Investment and sustainable development: Between risk of collapse and opportunity to build back better

Discussion paper for the joint IC-DAC session at the 2020 Roundtable on Investment and Sustainable Development

Abstract

The aim of this policy paper is to provide inputs for a debate among investment policymakers, donors and stakeholders regarding the role of private investment and aid for a sustainable recovery in the context of Covid-19 This policy paper is a preliminary reflection on how the investment and development cooperation communities could work together to more efficiently respond to the Covid-19 crisis and contribute to "building back better". It shows that financing for development has been severely hit by the crisis, with an unprecedented drop in external finance to developing countries, including investment, setting us back in our progress towards the SDGs. The investment and development cooperation communities have an important role to play in the recovery. Better understanding and leveraging the investment-development cooperation interlinkages, and promoting deeper coordination could help identify responses to the Covid-19 crisis around three proposed areas of action: (1) mitigating the effects on livelihoods, (2) containing the drop in FDI to developing countries, and (3) building back better. The paper was jointly prepared by teams from the OECD Investment Division at the Directorate for Financial and Enterprise Affairs (Fares Al Hussami, Stratos Kamenis, Letizia Montinari, Baxter Roberts and Martin Wermelinger) and the OECD Financing for Sustainable Development Division at the Development Cooperation Directorate (Olivier Cattaneo, Sam Mealy, Jieun Kim and Cécilia Piemonte).

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Executive Summary

The current crisis is unprecedented in many ways, both in scope and magnitude, combining demand and supply shocks, and stretching countries' financing capacities to their limits. Unfortunately, not all countries can raise the billions of dollars necessary to contain and mitigate the effects of the crisis, or adopt ambitious stimulus packages to reconstruct their economies. If they do, it could also be at the cost of surging debt levels and risk of debt distress. Inequalities that were already widening prior to the crisis have worsened even further. Recent progress made towards the Sustainable Development Goals (SDGs) is severely threatened, with a possible 10 or more year setback in our fight against poverty. The Covid-19 pandemic has the potential to further widen the USD 2.5 trillion SDGs and destroy any hope of achieving the 2030 Agenda as we enter into the "decade for action".

The investment and development cooperation communities can act in response to the crisis and help avoid a collapse of financing flows to developing countries. During the 2008-09 global financial crisis, official development assistance (ODA), along with remittances, proved to be the most stable sources of external financing for developing countries, and continued to increase. While private flows sharply dropped, they rebounded shortly after, and a strong trade and investment regime contributed to avoid repeating "the historic mistakes of protectionism of previous eras" (G20 Leaders Summit Declaration, London, April 2009).

This time around, the scissors effect of surging financing needs to face the health and economic crises, and declining resources caused by the economic shock is even greater. Conservatively, it is estimated that the drop in external resources to developing countries will be at least 60% greater than during the global financial crisis. All sources of financing for development are under stress, and none are sufficient for the recovery alone. Therefore, it will be necessary to better exploit leverage capacities and interactions among the different sources of financing that were identified by the Addis Ababa Action Agenda (AAAA).

In particular, it will be about having the more volatile and higher volume sources of financing (investment) and stable and lower volume sources (ODA) support each other for a faster recovery. Progress towards the SDGs is the essence of the development cooperation community's work, it has become a priority for national and international efforts of investment policymakers, and importantly, it is also essential to sustaining the long-term value of investors' assets and market development prospects. The objective is not only to restore and increase pre-crisis levels of investment, but also enhance their SDG alignment or development footprint – the qualities of foreign direct investment (FDI). Success of the two communities is intertwined, and the following paper explores the underpinnings of this success, taking into consideration specific country contexts and stages of transition as countries move towards high-income status. First, the paper analyses the impact of the pandemic on financing for sustainable development, particularly ODA and private investment. Second, it assesses the specific impact of the collapse in FDI and what this means for development outcomes. Third, it explores a way forward for the enhanced leveraging of ODA for investment and vice versa.

Financing for sustainable development – including investment – is at risk of collapse

The pandemic has caused a global humanitarian, social and economic crisis. Poverty will rise for the first time since 1998 with 70-100 million people estimated to be pushed back into extreme poverty, at least twice as many into poverty, with hundreds of millions jobs lost and livelihoods affected.

The Covid-19 crisis is hitting developing countries at a critical moment. Even before Covid-19 struck, financing levels and trends were insufficient to meet the SDGs and Paris Agreement. Now, all sources of financing for developing countries, including private investment, face severe, long-lasting setbacks. External private finance – predominately foreign direct investment and portfolio investment – to developing countries could decrease by around USD 700 billion in 2020. Private investment counts for the largest part of this decrease. Yet, the share of investment in total external finance varies a lot across countries, and the impact of the decrease will depend on country context and stage of transition, calling for tailored responses from the investment and development cooperation communities.

Even under the most optimistic scenario, global FDI flows will likely fall by at least 30% in 2020 compared to 2019 as investors decide to reinvest less earnings and postpone or cancel equity flows in developing countries in the context of high uncertainty. Divestments may also increase in OECD and developing countries – a trend seen during the 2008 financial crisis. Exacerbating these negative trends in investment flows, MNEs in afflicted sectors (e.g. primary, consumer goods, and tourism) are operating at severely reduced capacities due to the global collapse in supply and demand with a knock-on effect on livelihoods. Moreover, there could be long-term demand implications as millions more people fail to reach the global middle class.

The new FDI reality puts stress on sustainability outcomes

Scarcity of FDI and crippled MNE operations during the pandemic are affecting past achievements of inclusive and sustainable development as well as future prospects FDI may bring. Beyond the quantity, the qualities of FDI matter. When FDI decreases, losses for development include not only financing levels but also their spill-over effects.

- **Jobs:** The collapse of FDI flows has put a halt, at least temporarily, to the significant and sustained contribution of FDI to direct job creation. The decline reduced the potential of job creation by nearly 50%, representing between 400-500,000 jobs that were not (but were expected to be) created earlier in 2020. While this number appears low next to the millions of 'real' jobs lost in 2020, it adds strain to the ambition of creating quality jobs through FDI. Foreign firms have not been more resilient compared to domestic firms to lay off staff during the crisis; however, they cope better with new ways of working – essentially implementing remote working arrangements. These good practices may eventually spill over to domestic firms in developing countries.
- **Productivity:** Productivity growth in developing countries is expected to slow and productivity disparities between more productive large – including foreign – firms and SMEs are likely to increase. This risks to weigh on a longer-term productivity slowdown since the 2008 crisis. Some industries – like tourism, retail and transport services and some manufacturing – that were driving productivity in developing countries pre-Covid may receive less FDI for some time.
- **Gender equality:** Women are over-represented in sectors that are severely affected by the Covid-19 crisis and depend extensively on foreign investment in developing countries, particularly apparel and food. Reduced MNE operations – including those of their suppliers – directly translate into employment and livelihood risks for women. In developing countries, women are also more likely to be in informal employment and have thus little access to social protection schemes.

- **Low carbon transition:** The renewable energy sector has demonstrated considerable resilience in OECD and developing countries since the onset of the crisis. In upper middle income countries, for example, almost 70% of total greenfield FDI in the energy sector went into renewables earlier in 2020; more than doubling its share compared to 2019. Despite this resilience, the pace of renewable power capacity additions will likely slow down due to persisting disruptions in global supply chains, construction delays, a decline in installation activity, and currently low prices of oil and gas.

