OECD, 2016[48]). 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 a long and costly process and sometimes end with no project. Governments should design tenders with a view to guaranteeing competitive neutrality and minimising the risks of fraud and bid rigging (OECD, 2015[38]).

Box 5.7. Financial support for renewables decreases as technologies mature

The extent and type of financial support provided to expand renewable energy generation capacity varies across countries, often as a function of the extent of penetration of renewable energy technologies. Climate leaders like Sweden and Costa Rica, which rely overwhelmingly on renewable energy, tend to offer little or no government support for renewable energy generation in the form of tax incentives, grants or subsidies (aside from subsidies for micro-production by households and non-energy enterprises). Sweden rather adopts market-based support measures, like tradable electricity certificates. Costa Rica focuses on developing domestic supply chains to produce renewable energy equipment locally.

Countries that still depend heavily on fossil fuels but where renewable capacity is rising rapidly, like Thailand, Morocco and Jordan, tend to offer a mix of investment incentives on renewable energy equipment, fixed feed-in-tariffs for renewable electricity fed into the grid, and public tenders for new installations of renewable energy infrastructure. Studies provide some evidence that price-based support schemes such as FiTs and premiums are more positively correlated with investors’ ability to raise private finance than quota-based schemes, and therefore may be more appropriate for countries at an earlier stage of the energy transition (Cárdenas-Rodríguez, Haščič and Johnstone, 2014[49]).

Countries with still limited renewable energy capacity like Tunisia and Uzbekistan primarily employ a combination of public tenders, corporate tax holidays and import duties exemptions on machinery and equipment.

<table>
<thead>
<tr>
<th>Country</th>
<th>Tax incentives</th>
<th>Feed-in-tariffs</th>
<th>Public procurement</th>
<th>Tradable certificates</th>
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<tbody>
<tr>
<td>Canada</td>
<td>Accelerated depreciation of RE machinery and equipment</td>
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<tr>
<td>Costa Rica</td>
<td>VAT exemption on imported machinery and equipment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jordan</td>
<td>Customs and VAT exemption on machinery and equipment</td>
<td>Wind, solar PV, thermal, biomass and biogas</td>
<td>Direct Proposal Submission, Build Own Operate scheme</td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td>Wind power (EnergiPro Programme)</td>
<td></td>
<td>ONE IMs tender process</td>
<td></td>
</tr>
<tr>
<td>Rwanda</td>
<td>CIT reduction (50%) and VAT exemption (machinery)</td>
<td>Small hydro power</td>
<td>Tenders for solar plants</td>
<td></td>
</tr>
<tr>
<td>Senegal</td>
<td>Deductions on installations, VAT and customs exemptions</td>
<td>Solar PV</td>
<td>Tenders for suppliers of solar mini-grids</td>
<td></td>
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<tr>
<td>Sweden</td>
<td>Energy tax exemption for self-produced RE</td>
<td></td>
<td></td>
<td>Tradable Electricity Certificate</td>
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<tr>
<td>Thailand</td>
<td>CIT holiday, customs exemption (machinery)</td>
<td>Distributed solar systems</td>
<td></td>
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<tr>
<td>Tunisia</td>
<td>Exemptions on CIT (4 years) customs and VAT (machinery)</td>
<td></td>
<td>Build Own Operate scheme</td>
<td></td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>Exemptions on CIT (5 years), property and land tax (10 years)</td>
<td></td>
<td>Several tenders for RE installations</td>
<td></td>
</tr>
</tbody>
</table>

Source: OECD FDI Qualities Mapping
Technical support is a useful tool for reducing the emissions intensity of investments, building capabilities related to low-carbon technologies, and promoting low-carbon innovation and spillovers. These initiatives are important for attracting foreign investors that seek skills related to green technologies and local business partners in green supply chains. By building domestic low-carbon supply chains and creating capable low-carbon workforces, these programmes are crucial for the transfer of knowledge and technology from foreign to domestic firms. Countries use a variety of programmes to develop domestic know-how and support low-carbon innovation (Box 5.8). In many cases, governments finance these programmes but outsource their delivery to specialists.

