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Supporting EMDEs in attracting more, better, and safe FDI

A strategy for action

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Key issues

- In the Communiqué released after their Niigata meeting in May 2023, G7 Finance Ministers and Central Bank Governors (FMCBGs) expressed their support to emerging market and developing economies (EMDEs) in their efforts to attract "more, better, and safe" foreign direct investment (FDI) to achieve resilient growth. They also expressed their support for the OECD to expand and deepen its outreach with non-OECD members and assist them in strengthening their investment frameworks.
- A comprehensive set of OECD policy tools are available to assist EMDEs in attracting more, better, and safe FDI. They include the Policy Framework for Investment, the FDI Qualities Policy Toolkit, and Guidelines for the design of policies to manage security implications of FDI. Many EMDEs on all continents have applied one or more of these instruments and drawn on the associated experience and practice to strengthen their investment policy frameworks.
- In their Niigata Communiqué, G7 FMCBGs invite the OECD to develop a strategy to deliver such support to EMDEs. This document contains this strategy. The OECD will implement this strategy focusing on policy issues that are central to EMDEs' efforts to attract more, better, and safe FDI.

In the Communiqué on the outcomes of the Niigata meeting in May 2023, G7 Finance Ministers and Central Bank Governors expressed their support to EMDEs in their efforts to attract "more, better, and safe" FDI to achieve economic efficiency and resilient growth. They underline the importance of FDI as an enabler of global economic integration through its benefits such as job creation, local skills development, and technology transfer. The Communiqué underscores the role that FDI plays in meeting the substantial infrastructure needs of EMDEs, while recognising, based on fresh evidence, that foreign investment in critical infrastructure may pose risks for economic sovereignty.

To ensure that FDI goes where it is most needed, is of high quality and does not undermine the economic sovereignty of host countries, G7 Finance Ministers and Central Bank Governors point specifically to the potential of the OECD's FDI Qualities Initiative, which aims at improving the investment climate to encourage more and better FDI into EMDEs with emphasis on productivity and innovation, job quality and skills, gender equality, and decarbonisation.

In recognition of the OECD's longstanding role as a partner for EMDEs on all continents in developing better investment policies, G7 FMCBGs also support the OECD to expand its assistance to EMDEs in this important area. They called on the OECD to develop a strategy that would guide these efforts. The present document provides the policy context that many EMDEs experience with respect to international investment and proposes the strategy to support their efforts to attract more, better, and safe investment.

EMDEs face complex policy choices in their attempts to attract foreign investment

The succession of recent crises has made it even more difficult for governments of EMDEs to advance the Sustainable Development Goals (SGDs), ensure resilience and prosperity of their societies, and decarbonise and transform their economies to mitigate the effects of the climate crisis. These crises disproportionally affect EMDEs which are also the least resilient to future shocks. One of their main challenges is access to financial resources: The collective financing gap to reach the SDGs is estimated to have widened to USD 3.9 trillion annually since the beginning of the COVID-19 pandemic and is estimated to further increase by USD 400 billion per year between 2020 and 2025.

At present, EMDEs do not receive nearly as much FDI as they need. FDI can make an important contribution to filling the financing gap, and to revitalising economies. Success in attracting FDI depends to a significant extent on policies of host economies. Better investment policies enhance the attractiveness for FDI and are a condition for greater inflows. Governments can define these policies, and their choices determine the extent to which a given economy realises its potential. Beyond the sole volume of investment, governments are interested in ensuring that inward FDI makes a positive contribution to their societies and advance efforts to achieve the SDGs. Governments are seeking to identify the qualities of FDI and to incentivise flows in areas where benefits are greatest to achieve specific objectives.

The OECD's FDI Qualities initiative has documented that since 2021 greenfield FDI created more than 160,000 new direct jobs every month worldwide and accounts for around 30% of all new investment in renewable energy. Overall, foreign firms tend to be more productive, pay higher wages, and offer women greater opportunities for career advancement than domestic firms. Foreign firms investing in non-OECD economies are also over 50% more likely to offer training opportunities than their domestic counterparts, 60% more likely to invest in research and development, and more than twice as likely to incorporate climate change issues in their strategic objectives than domestic firms. Greater performance and innovation by foreign investors suggest that there is a potential for knowledge spillovers, although this depends on the absorptive capacities of the host economy, particularly of domestic SMEs. For FDI to play a catalytic role in these various dimensions of importance to the SDGs, attention needs to be paid to the qualities of FDI.