A three pronged agenda of action for investment and donor communities

The collapse in FDI compounds developing countries' financing difficulties and could prolong the dependence on ODA of transitioning countries – at a time when ODA is also under stress. While donors already contribute to investment climate improvement and private sector development, silos remain, and the implementation of the AAAA's holistic approach to financing sustainable development is far from being achieved. The current crisis could be an opportunity to remedy this situation and have the development cooperation and investment communities work better together. A three-pillar action plan is proposed so the two communities respond more efficiently to the crisis: (i) mitigate the effects of FDI disruptions, (ii) contain the drop in FDI, and (iii) build back better:

- **Mitigating the impacts of the investment collapse on livelihoods.** Development cooperation is historically the most stable source of external financing for developing countries and thus plays a key stabilising role during crises. Donors must maintain this role, step up their game and provide funding to mitigate the impacts on livelihoods, for example through temporary unemployment or social protection schemes, working with MNEs where appropriate (e.g. in specific sectors such as garments and textiles) and tailored to groups in need and different country contexts.
- **Containing the drop in FDI to developing countries.** As countries transition to higher income levels, they reduce their dependency on ODA and require higher levels of private investment. Creating an enabling investment environment is crucial to contain the drop in FDI. Donors can help public authorities to improve framework conditions for investment that could reduce costs, risk and uncertainty for investors.
- **Building back better: resuscitating investment for sustainable development.** Mitigating impacts on livelihoods and restoring investment flows is not enough: donors and investment policymakers must work together to ensure that investments are more sustainable and resilient to future crises. This involves using the catalytic role of ODA to build partnerships with private sector actors, conditioning recovery and stimulus packages on SDG and Paris-aligned criteria, embedding responsible business conduct (RBC) principles and standards into investment decision-making, enhancing the qualities of FDI and exploring how to enhance the impact of the international investment regime on sustainable development.

Questions for discussion

This paper serves as background for the discussions at the joint session of the OECD Investment Committee (IC) and the Development Assistance Committee (DAC) during the 2020 Roundtable on Investment and Sustainable Development on 30 September 2020. The session will focus on the following policy questions and explores avenues of possible new OECD research in the area of investment and sustainable development during the post-Covid recovery:

- Should coordinated action of investment policy and development cooperation be a policy priority for the recovery?
- Are directions for action, as outlined in this paper, to (1) mitigate the impacts of the economic collapse on livelihoods; (2) contain the drop in FDI to developing countries; and (3) build back better by ensuring that new and existing investments are aligned with the SDGs and the Paris agreement appropriate? Which actions should be prioritised?

1. The risk of collapse: financing for development, including investment, dropped dramatically during the Covid-19 crisis

The Covid-19 crisis is hitting developing countries at a critical moment. Financing levels and trends to achieve the Sustainable Development Goals (SDGs) by 2030 were already insufficient before the pandemic struck, and fiscal space in developing countries was limited due to rising public debt levels and servicing costs (OECD, 2020e). The pandemic risks creating major shortfalls for all sources of development finance in the absence of urgent, coordinated policymaking. These shortfalls will have serious consequences for livelihoods as millions of people are projected to be pushed back into poverty, potentially threatening the sustainable development trajectories of developing countries for years to come. This section provides a snapshot of the pandemic's impact on all sources of financing for sustainable development (FSD) before providing an overview of expected declines of foreign direct investment (FDI) and related operations of multinational enterprises (MNEs) in host economies.

1.1. Reduced financing for sustainable development puts prior achievements and future progress at risk

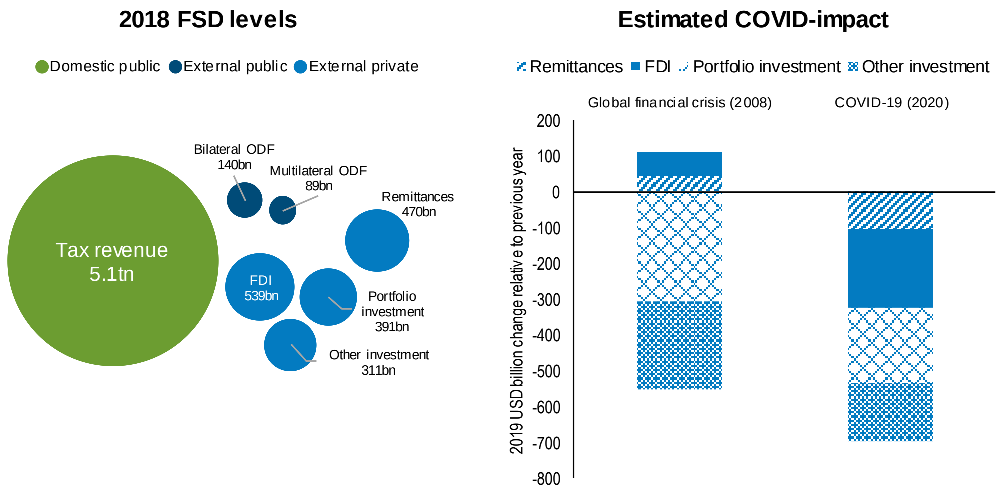
At the onset of the Covid-19 crisis, financing for sustainable development was already in a critical condition (OECD, 2018g). The SDG financing gap in developing countries alone was approximately USD 2.5 trillion per year (UNCTAD, 2014). Recent estimates predict that low-income countries would need to spend, on average, an additional 15% of gross domestic product (GDP) and emerging economies an additional 4% of GDP to fill their SDG spending gaps (Gaspar et al., 2019). While the gap can partly be explained by sub-par spending efficiency, it is well established that pre-Covid levels of domestic and external resources were insufficient to meet the SDGs. In addition, margins of manoeuvre to close the gap were limited by high debt levels and servicing costs.

Before the Covid-19 outbreak, domestic tax revenue remained the most important pillar of financing for sustainable development (FSD) in developing countries (73%), followed by external private finance including FDI, portfolio investment and remittances (24%) (Figure 1, left panel). External public resources (including bilateral and multilateral official development finance, ODF) provide only a marginal contribution to total financing available to developing countries (3%). Domestic private investment is the main source of fixed capital formation in developing countries – estimates suggest that domestic investment could exceed FDI by multiples – but data availability is only comprehensive for around one-third of developing economies. The domestic financial sector plays a central role in intermediating savings and borrowing but access to financial institutions and markets has remained more limited in low- and lower middle-income countries, and borrowing costs are often high (OECD, 2020a, forthcoming).[1]

The OECD's work on transition finance shows the progressive substitution of public by private finance and external by domestic. As countries reach higher income levels, external private finance complements public resources in financing the SDGs. While FDI stocks are often relatively more stable due to longer term commitments, portfolio investment and other investment account for most of the volatility in external financing. Remittances represent household income from the non-resident economy and have been one of the most stable components of private external finance in past crises, although this is not the case in the current crisis as job and incomes losses mount due to lockdowns globally.

While the pandemic and its socioeconomic consequences have had a heavy toll on domestic public resources[2], it has also hit all sources of external private finance. The total volume of external private financing for development to recipient countries had recovered from a large drop in 2015 but overall levels in 2018 had remained below the peak in 2013. With Covid-19, these previous gaps could turn into a collapse as current OECD projections suggest that net inflows of external private investment and remittances could drop by almost USD 700 billion in 2020 compared to the previous year, exceeding the impact following the 2008 global financial crisis by 60% (Figure 1, right panel).

Figure 1. Financing for sustainable development in developing countries: pre-Covid and the estimated Covid-impact



Note: Note that due to data availability, tax revenue is calculated using 2017 tax-to-GDP ratios and domestic private investment are not included in this figure.
Source: OECD (2020, forthcoming)

[1] Domestic private investment is not included in Figure 5, due to limited available data

[2] The economic slowdown due to containment measures as well as fiscal policy measures to mitigate this impact put a severe constraint on domestic public resources. Forecasting public revenue during this time of uncertainty is especially challenging. In the case of Rwanda total public revenues are estimated to decline by 24% (IMF, 2020).

2020 thus presents a bleak prognosis for sustainable development. Poverty is projected to rise for the first time since 1998 with 70-100 million people estimated to be pushed back into extreme poverty, at least twice as many into poverty, with hundreds of millions more jobs lost and livelihoods affected. This also implies a significant medium- to long-term demand shock as fewer people will reach middle class incomes and are thus unable to buy products and services from multinational enterprises. Growth will collapse in most countries and the SDG financing gap will likely double in many developing countries. Debt levels will increase and inequality will worsen, including gender disparities. Uncertainty regarding the interrelated health and economic shocks is increasing tensions within the multilateral system, compounding pressure on available resources for sustainable development.