Business support initiatives are typically designed to help investors reduce their energy use, waste, or emissions levels. They include seminars, events, and specialised technical assistance (e.g., support for energy audits). In Morocco, the audit results of an energy efficiency training programme for large corporations showed that 5% of the 8000 companies audited accounted for 70% of industrial energy consumption, suggesting there may be opportunities to achieve large energy savings by targeting a relatively small number of investors. While these initiatives tend to target local businesses, and often SMEs, rather than foreign investors, they can help create a pool of low-carbon champions that attract MNEs concerned with the carbon footprint of their supply chains. By increasing the opportunities for local linkages, these initiatives can be an important driver of FDI spillovers that advance decarbonisation of domestic industry.

Training programmes that target workers can similarly help encourage FDI spillovers by creating pools of qualified workers with the skills necessary to operate low-carbon technologies, and by increasing the potential for labour mobility between foreign and domestic firms. These programmes include specialised training, learning-by-doing, apprenticeships and secondments, and in-depth professional certification programmes (see Chapter 3). Other programmes offer community-level capacity building (e.g., energy literacy) to influence consumption behaviours, and reduce the demand for energy- or emissions-intensive products and services. These initiatives can help create new markets for foreign investors seeking to expand their low-carbon investments.

Beyond mitigating adverse environmental effects of business, technical support can be used to foster innovation and commercialisation of new climate-friendly technologies (see Chapter 2). Technology parks, incubators and accelerators can be tailored to support businesses in finding innovative solutions to reducing GHG emissions, and create low-carbon innovation hubs that attract talent and investors. Eco-friendly by design, and often located close to universities and research centres to promote the exchange of knowledge, these parks can help facilitate synergies and partnerships between foreign investors, local business and research institutions, and support local industries in acquiring knowledge and know-how. By upgrading the capabilities and innovation potential of domestic industry, green technology parks and incubation facilities can heighten competitive pressures and encourage FDI spillovers that arise from imitation of foreign technologies and operating procedures.
Box 5.8. Examples of technical support for developing low-carbon capabilities

Countries tend to offer a mix of technical support initiatives directed at businesses and workers. Many countries support businesses in reducing GHG emissions, by providing technical assistance for improving energy efficiency (Sweden, Morocco, Jordan, and Uzbekistan), reducing waste (Tunisia), and developing electrifying industry (Costa Rica). More advanced programmes can support entrepreneurs in developing breakthrough technologies and solutions to reduce GHG emissions (Canada).

Training and skills development initiatives are also increasingly tailored to green technologies. In Costa Rica, in order to boost green jobs, the National Apprentice Institute has incorporated environmental courses into its training catalogue, including subjects like GHG emissions control. Jordan offers vocational training on renewable energy and energy efficiency, and an in-depth professional certification program for energy managers tailored to the Arab region. Training programmes in Canada target rural communities, encouraging regional collaboration and knowledge-exchange, and seek to reduce their reliance on diesel products. Since 2016, the Swedish Energy Agency in cooperation with other actors has been responsible for a set of capacity building programmes in the area of building for low energy consumption. The programmes target different construction stakeholders, such as architects, engineers, clients, technicians, installers, and site managers.

Countries at more advanced stages of the low-carbon transition sometimes seek investors with high innovation potential, and support them in developing innovative solutions to address climate change across sectors. Incubators and technology parks in Canada (Net Zero Accelerator), Costa Rica (Green Tech Incubator) and Morocco (Green Energy Park) serve as platforms for researching, developing, testing, and rolling out low-carbon technologies and processes.