While more and better FDI can help EMDEs meet the SDGs, consideration should also be given to the economic resilience and economic security implications that some foreign investment may have. These considerations are often overlooked and eclipsed by prospects of new sources of finance, particularly in areas such as infrastructure where choices of funding are limited and needs are significant. If not properly managed, seemingly attractive foreign State-backed investment in critical infrastructure can undermine security interests and economic and strategic independence today or in the future. For example, such investment can create dependencies and compromise network confidentiality and integrity. Economies in which foreign State-funded FDI in critical infrastructure is prevalent may also become less attractive destinations of foreign private capital if access to infrastructure is assessed as unreliable and its integrity questionable, and if governments are known to be indebted to third countries' governments.

The imperative to attract more investment to address the widening funding gap, the desire to reap benefits from FDI to advance societal and environmental objectives, and the need to identify and manage economic security implications of FDI represent a formidable challenge to any government, and to governments with limited capacity in particular. G7 Finance Ministers and Central Bank Governors expressed their support to EMDEs in managing this challenge.

Expanded, systematic, and holistic support for EMDEs to enable them to attract more, better, and safe FDI

The expression by G7 economies to support EMDEs in designing better investment policies to attract more, better, and safe FDI brings new impetus to ongoing OECD co-operation with partner countries on all continents. Building on the support, the OECD endeavours to:

- support EMDEs' investment policy reforms in a holistic manner, covering quantity, quality, and security of FDI,
- broaden the geographic reach of this work, and
- strengthen regional cooperation and regional policy dialogues with EMDEs.

In keeping with the principles that have underpinned successful co-operation with EMDEs in the past, OECD support will leverage the policy disciplines and evidence-based policy guidance that the OECD has developed or is developing to enhance the positive impact of FDI and to manage security implications that may arise in the context of international investment.

A tradition of supporting investment policy reform and a history of impact

The OECD has been a partner for many EMDEs on all continents to share its expertise in reforming investment frameworks. The insights and policy lessons from multiple countries' decades-long efforts to attract FDI have been distilled into a set of instruments that policy makers can use to enhance the attractiveness of their economies for more, better, and safe FDI (Figure 1).

Figure 1. OECD standards to support governments in attracting more, better, and safe FDI

OECD Recommendation on the Policy Framework for Investment (2015)

- Comprehensive and systematic approach for investment climate reforms. Covers 12 policy dimensions, including infrastructure.
- Emphasises the principles of rule of law, transparency, non-discrimination and protection of property rights.

OECD Recommendation on FDI Qualities for Sustainable Investment (2022)

- Commitment to using policy and institutions to increase sustainable investment and deliver on the 2030 SDGs.
- First government-backed standard to help policymakers finance the SDGs and fulfill commitments made in the Paris Agreement.

OECD Guidelines for Recipient Country Investment Policies relating to National Security (2009)

- Helps governments reconcile openness with security needs.
- Provides standards and guidance for policy design and serves as reference framework for peer-review.

The OECD Policy Framework for Investment (PFI) constitutes a comprehensive set of aspects that determine the attractiveness to invest in a given jurisdiction and allow a systematic assessment. So far used in the context of Investment Policy Reviews (IPRs) in and with almost 40 jurisdictions of varying levels of development, the PFI can underpin specific, actionable recommendations that allow governments to set priorities for investment policy reform to attract greater volumes of FDI.

The more recent FDI Qualities initiative complements the PFI with insights and policy recommendations to ensure that FDI develops its potential to foster SDGs in host economies. The FDI Qualities initiative provides governments with policies, indicators, data, and expertise to encourage sustainable investment that is greener, promotes quality jobs and upskilling, advances gender equality, and to make their economies more productive and innovative. With the FDI Qualities Policy Toolkit and guided by the *Recommendation on FDI Qualities for Sustainable Development*, this analysis allows host governments to shape policies and incentives to attract FDI to satisfy their priorities and needs. Several economies have already applied the assessment tool, and others are planning to undertake a review to obtain tailored policy advice on how to strengthen the impact of FDI in favour of sustainable development.

The OECD has also responded to the growing demand for insights on how investment policies can be designed to manage occasional security implications of FDI while maintaining and enhancing the attractiveness for beneficial FDI. OECD *recommendations* for non-discriminatory, transparent, and proportionate policies and associated accountability mechanisms shape policy design in the growing number of jurisdictions that seek to enhance their openness and attractiveness to FDI while better managing the security risks that may occasionally be associated with such investment. Exchanges among policy makers on implementation experience and ongoing documentation of policy trends support governments in adopting best practices in this area. The present strategy aims at advancing these efforts further in close co-operation with interested EMDEs to ensure that the 'safe' dimension is considered as an integral part of efforts to strengthen their investment frameworks.