1.2. FDI flows are likely to be lower for some time and MNE activities continue to be disrupted

Recent OECD projections show that even under the most optimistic scenario, global FDI flows will likely fall by at least 30% in 2020 compared to 2019.[3] The impact on FDI flows will depend on whether measures taken by governments to contain the virus and boost the economy are successful, the extent to which investors will adjust their production locations and how global trade and investment regimes evolve. Under the pessimistic scenario, the drop in FDI flows may last until 2021 and beyond (OECD, 2020h). It is accelerating the steady decline of FDI flows observed in the past five years. The pandemic hit at a time when FDI flows were at the second lowest level recorded since 2010 in the aftermath of the global financial crisis; although this masks growing FDI towards developing countries during this period (OECD, 2020c).

FDI is falling due to less reinvested earnings and postponed or cancelled equity flows

The immediate impact on FDI flows comes from a reduction in reinvested earnings. Reinvested earnings are an important component of FDI flows, accounting for more than half of FDI inflows in 2019. Two factors determine the amount of reinvested earnings: the earnings of direct investment enterprises and the share that the direct investor chooses to reinvest. Earnings of large multinational enterprises are likely to fall in 2020, with various impacts across sectors. While primary, manufacturing, financial and consumer goods industries were particularly hard hit, sectors like technology, health care and communications have seen rising earnings (Refinitiv, 2020). FDI in developing economies will likely be more seriously impacted due to the higher share of the primary sector and manufacturing in their FDI than in developed economies, where high-end services play a more important role. Moreover, the share of earnings investors choose to reinvest is likely to fall during this crisis similar to what was observed during the 2008 global financial crisis.

Equity capital flows, the second important component of FDI flows, are also impacted as companies put some mergers and acquisitions (M&As) and greenfield investments on hold. The latest data on cross-border M&As from the Refinitiv database show a collapse of new completed M&A deals in middle income countries in the first three quarters of 2020 (Figure 2).[4] The collapse in upper middle income countries (UMICs) is considerably more dramatic as compared to that during the 2008 crisis.

Fewer completed M&A deals during the crisis could mean more deals during the recovery as some may not have been cancelled yet but put on hold. However, if the economy does not recover, it is likely that companies will begin to abandon deals. As discussed further in Section 3, the data show that low income

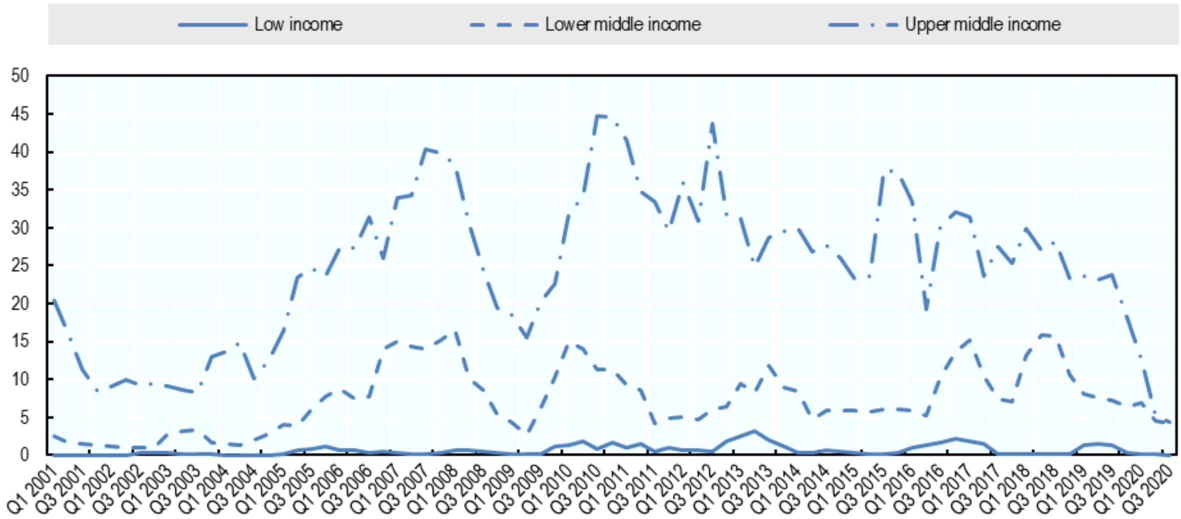
[3] OECD projections will be updated by the end of October (based official FDI statistics for the first half of 2020i). Projections of other international organisations, produced in the first half of 2020, are more pessimistic. UNCTAD (2020) projects global FDI to decline by up to 40%, while the World Bank Group (2020) estimates FDI to decline by up to 40% in 2020 compared to flows in 2019.

[4] Trends for high income countries are not shown in Figure 2 but a similar collapse of completed cross-border M&A deals can be observed (OECD, 2020h).

countries (LICs) may be less directly affected by a decline in global M&A activity as cross-border deals are generally low for this income group.

Figure 2. Completed cross-border M&A deals in developing economies, 2000-2020

Value of deals in USD billions on a quarterly basis, three year moving average



Source: Author's calculation from Refinitiv M&A database

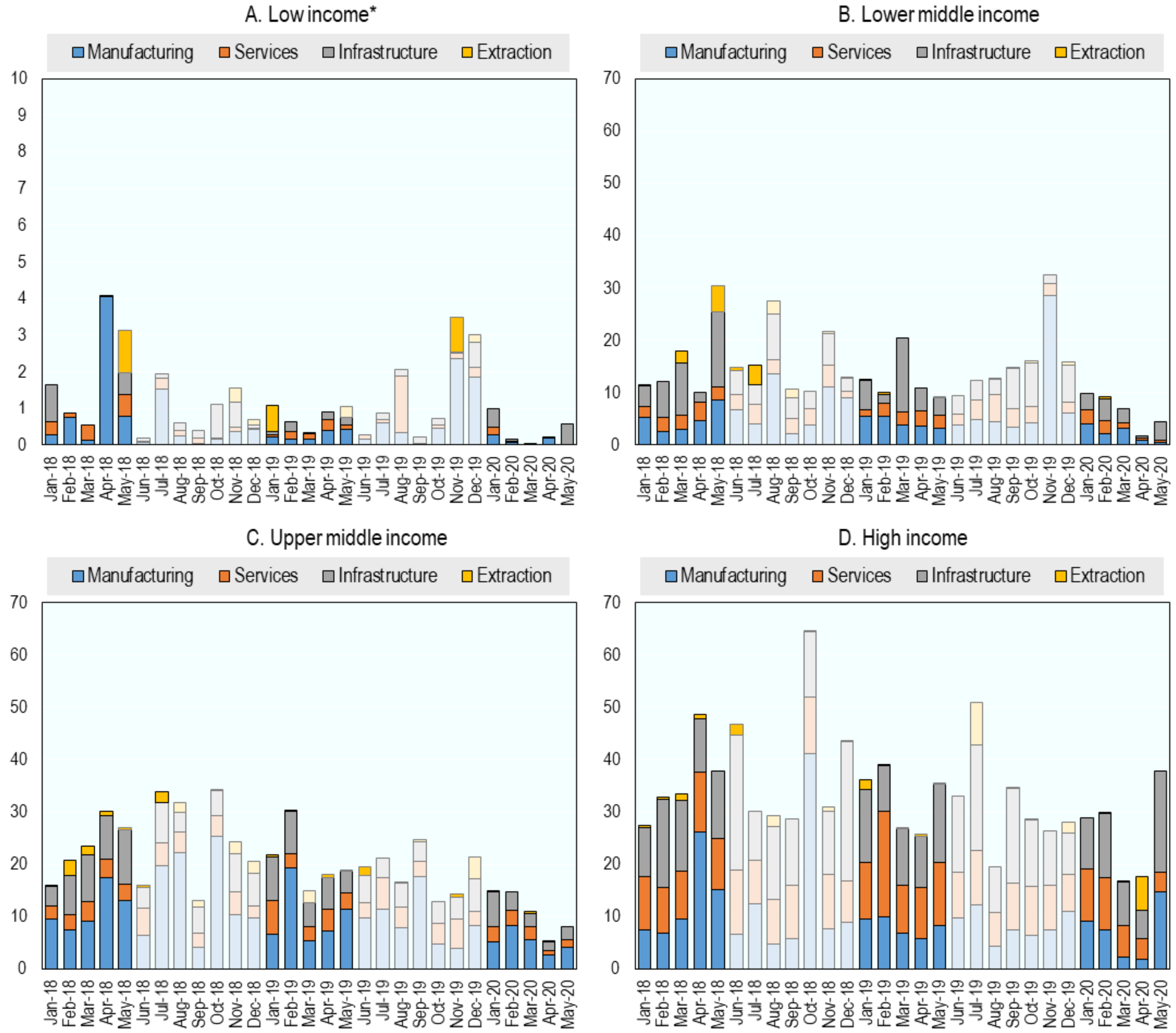
While cross-border M&As play a particularly important role in advanced economies, greenfield FDI tends to play a relatively more important role in developing economies. The latest data on greenfield FDI from the Financial Times' fDi Markets database provides further evidence that investors have become more reluctant to explore new investment opportunities in the face of the pandemic. This is shown by the decline in new project announcements over January to May 2020, compared to previous years (Figure 3). This decline is sharper across developing country income groups, where the monthly value of greenfield FDI pledges dropped by 50% relative to 2019 and more than 50% relative to 2018. In high income countries[5], the decline is lower – at a 20% drop relative to 2018 and 2019 – and in fact investment announcements returned to positive growth in May when lockdown restrictions started to ease in many OECD countries. A sectoral breakdown of greenfield investments shows that manufacturing, which tends to be more important in developing regions, suffered the largest decline in middle income countries. At the same time, investment pledges in manufacturing and infrastructure have triggered a return to positive growth in the OECD.