Source: OECD FDI Qualities Mapping
Addressing information failures and administrative barriers that deter low-carbon investments

Raising public awareness on carbon performance

Insufficient, inaccurate or costly information on the carbon performance of different technologies, products or services leads to sub-optimal decisions by consumers and investors, and generally results in under-investment in low-carbon technologies. For instance, lack of awareness on the energy performance of household appliances leads to an inability of consumers to interpret the impact of energy prices on the operational costs of one product relative to another, meaning that price signals do not influence purchasing behaviour as expected and carbon pricing instruments may be ineffective.

Concerns about access to information on the carbon footprint of consumption and investment choices have led many governments to introduce measures to raise public awareness and understanding of carbon performance, including platforms for dialogue and information sharing, information campaigns, and product labelling schemes. For instance, many governments have long ago introduced mandatory energy labelling schemes for appliances, which have been key in helping consumers choose more energy-efficient products. According to the Eurobarometer on energy, in 2019, the EU energy label was recognised by 93% of consumers and considered by 79% when buying energy-efficient products. The energy label has also encouraged manufacturers to seek more energy-efficient technologies and stimulated innovation, in an effort to see their energy-labelled products in the highest available category when compared to competitors. For example, roughly two-thirds of refrigerators and washing machines sold in 2006 were labelled as class A, compared to over 90% in 2017 (Ang, Röttgers and Burli, 2017[11]).

While there are still no regulatory requirements on carbon labelling, some investor-driven initiatives are emerging to cater to customers that are responsive to climate credentials. The meat substitute, Quorn, started including carbon labels on its most popular products in 2020; Popular oat milk brand, Oatly, began using the labels in 2019; Unilever, one of the world’s largest consumer goods companies, recently stated its intention to include carbon labels on all of its products; and Nestlé is considering carbon labelling (Financial Times, 2020[50]). Emissions consultancies have supported investors in measuring the emissions embodied in their products, and labelled hundreds of thousands of products, from cement to bank accounts (Carbon Trust, 2021[51]). Canadian directory business Ecolabel Index has identified more than 455 green labels across 199 countries, including 34 relating to carbon footprint (Ang, Röttgers and Burli, 2017[11]).

Encouraging climate-related risk disclosure

The complex nature of climate change makes it uniquely challenging for investors to adequately view and take into account longer-term implications of climate risks on their returns. Valuations of assets may not factor in climate-related risks because of insufficient information. To address this challenge, the Task Force on Climate-related Financial Disclosure (TCFD) provides recommendations to companies on effective, clear, and consistent climate-related disclosure. This helps to reveal how companies are preparing for a lower-carbon economy and thus supports investors to better assess financial exposure to climate-related risks. The recommendations include expectations from companies for disclosure of information on the governance, strategy, management and targets around climate-related risks, which are increasingly adopted by the largest carbon emitters and supported by the public sector (TCFD, 2021[52]).

Better corporate disclosure of climate-related risks will also help aligning the environmental pillar of ESG investment ratings with a low-carbon transition. Inconsistencies in the construction of ESG ratings across providers, the multitude of different metrics, and insufficient quality of forward looking metrics prevent agencies from supplying consistent and comparable information on transition risks and opportunities across firms and jurisdictions. Notably, rating providers appear to place less weight on negative environmental impacts while placing greater weight on the disclosure of climate-related corporate policies and targets, with limited assessment as to the quality or impact of such strategies. Such limitations could

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mislead investors with an aim to align portfolios with the low-carbon transition. Greater transparency and precision of climate-related corporate risks along the TCFD recommendations, for example, would facilitate investments into lower carbon assets (OECD, 2021[53]).