New impetus, more holistic approach, greater geographical inclusiveness, regional policy dialogue

The central tenants of the new strategy to support EMDEs are: (1) a more holistic approach to investment policy reform that addresses quantity, quality, and security of FDI; (2) a wider geographic reach; and (3) strengthened regional policy dialogue among interested EMDEs.

Support to EMDEs will leverage the policy disciplines and evidence-based policy guidance that the OECD has built and continues to build with governments and stakeholders to enhance the positive impact of FDI and to manage security implications that may arise in the context of international investment. Support for investment policy reform will remain demand-driven, context-specific, and action-oriented, guided by the latest available evidence, and mindful of the evolving parameters of the global economy and national priorities, circumstances, and implementation capacity. The support will also build on and develop existing work, co-operation, and deep and trustful relationships that exist between the OECD and many regions such as Southeast Asia, Middle East and North Africa (MENA), Southern African Development Community (SADC), and Economic Community of West African States (ECOWAS). The strategy also constitutes a mechanism for renewed engagement with additional geographical regions and countries, especially in Africa, with the additional benefit of providing support to specific regional integration initiatives such as the AfCFTA Investment Protocol.

1 **A holistic approach to investment policy reform**. EMDEs will henceforth benefit from support on the full spectrum of parameters that matter for investment policy and development of their potential, beyond aspects that merely induce a quantitative expansion of FDI inflows. Analysis and recommendations that allow EMDEs to shape their frameworks to reap the greatest benefits for their sustainable development will be included in future work, along with suggestions on how security aspects can be addressed while further enhancing their attractiveness as a destination for FDI.

Building on lessons from past engagement in the context of Investment Policy Reviews, this reinforced holistic engagement would seek to identify challenges and opportunities to promote greater openness to foreign investment, maximise the contribution of FDI to sustainable development and manage security risks occasionally associated with certain foreign investment in certain strategic sectors or projects.

Work on FDI Qualities will likely help the region attract sustainable investment that is greener, promotes quality jobs and upskilling for the digital transition, improves gender equality, and contributes to more productive and diversified economies. Furthermore, the potential for greater openness and a rationalised and modern management of economic security risk would help some countries that still maintain significant barriers to foreign investment eliminate these while maintaining their autonomy and independence with respect to policy.

2 **Geographic expansion**. The OECD endeavours to expand the geographic reach of its support. It would specifically expand and deepen its engagement with African countries on investment policy reform, reinforce its work with Southeast Asia, and assist EMDEs in other world regions such as Latin America, Central Asia and Central and Eastern Europe.

The work with African countries would contribute to the renaissance of investment policy on the African continent that the AfCFTA Investment Protocol has ushered in and would help African nations reap the opportunities of the new regional framework. Engagement with Africa is particularly important given the continent's exceptional challenges to meet the SDGs, the difficult and volatile economic, political, and security environment in some countries, and the potential that FDI has to address some of these challenges.

EMDEs from other world regions have also not always received the extent of support that they may require. The OECD endeavours to reach out to interested EMDEs and to contribute to remedying this shortfall.

3 **Dedicated regional policy dialogues based on evidence and engagement**. Past work has often focused on individual countries in an ad hoc manner, an approach resulting from funding constraints. The OECD endeavours to deliver dedicated assistance and collaboration at a regional level.

Regional efforts, facilitated, supported, and informed by the OECD would engage policymakers in each region as peers to share concerns, challenges, and opportunities of investment policy reforms. They would foster a common understanding on priorities and approaches to attracting more, better, and safe FDI to their region and its constituting nations, and how intra-regional co-operation could allow unlocking further potential to address the challenges that they face as a region and as individual countries.

A regional approach to investment policy reform corresponds to linkages and trade and investment relationships that result from geographic and cultural proximity, alliances, and regional co-operation across policy areas. Co-ordinated investment policy reform in a given region also yields greater benefits due to economies of agglomeration, spill-over effects for enhanced political and economic stability in addition to the positive effects of strengthening regional co-operation, peer-learning, cohesion and solidarity. Successful OECD work with ASEAN and MENA countries and, so far to a lesser extent in the Americas, have shown the benefits of a regional approach to investment policy making.

The OECD endeavours to expand and revitalise regional work and approaches and revive engagement with regional groups in Africa and the Americas, based on policy analysis and policy dialogue of peers from within a geographic region ■