A closer look at greenfield FDI announcements across the six developing regions (not reported in Figure 3) illustrates that there is no region that is exempted from investment declines. All have seen drops in announcements in the first five months of 2020 compared to previous years. FDI slowdowns are particularly severe in Latin America and South Asia, while a sharp fall of FDI announcements has hit developing Europe and the Middle East & North Africa in more recent months (particularly April and May). Sub-Saharan Africa is the only developing region that returned to positive greenfield FDI growth in May, although this could be due to a few large projects and may not indicate a general trend.

[5] The high income group includes all high income countries and is not limited to the group of OECD economies.

Figure 3. Value of announced greenfield projects by income group, 2018-2020

Announced capital expenditure, USD billions on a monthly basis



Notes: *Note that scale for the low income group is different compared to the other regions.
Source: Author's calculation from Financial Times fDi Markets, as of 10 August 2020.

Divestments could increase

Divestments are a frequent and natural feature of the global economy, allowing firms to adapt their operations to rapidly changing business realities, including during crises.[6] A study by the OECD found that one in every five foreign-owned firms is divested every five years (Borga et al, 2020). Global surveys conducted just before the outbreak found that almost 80% of surveyed firms planned to divest some operations over 2020-21 and 60% in 2020 (Ernst & Young, 2020; and Deloitte, 2020). Understanding the dynamics of divestments is relevant not least because divestments can affect the performance of affected firms and the well-being of impacted workers and their communities. For example, formerly foreign-owned

[6] A 'divestment' is a situation when a foreign investor with at least 10% equity share in a company located abroad sells its equity shares either to domestic investors in host economies or operations are closed completely.

firms that were sold off to a domestic owner by their global parent, experienced, on average, about 25% drop in sales and value-added as well as 15% in employment.

Financial health and debt levels of MNEs are important drivers of international divestment. If firms are in sufficiently good financial health, they may be able to hold off divestments until the economy improves to obtain a better bid for the affiliates they are selling. Other firms may face severe liquidity constraints and rising debt levels that could force them to divest operations, especially as the pandemic hit when corporate debt had reached record levels (Celik et al, 2020).

Research has shown that, while corporate debt levels were lower on average in 2008 than today, foreign divestments in OECD and G20 countries increased during the 2008 crisis, exceeding foreign acquisitions in terms of number and value (OECD, 2020b). While some indicators point to an increase in divestments, little is known about trends in the current crisis. Additional research would be needed to study these trends, particularly in developing countries, and to understand factors that contribute to lower divestment risk – thereby balancing potential negative knock-on effects on livelihoods.

MNEs operate at reduced capacities

Even if divestments are not increasing, the global demand and supply collapse in some sectors (e.g. primary and consumer goods sectors) has led to shrinking MNE operations and cancellations of their orders with devastating economic and social implications for advanced and developing countries, as discussed in Section 2. Primary and capital goods, non-essential consumer goods and tourism have been relatively more affected (OECD, 2020k).

Macroeconomic turbulences directly translate into companies operations and ultimately affect jobs and livelihoods, as illustrated for the garments value chain in Bangladesh (Box 1). Companies' operations and the demand for their products or services are affected to varying degrees. According to a May 2020 survey by the Responsible Business Alliance – one of the world's largest industry coalitions covering electronics, retail, auto and toy manufacturing –, 50% of their members' and their members' supplier factories were not functioning at full capacity, almost 60% were receiving funding assistance from local governments and almost 80% of factories were seeing a negative impact to their revenue (RBA, 2020). Only 35% of factories were paying workers who could not yet return to work. Similar negative impacts on MNE operations are revealed in World Bank's (2020) most recent Investor Confidence Global Pulse Survey conducted earlier in 2020 (Figure 4).

It is unclear whether MNE operations in developing countries will soon recover to their pre-crisis output and employment levels. Several factors account for this. First, the economic recovery will likely take several years and economic scars will be deep. Second, the longer factories remain closed the higher the probability that production capacities are eroded. Investors will search for alternative investment opportunities whilst workers will consider migration and alternative employment opportunities. This could be a reality in India, for example, where 100 million migrant workers – corresponding to 20% of India's workforce – have been struggling to secure their basic livelihoods when India entered into lockdown in late March 2020. This ordeal has made them reluctant to return to work despite India easing restrictions to reboot industrial activities (Thomson Reuters Foundation, 2020).

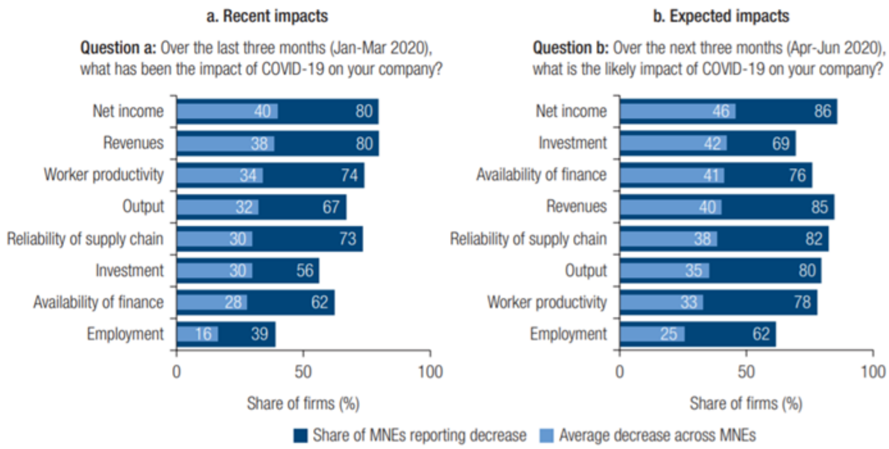
Some facts point to the relative resilience of pre-crisis investment locations and GVCs in developing regions. Almost 90% of factories represented by the Responsible Business Alliance reported in May 2020 that they could re-establish full production in less than one month if orders pick up (RBA, 2020). Additionally, MNEs' location decisions for production and sourcing are determined by various factors including those related to costs and risks, availability of human capital and natural resources, policy conditions, and, importantly, proximity to regional markets. If all these conditions have not fundamentally changed due to the pandemic, it is likely that MNEs re-establish previous production locations, which were evaluated as strategically optimal. Thailand's past experience of severe floods in 2011, which also resulted in a sudden supply shock, provides some hope that foreign investment locations are relatively resilient. Key producers relaunched and expanded operations in Thailand soon after the floods in 2011 (Miroudot, 2020; APEC, 2014). Nonetheless, recent research points to ongoing shifts in global value chains, with increased re-shoring and shortened value chains (De Backer and Flaig, 2017). These shifts have been observed pre-Covid and could continue or even accelerated in the post-Covid period.