Beyond non-binding recommendations, environmental regulations on reporting requirements are increasingly being used to address the cross-border environmental footprint of multinationals. The EU Taxonomy Regulation, which entered into law in 2020, for instance, places a reporting obligation on certain companies to disclose how much of their global investment is aligned with environmentally sustainable activities (Box 5.9). Starting from 2022, large investors (with over 500 employees) with operations in the EU must disclose which proportion of their turnover, capital expenditure and operating expenditure is associated with environmentally sustainable economic activities. Non-financial investors can use the EU Taxonomy to plan their climate and environmental transition and raise finance for this transition, while financial companies can use the EU Taxonomy to design credible green financial products. Going forward, implementation of the Regulation is likely to have significant influence on the carbon implications of inward and outward FDI of companies operating in the EU. The emergence of new taxonomies in other countries and regions can result in inconsistent definitions of what is environmentally sustainable and create additional uncertainty and costs for multinational investors.

Box 5.9. The EU Taxonomy Regulation

The EU Taxonomy is a regulatory classification system that helps investors and companies define which economic activities are environmentally sustainable. To qualify as environmentally sustainable, the activity must substantially contribute to at least one of six environmental objectives (i.e. Climate Change Mitigation, Climate Change Adaptation, Sustainable Use and Protection of Water and Marine Resources, Transition to a Circular Economy, Pollution Prevention and Control, and the Protection and Restoration of Biodiversity and Ecosystems), while at the same time not significantly harming any of these objectives and meeting minimum social safeguards.

The Regulation is a transparency tool that will introduce mandatory disclosure obligations on some companies and investors, requiring them to disclose their share of Taxonomy-aligned activities. Reporting under the Taxonomy will be a mandatory requirement for three key users: (1) financial market participants and issuers offering financial products within the EU; (2) large companies (with over 500 employees) who are already required to provide a non-financial statement under the EU Non-Financial Reporting Directive (NFRD); and (3) EU and Member States when setting public measures, standards or labels for green financial products or green bonds.

The EU Taxonomy is not a mandatory list of economic activities for investors to invest in. Nor does it set mandatory requirements on environmental performance for companies or for financial products. Companies are free to choose what to invest in. Companies with products and services that are not sustainable will have to state that their investments do not consider the regulation. However, the mandatory disclosure of the proportion of Taxonomy-aligned activities will allow for the comparison of companies and investment portfolios, and can guide market participants in their investment decisions.

Promoting and facilitating low-carbon investments and their spillovers

Investment promotion agencies (IPAs) are key players in bridging information gaps that may otherwise hinder the realisation of foreign investments, and their potential sustainable development impacts. Their primary role is to create awareness of existing investment opportunities, attract investors, and facilitate their establishment and expansion in the economy, including by linking them to potential local partners.

Most IPAs prioritise certain types of investments over others, by selecting priority sectors, countries or investment projects, and allocating resources accordingly (Box 5.10). The prioritisation approaches and tools adopted by IPAs are intended to influence the kind of investment that is attracted into the local economy and, increasingly, their sustainable development impacts, and should reflect the national investment promotion strategy and any climate considerations embedded in the strategy. Since few economies can offer an attractive environment for all low-carbon technologies and all segments of their value chains, IPAs should review and identify specific economic activities where they see a potential to develop low-carbon activities or growth poles. On this basis they can design investment promotion packages combining a variety of tools that range from intelligence gathering (e.g. market studies) and sector-specific events (inward and outward missions) to pro-active investor engagement (one-to-one meetings, email/phone campaigns, enquiry handling).

IPAs are also responsible for investment facilitation and retention. Facilitation services can help reduce administrative barriers to low-carbon investments. While imperative for curbing environmental impacts of FDI, the multitude of permits and licenses for air emissions, water abstraction, wastewater discharges, waste generation, storage and disposal, and other environmental impacts, can create significant hurdles for foreign investors and discourage investment rather than help improve their environmental performance. As the first point of contact of foreign investors, IPAs can support them in acquiring the necessary permits and clearances, including from environmental authorities, by guiding them through the requires procedures facilitating access to relevant government bodies. Having a single window portal for all administrative procedures can help reduce transaction costs for investors, as long as it does not create additional duplication and complexity in the company establishment process. As a general rule, one-stop shops should not be mandatory entry points for investors, as allowing businesses to opt for alternative routes to open a business if they so wish is an incentive for one-stop shops to remain efficient. Additionally, they should be equipped with a Customer Relationship Management (CRM) system, including indicators for monitoring performance, and customers should be invited to fill in satisfaction surveys and forms. It is also important that the decisions to grant or refuse a business licence are transparent and made publicly available, with a right of appeal for those investors who have seen their licence rejected.

Investment aftercare services are an important channel for the propagation of FDI spillovers through the interactions of foreign MNEs with domestic firms and workers. In the context of improving FDI impacts on carbon emissions, aftercare services can help foreign investors overcome information barriers associated with identifying low-carbon business partners, suppliers and distributors, and help them reduce emissions along their supply chains. When IPAs engage in matchmaking, they should look for complementarities with local firms. Even if these firms do not have a low-carbon profile, they may possess skills and technologies that could be used for low-carbon projects. Examples include skills and technologies in the field of electronic components, computer software, and various biological processes that could be used in the production of biofuels.

As discussed throughout the chapter, a range of targeted policies are necessary in order transition to low-carbon economies and to attract low-carbon foreign investment, including those that create a market for low-carbon products and services by addressing market failures, administrative barriers and information asymmetries, and those that build low-carbon capabilities across workers and firms through financial and technical support In order to ensure that such issues are given due consideration by governments and that they are in a position to proactively market the country as a low-carbon investment destination, IPAs need to pay particular attention to their advocacy function. IPAs can be more up to date on the latest trends in
foreign investment flows and serve as the primary interface between TNCs and government. Their role in making policy makers aware of regulatory needs to promote low-carbon investment are thus be crucial.

**Box 5.10. IPA prioritisation and tracking of contribution to climate-related SDG**

According to the OECD Survey on Prioritisation and Monitoring & Evaluation of IPAs, close to 40% of OECD IPAs prioritise investments that help mitigate climate change (SDG 13); 60% prioritise investments that support the energy transition (SDG 7); and 70% prioritise investments that contribute to resilient infrastructure, sustainable industry and low-carbon innovation (SDG 9). In contrast, between 23% and 30% of IPAs track their investment attraction efforts along transition-related indicators (e.g. number of new renewable energy projects). Virtually no IPAs monitor the impact of the investments attracted against climate-related indicators (e.g. GHG emissions). This suggests that IPAs in the OECD tend to allocate considerable resources to investment attraction activities that can support decarbonisation objectives and tailor their activities accordingly, but continue to struggle to measure and monitor their contribution to these climate objectives. Potential approaches to overcome these challenges may include translating climate goals (e.g. based on the SDGs) to specific key performance indicators (KPIs) and complementing these measures with official sources of data to evaluate targets (Sztajerowska and Volpe, 2021 forthcoming).

![Graph showing prioritisation and tracking of SDGs by IPAs](image)

*Source: OECD survey on IPA monitoring & evaluation and prioritisation, 2021*

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IPCC (2018), Global Warming of 1.5°C above Pre-industrial Levels and Related Global Greenhouse Gas Emission Pathways, in the Context of Strengthening the Global Response to the Threat of Climate Change, Sustainable Development, and Efforts to Eradicate Poverty.


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


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Market”, *Policy Research Working Paper* 6376,
## Annex 5.A. Assessing the impacts of FDI on carbon emissions