Box 1. Severe GVC disruptions in the garment sector in Bangladesh

The case of Bangladesh, where garments account for more than 80% of exports, points to the severity of the crisis and its knock-on effects on global demand, operations and orders of MNEs and ultimately on garment producers and their workers. By April, more than 1100 garment factories in Bangladesh reported demand shocks that represented almost 1000 million pieces worth more than USD 3 billion in cancelled or postponed orders by global buyers (FWF, 2020). International buyers are halting new orders but also asking suppliers not to ship clothing that has already been made and deferring payments. In these cases, manufacturers have already incurred costs and may be in debt to their raw material suppliers. Cancellation of orders may cause suspension of scheduled wages and shut down of factories at a large scale. As the sector employs over 4 million people in Bangladesh, mostly women, this will have a severe knock-on effect on livelihoods (OECD, 2020h).

Donors and international organisations are helping to mitigate these effects and building resilience in the sector through coordinated efforts, such as Better Work Bangladesh, a multi-stakeholder initiative led by the ILO, IFC, Bangladesh Ministry of Labour and Employment, various employer organisations, 25 brand and retail partners, and supported by multiple donors, including Australia, Canada, Switzerland, the UK, Denmark and the Netherlands.

Figure 4. Multinational Enterprises experience significant economic impacts during the pandemic



Note: Computation based on World Bank's Investor Confidence Global Pulse Survey, conducted March-April 2020. Sample includes 105 MNE affiliates operating in 26 developing countries.
Source: World Bank (2020).

2. The new FDI reality puts stress on sustainability outcomes

Scarcity of FDI and crippled MNE operations during the pandemic are likely to affect past achievements of inclusive and sustainable development as well as future prospects FDI may bring. This section reflects on Covid-19 impacts on the clusters of sustainability – employment and job quality; productivity and innovation; gender equality; and carbon footprint – covered in the 2019 *FDI Qualities Indicators* (OECD, 2019a).

2.1. Jobs in foreign firms are not shielded from negative impacts

FDI can have widespread effects on host country labour markets. The establishment or relocation of a foreign greenfield investment and a change in the nationality of a firm's ownership causes changes in the demand for labour, thereby affecting employment, wages and the labour force composition (e.g. skill intensity or gender balance). FDI can also have effects on other working conditions, including on job security (e.g. whether foreign firms rely more on temporary workers than domestic business), occupational health and safety at work. The *FDI Qualities Indicators* show that FDI supports more jobs and better wages but could further improve job quality (OECD, 2019a). For instance, the indicators reveal that foreign firms are on average twice as productive as domestic firms, but they pay only 50% higher wages. This means that performance premia of foreign firms are not fully translated into wage benefits for workers.

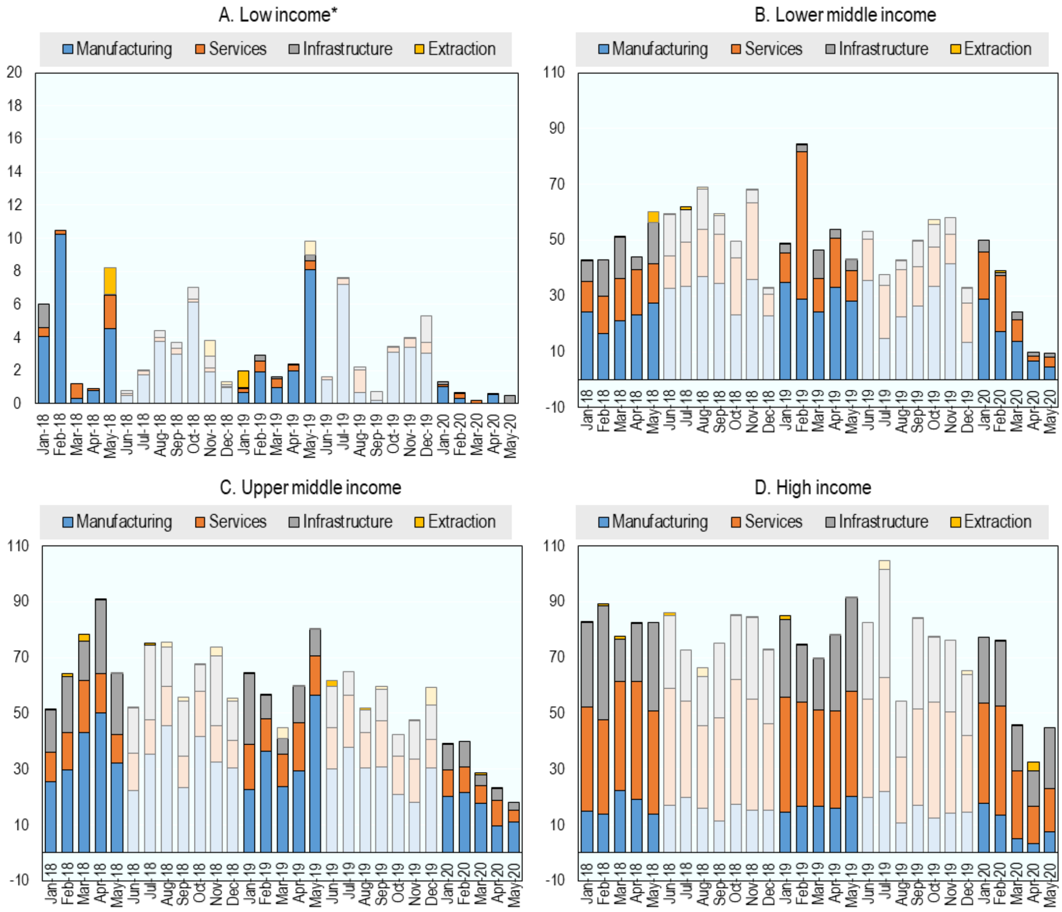
The drop in FDI has led to fewer jobs

The Covid-related drop in FDI flows has put a halt, at least temporarily, to the significant and sustained contribution of FDI to direct job creation. Greenfield FDI projects in 2018 and 2019 have generated every month nearly 80 thousand new jobs in the OECD area and more than 100 thousand new jobs in the developing world (Figure 6). The decline in new project announcements earlier in 2020 reduced the potential of job creation by nearly 50%, representing between 400 and 500 thousand jobs that were not (but were expected to be) created in the first five months of 2020. While this number appears low next to the almost 100 million 'real' jobs lost worldwide in 2020, it adds strain to the ambition of creating quality jobs – which FDI helps generating – to advance the SDGs.

Besides the amount of investment, labour intensity of an investment project (e.g. the number of jobs created per one USD million) also influences the number of direct jobs created by FDI. This is directly related to the nature of the economic activity (Box 2). Across all income groups, and relative to pre-pandemic levels, the number of jobs expected to be created by greenfield FDI projects in manufacturing dropped more than in services. This is particularly the case for middle-income countries with large manufacturing activities. Resilient investment pledges in infrastructure and, to a lower extent, in services shielded high-income countries from a collapse in expected job creation.