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Questions</th>
<th>Potential data sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carbon performance</td>
<td>How does the country perform in terms of carbon and other GHG emissions?</td>
<td>Carbon emissions by sector (IEA)</td>
</tr>
<tr>
<td></td>
<td>What sectors are driving these emissions?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>How does the country perform in terms of energy efficiency (e.g. power</td>
<td>Energy intensity by sector (IEA)</td>
</tr>
<tr>
<td></td>
<td>generation, end-use fuel, end-use electricity, transmission losses)?</td>
<td></td>
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<tr>
<td></td>
<td>How does the country perform in terms of fuel switch technologies (e.g.</td>
<td>Renewable energy, energy storage, EVs, hydrogen tech (IEA, OECD)</td>
</tr>
<tr>
<td></td>
<td>renewables, electric vehicles, hydrogen fuel)?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>How does the country perform in terms of end-of-pipe solutions (e.g. carbon</td>
<td>Capture, storage, sequestration or disposal of GHGs (OECD)</td>
</tr>
<tr>
<td></td>
<td>capture and storage for power generation and industry)?</td>
<td></td>
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<tr>
<td></td>
<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>
</tr>
<tr>
<td>Economic structure and</td>
<td>Is economic activity concentrated in carbon- or energy-intensive sectors?</td>
<td>Value added by sector (OECD, UN)</td>
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<tr>
<td>comparative advantage</td>
<td>Is the country endowed with fossil fuels? Is it endowed with renewable</td>
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</tr>
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<td></td>
<td>natural resources?</td>
<td>Oil and coal rents as a share of GDP (WB), Global RE Atlas (IRENA)</td>
</tr>
<tr>
<td></td>
<td>Does the country export fossil fuels? Does it export electricity? Does it</td>
<td>Export data by sector (WITS)</td>
</tr>
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<td></td>
<td>export high-tech goods?</td>
<td></td>
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<tr>
<td></td>
<td>To what extent does the country participate in green global value chains?</td>
<td>Foreign value added share of gross exports (OECD TiVA)</td>
</tr>
<tr>
<td></td>
<td>(see EU taxonomy) Where is it position along these value chains?</td>
<td></td>
</tr>
<tr>
<td>FDI transmission channels</td>
<td>How polluting are the sectors that account for most of the country’s FDI?</td>
<td>FDI inflows by sector (OECD, UNCTAD, Financial Times)</td>
</tr>
<tr>
<td></td>
<td>How much FDI do renewables/ fossil fuels attract?</td>
<td></td>
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<tr>
<td></td>
<td>How green are foreign firms relative to domestic peers (e.g. strategy and</td>
<td>Green economy indicators by firm ownership (WBES)</td>
</tr>
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<td></td>
<td>management, energy use and monitoring, environmental impacts)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To what extent do firms monitor emissions along their supply chains? How</td>
<td>Green economy indicators by firm ownership (WBES)</td>
</tr>
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<td></td>
<td>does this vary by firm ownership?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>How does the extent of supply chain linkages between foreign and domestic</td>
<td>Share of local sourcing of foreign firms (WBES)</td>
</tr>
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<td></td>
<td>firms vary across sectors with differing carbon emissions?</td>
<td></td>
</tr>
</tbody>
</table>

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Annex 5.B. Assessing policies that influence FDI impacts on carbon emissions