Figure 5. The impact of the COVID-19 crisis on jobs created through FDI, by income group

Jobs created in 1'000

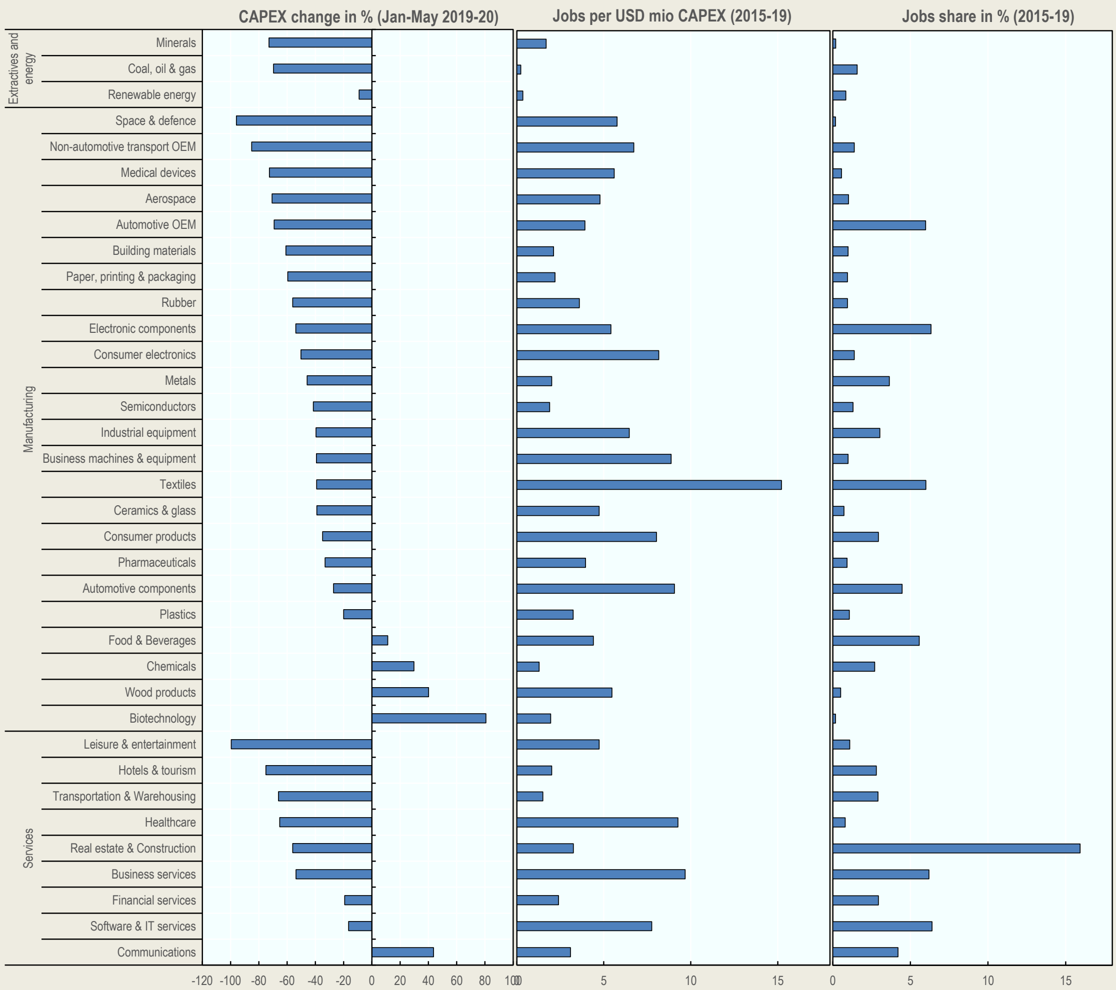


Note: *Note that scale for the low income group is different compared to the other regions.
Source: Author's calculation from Financial Times fDi Markets, as of 10 August 2020.

Box 2. Labour intensity of FDI and implications on job creation during the pandemic

In the developing world, sharp declines in greenfield FDI in infrastructure, automotives, consumer electronics, textiles, business services and software and digital services are likely to have affected most job creation in the first months of 2020 (Figure 6). These sectors have both a high job-creating propensity and received large investments before the pandemic, as illustrated by their high share in total FDI job creation between 2015 and 2019. Healthcare or medical devices also have strong propensities to create jobs but investment in these tend to be small, despite the ongoing needs generated by the health crisis. Resuming or increasing investment in all these activities will be crucial for boosting recovery on the jobs front. It is likely that countries with competitive and large agrifood and communications sectors have weathered the Covid-19 crisis with less damages on their labour markets, as announced investments in these highly job-creating sectors rose in the first months of 2020.

Figure 6. Job creation intensity of FDI in the developing world during Covid-19, by industry

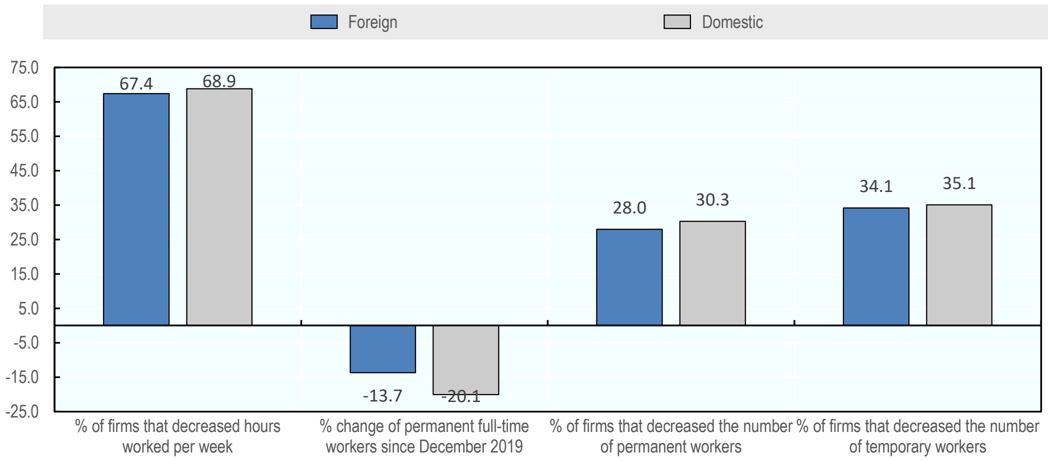


Note: CAPEX: announced capital expenditure.
Source: Author's calculation from Financial Times fDi Markets, as of 10 August 2020

Foreign – just like domestic– firms removed jobs massively and remaining staff work fewer hours

The Covid-19 crisis is also causing abrupt reductions in the operations of foreign firms in host countries. This in turn impacts workers, whose jobs, income and livelihood are at risk. While some foreign firms have been able to shield their workforce from such impacts and are choosing to keep and pay employees during the suspension of their activities, many businesses have had to lay off workers or reduce their working hours (see Box 1 in Section 1.2 for the example of Bangladesh). The behaviour of foreign firms has not been different from the one adopted by domestic businesses (Figure 7).

Figure 7. Covid-19 impact on labour market outcomes across foreign and domestic firms



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

This finding contrasts with other research, arguing that foreign businesses may carry out faster or larger adjustments when facing adverse shocks (Navaretti et al. 2003). For instance, a survey of professionals in India find that 67% of professionals see jobs in MNEs as the most vulnerable during the time of Covid-19.[7] This is plausible as MNEs have the option of relocating output across subsidiaries, an operation that may reduce their hiring and firing costs. However, further evidence indicates that labour adjustments by MNEs tend to be more elastic in cases of expansions than of contractions. It is possible that, when facing downward pressures, as with the Covid-19 crisis, foreign firms find it costly to reduce their workforce because of their higher skill-intensity, and thus larger efforts will be needed to find suitable candidates during the recovery (OECD, 2019a).

Foreign firms cope better with new ways of working compared to their domestic peers

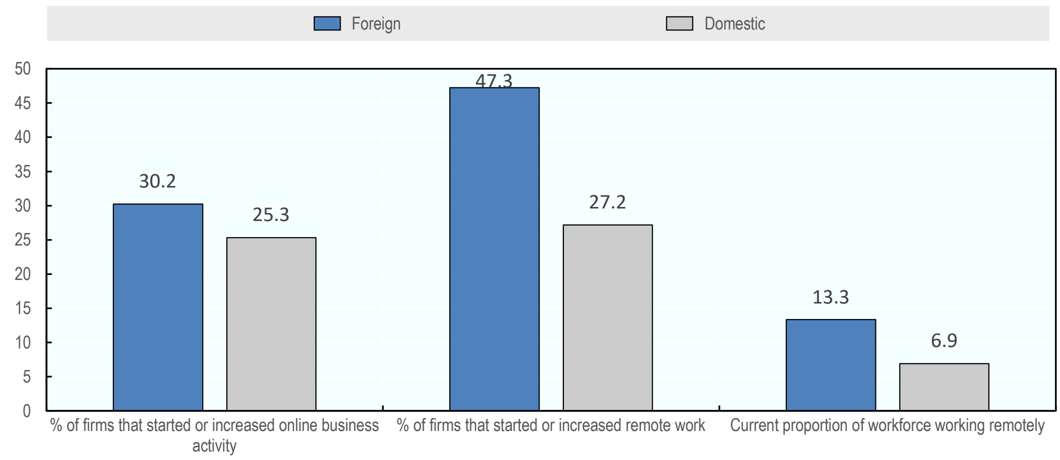
One priority for companies that are able to continue activity is protecting the health and safety of workers, and reducing workers’ exposure to Covid-19 in the workplace. Many businesses struggle to identify the right balance of measures to protect workers from being exposed or spreading the virus, including through limiting physical interaction at work, to enhance sanitary measures and to encourage teleworking, while

[7] The Economic Times, 19 March 2020, “Covid-19 impacts professional life: Jobs at MNCs to be most vulnerable; virus affects hiring”, https://economictimes.indiatimes.com/magazines/panache/covid-19-impacts-professional-life-jobs-at-mncs-to-be-most-vulnerable-virus-affects-hiring/articleshow/74710055.cms

keeping essential services going. This can be particularly challenging for businesses in labour-intensive sectors, such as garments, construction or healthcare.

Overall, foreign firms have managed relatively better than their domestic peers to adapt their *modus operandi* to the new business and work realities created by Covid-19 crisis. More foreign firms started or increased their online activities than domestic businesses since the outbreak of the pandemic (Figure 8); even though this might be related with the sectoral distribution of MNEs as illustrated in Box 3. Foreign firms also reported higher shares of their staff working from home than domestic businesses. Together with donors and other partners, MNEs may help domestic firms in host economies in their transition to new ways of work.

Figure 8. Foreign and domestic businesses are adapting their businesses to new forms of work



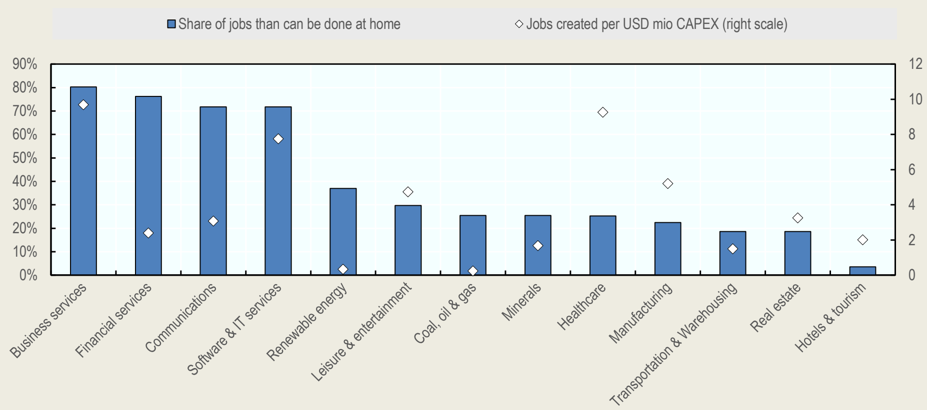
Note: Each indicator is an average of the 19 countries covered by the World Bank Enterprise Survey "Covid-19: Impacts on Firms". The countries are: Albania, Chad, Cyprus, El Salvador, Georgia, Greece, Guatemala, Guinea, Honduras, Italy, Jordan, Moldova, Nicaragua, Niger, Russian Federation, Slovenia,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

Box 3. Investment policymakers and development partners can help foreign firms promoting new ways of working

Differences in the ability to perform jobs remotely have affected the impact of confinement and other social distancing measures on both individuals' employment outcomes and disruptions to local economies (OECD, 2020w). Foreign firms may be well-placed to promote these new forms of work in host countries, either through imitation effects or through business relationships with local suppliers; donors may help to encourage them to do so.

MNEs have influenced the demand for telework even before the pandemic. Globalisation has expanded interconnectedness among business units, and digitalisation has enabled much of this coordination (Mayo et al., 2016). The intensity of teleworking strongly differs across tasks and sectors, and the new jobs that foreign companies will create during the recovery will not be equal in terms of their teleworking feasibility (Figure 9). For instance, foreign projects in business and digital services have high propensities to create many jobs with high teleworking feasibility. FDI in manufacturing or healthcare also generate numerous jobs but these often include tasks that can hardly be executed from home.

Figure 9. FDI-jobs in the developing world and the feasibility of teleworking, by industry



Note: Shares of jobs that can be done at home are calculated based on estimates for the United States. See Dingel and Neiman (2020) for further details. CAPEX: announced capital expenditure.
Source: Author's calculations based on Dingel and Neiman (2020) and Financial Times fDi Markets.

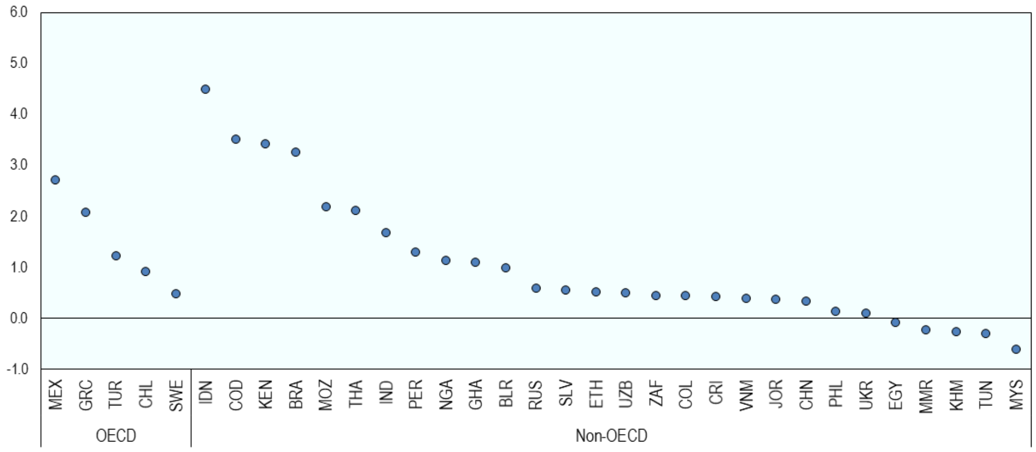
The feasibility of teleworking, and regulations on teleworking arrangements, are likely to affect future companies' investment (or divestment) decisions, the type of investment they intend to do and the way they adjust their ongoing operations. Unlike domestic businesses, multinational employers must also consider how different approaches to address the impact of the pandemic can be implemented in the various countries in which they operate. This can be challenging for companies that wish to implement uniform global practices, but that may be prevented from doing so due to varying policies and protocols across countries (Collins and Hutzler, 2020). In the OECD area, countries adapted their regulations to teleworking (OECD, 2020x). In developing countries, MNEs, with support from labour unions and development partners, can play a leading role in adapting themselves to new work realities without waiting for regulatory measures to contain the pandemic. Their good practices could serve as a basis for promoting global agreements to protect workers' health, employment and wages. Donors and investment policymakers could help to promote such practices and global standards.

2.2. FDI's role to drive productivity growth in developing countries is challenged

FDI can accelerate productivity growth by modernising production techniques and enabling transmission of new technologies. Sectors receiving more FDI tend to experience higher growth in labour productivity and R&D intensity than other sectors (OECD, 2019a). This is the result of foreign firms being on average more productive than domestic firms (Figure 10), which is in turn linked to foreign affiliates having stronger access to technology, better managerial skills and more resources for capital investment than domestic firms. 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 local companies, especially SMEs.

Figure 10. Productivity outcomes of foreign and domestic manufacturing companies

Are foreign firms more productive than their domestic peers? (yes if score > 0; no if score < 0)



Note: The figure compares labour productivity levels between foreign and domestic firms. If the score is >0, foreign firms outperform domestic firms and vice versa if it is less than 0. Foreign firms are firms with at least 10% foreign ownership. For more details, please see methodology (Annex B) in OECD (2019a),

Source: OECD (2019a), FDI Qualities Indicators, based on World Bank Enterprise Surveys.