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Instrument</th>
<th>Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance</td>
<td>National strategies and plans</td>
<td>Has the government adopted a cross-sectoral national climate strategy? Does it outline targets for GHG reductions, renewable energy and energy efficiency? Does it clarify expectations on private sector contribution to these targets?</td>
</tr>
<tr>
<td></td>
<td>Oversight and coordination bodies</td>
<td>Are there high-level cross-ministerial coordination mechanisms in the policy areas of investment promotion, environmental regulation and energy policy?</td>
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<tr>
<td></td>
<td>Public consultation</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>
</tr>
<tr>
<td></td>
<td>Data, monitoring &amp; evaluation</td>
<td>Do relevant institutions monitor and evaluate the impact of FDI on carbon emissions, including knowledge spillovers to domestic firms? What environmental impact assessment and strategic environmental assessment requirements are in place and are they adequately enforced?</td>
</tr>
<tr>
<td>International agreements &amp; standards</td>
<td>International agreements on climate change</td>
<td>What are the country’s international commitments in terms of GHG emission reduction targets under the UNFCCC?</td>
</tr>
<tr>
<td>International agreements &amp; standards</td>
<td>International agreements on RBC</td>
<td>Has the country adhered to the OECD Guidelines for Multinational Enterprises? What measures are in place to promote the OECD Due Diligence Guidance for Responsible Business Conduct</td>
</tr>
<tr>
<td>International agreements &amp; standards</td>
<td>Environmental provisions of BITs and RTAs</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>
</tr>
<tr>
<td>Domestic regulation</td>
<td>Legal framework for investment</td>
<td>Are there any exceptions to national treatment in sectors with large emissions reduction potential (e.g. energy, transport)? Are technologies critical for the transition subject to review mechanisms? Do all investors (SOEs, domestic, foreign) compete on a level playing field in energy markets? Are any anticompetitive practices addressed? What steps is the government taking to protect intellectual property rights and facilitate patenting for low-carbon technologies? What steps is the government taking to ensure that contracts between clean energy providers and their partners are enforced?</td>
</tr>
<tr>
<td>Domestic regulation</td>
<td>Environmental standards &amp; requirements</td>
<td>Are existing performance and technology standards aligned with the country’s emission reduction objectives? Are investors with potentially significant emissions impacts subject to EIAs and environmental permits? How effective is the implementation of EIA systems?</td>
</tr>
<tr>
<td>Domestic regulation</td>
<td>Regulatory incentives</td>
<td>Are any regulatory concessions available to foreign investors for specific low-carbon technologies, or for the transfer or low-carbon knowledge to domestic firms?</td>
</tr>
<tr>
<td>Financial &amp; technical support</td>
<td>Carbon pricing instruments</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>
</tr>
<tr>
<td>Financial &amp; technical support</td>
<td>Subsidies and tax relief</td>
<td>Are incentives (e.g. subsidies, tax exemptions, feed-in tariffs) in place to stimulate investment in low-carbon technologies? Are incentives time-limited and subject to regular review?</td>
</tr>
<tr>
<td>Financial &amp; technical support</td>
<td>Public procurement</td>
<td>Do public procurement policies include environmental and green growth considerations such as resource efficiency, pollution abatement and climate resilience?</td>
</tr>
<tr>
<td>Financial &amp; technical support</td>
<td>Business &amp; supplier development services</td>
<td>What initiatives are in place to support companies in reducing energy use, waste, or emissions? What initiatives to develop supplier capabilities related to low-carbon technologies?</td>
</tr>
<tr>
<td>Financial &amp; technical support</td>
<td>Green technology parks</td>
<td>Are initiatives and facilities in place to support low-carbon innovation (e.g. green tech parks, incubators)? Have efforts been made to reduce the carbon footprint of other economic zones?</td>
</tr>
<tr>
<td>Financial &amp; technical support</td>
<td>Training and skills development services</td>
<td>What measures are in place to promote skills development and prepare the labour force in areas relevant to low-carbon investment</td>
</tr>
<tr>
<td>Information &amp; facilitation services</td>
<td>Green investment promotion, facilitation and aftercare</td>
<td>Do investment promotion agencies tailor their activities to promote low-carbon investments? Are procedures for obtaining investment and environmental permits consistent and streamlined? Does the government maintain a local supplier database with information related to carbon performance? Is it easily accessible and regularly updated? Are business matchmaking services available?</td>
</tr>
<tr>
<td>Information &amp; facilitation services</td>
<td>Public awareness campaigns</td>
<td>How is the government consulting with civil society groups and encouraging public awareness of and engagement with low-carbon objectives?</td>
</tr>
<tr>
<td>Information &amp; facilitation services</td>
<td>Corporate environmental disclosure</td>
<td>What corporate disclosure mechanisms exist (e.g. carbon labelling, fuel economy)? Are the mandatory or voluntary? What measures are taken to ensure that end-users are aware of and understand these reporting mechanisms?</td>
</tr>
</tbody>
</table>