Productivity growth in both OECD and developing countries has faded or gone into reverse since the 2008 global financial crisis, affecting over 80% of the global extreme poor as well as reaching emerging markets and developing economies (Dieppe, 2020). The FDI Qualities indicators provide evidence that, while productivity and innovation gains from FDI exist, they vary greatly in magnitude and do not always materialise (OECD, 2019a). The gap in productivity between foreign-owned and domestic companies affects the likelihood of positive spillover effects on the productivity of local firms. The latter – whether SMEs or not – need to have enough "absorptive capacity" to benefit from the presence of foreign investors and to build buyer-supplier relationships with them (Imbriani et al., 2014; Zhang et al., 2010).

Productivity disparities between more productive large – including foreign – firms and SMEs are likely to increase

The Covid-19 crisis risks to weigh on longer-run trends that could further impede productivity growth in the developing world. Adverse demand and supply-side effects, such as disruptions in GVCs, weaker investment and trade, the tightening of financial conditions, and the reduction of consumer demand for goods and services, could push down labour productivity by disrupting the international technology diffusion that takes place through FDI flows. These adverse events could result in increasing productivity disparities across firms and sectors, particularly in developing countries where productivity gaps between foreign and domestic firms were already pronounced before the pandemic.

SMEs are likely to suffer the most without state support while larger firms, including affiliates of foreign MNEs, are typically better prepared to adjust their operations and move towards the automation of some occupations. SMEs are strongly represented in sectors such as tourism and transportation, which are significantly affected by the containment measures, as well as fashion and food where short delivery times are of essence (OECD, 2020z). They may also have less resilience and flexibility in dealing with the costs these shocks entail due to their limited resources and existing obstacles in accessing capital. Meanwhile, those SMEs participating in GVCs are even more vulnerable as they often bear the brunt of the difficulties of large MNEs. It may be difficult for many SMEs to rebuild connections with former business networks once supply chains are disrupted.

In the short-term, ‘measured productivity’ is likely to fall as governments in developing countries have implemented policies to help SMEs survive, and avoid or reduce labour lay-offs even if firms’ outputs decline. This could widen the productivity gap between foreign, typically large, firms and local SMEs, further weakening the impact of FDI on aggregate productivity growth. In the longer run, within-firm productivity losses could be balanced out through the adoption of new technologies in certain sectors and the organisational and technological changes in business models that have taken place during the pandemic, including remote working as illustrated above. By encouraging the adoption of more efficient production technologies to cope with the crisis, pandemic-induced structural changes may allow more performing firms, including innovative SMEs, to accelerate the automation of their production capabilities and be better equipped to act as partners or suppliers of foreign investors (Dieppe, 2020).

Some industries that were driving productivity in developing countries pre-Covid may receive less FDI in the future

Sectoral reallocations towards higher-productivity sectors could also be affected by the unprecedented containment measures put in place to curtail the spread of the virus (Di Mauro and Syverson, 2020). Although the economic and financial repercussions of the pandemic would naturally make workers shift from sectors most adversely affected to those less adversely, or favourably, affected (such as the technology, health care and communications sectors), restrictions in mobility due to the pandemic will most likely prohibit workers in rural areas from moving to urban centres, where more innovative and productive firms are located.[8] At the same time, severe disruptions of GVCs may also mean reduced demand for developing countries’ workers in urban centres.

These sectoral reallocations will also be affected by the direction and magnitude of future FDI flows, which could ultimately shape aggregate productivity impacts in developing regions. Economies with large and performing knowledge-intensive sectors that benefited from FDI prior to the crisis and were less adversely affected by the pandemic (such as ICT and health care services) could continue to grow and attract FDI that links foreign investors into the local economy. On the other hand, FDI in adversely-affected sectors, such as air and transport services, tourism and some retail activity will likely face more persistent contractions, further impairing developing countries whose economy disproportionately relies on these sectors.

[8] Rural workers may also be unwilling to move (back) to urban centres given the severe threats to their livelihoods experienced in cities during the pandemic, as illustrated for the case of India further above.

2.3. The Covid-19 impact on FDI may exacerbate existing gender inequalities

FDI affects labour market outcomes of recipient countries and may enhance gender equality. The 2019 *FDI Qualities Indicators* highlight potential trade-offs in the way FDI relates to different gender equality dimensions (OECD, 2019a). For instance, they show that investment by foreign MNEs in developing countries often creates a large number of jobs for women, especially in labour-intensive industries such as garment, electronics and food. Employment opportunities created in those sectors, however, tend to be low skilled and low paid and generally offer limited prospects for career development to women.

Impact of the pandemic has been especially hard on women (OECD, 2020o). This is because women are over-represented in the health sector, do most of the unpaid care work in households, face high risks of economic insecurity, and are more likely to be victims of violence, abuse or harassment during times of quarantine.

Women are also over-represented in sectors that are severely affected by the Covid-19 crisis. These include air travel, tourism, retail activities, accommodation services, but also several manufacturing industries like apparel and food. These sectors depend extensively on foreign investment in developing countries, particularly apparel and food (OECD, 2019a). Accordingly, cutting costs to tackle liquidity challenges directly translate into employment risks for women.

Disruptions in MNE activities are likely to affect not only women directly hired in MNE's own affiliates, but also those employed by suppliers, as initial evidence is showing. A survey of suppliers in Bangladesh's garment sector, a sector that in Bangladesh employs predominantly women, reveals that more than one million garment workers have already been fired or furloughed because of order cancellations and the failure of MNEs to pay for these cancellations (see above Box 1). Similarly, many garment suppliers in Myanmar and Cambodia have suspended work without paying workers, as some MNEs have not paid for orders already completed (The Anner, 2020).

In developing countries, women are also more likely to be in informal employment and have thus little access to social protection schemes like unemployment insurance and contributory health systems (OECD, 2020o). They may also be more exposed to the risk of infection, as companies may not be able to implement measures and safeguards to protect workers (OECD, 2020n).

While in the immediate term, cost cutting measures adopted by MNEs in financial distress may result in higher women unemployment, longer term risks will come from changes in MNE investment strategies. The Covid-19 outbreak has changed the way MNEs operate globally and it is likely that they will further revise their business strategies and investment decisions to build resilient supply chains. While longer term changes in GVCs are still unclear, any shifts in terms of MNEs' supplier base or re-shoring (parts of) production could have important implications on women workers, particularly in female-dominated sectors and low cost investment destinations (Javorcik, 2020).

2.4. FDI in renewables appears resilient despite disruptions in global supply chains

FDI can facilitate the transition to a low-carbon economy by contributing the needed financial and technological resources to curb CO_2 emissions, induce the adoption of new energy-saving technologies and influence the uptake of clean energy sources. The *FDI Qualities Indicators* provide, for example, evidence that FDI prevails in cleaner, less CO_2-emitting sectors with the exception of countries that rely heavily on fossil fuels as a source of income (OECD, 2019a). FDI is also associated with sectors that consume less electricity and heat, and are therefore more energy efficient. Foreign MNEs can also play a critical role in improving energy efficiency in host countries through the deployment and innovation of renewable energy technologies, whose positive impact may be amplified if they are diffused to domestic firms. Low income (LICs) and lower middle income countries (LMICs) with greater financing needs could therefore draw particular benefits from attracting FDI in renewable energy as well as low-carbon infrastructure and technology.

The containment measures imposed across the globe to curb the spread of the virus and the associated collapse of economic activity have caused large reductions in CO_2 emissions, particularly due to the slowdown in industrial activity and transportation. The IEA expects global CO_2 emissions to decline by 8% in 2020 compared to 2019 (IEA, 2020). In China, for example, the slowdown of industrial activity is estimated to have caused a 25% reduction in CO_2 emissions in February 2020, compared with the same month in 2019 (OECD, 2020p). Despite this temporary drop in emissions, it is too early to draw conclusions about whether the impact of the Covid-19 crisis will be large enough to significantly alter the climate problem. Reducing emissions in the long run will require considerable public and private investment in low-carbon technology and infrastructure.

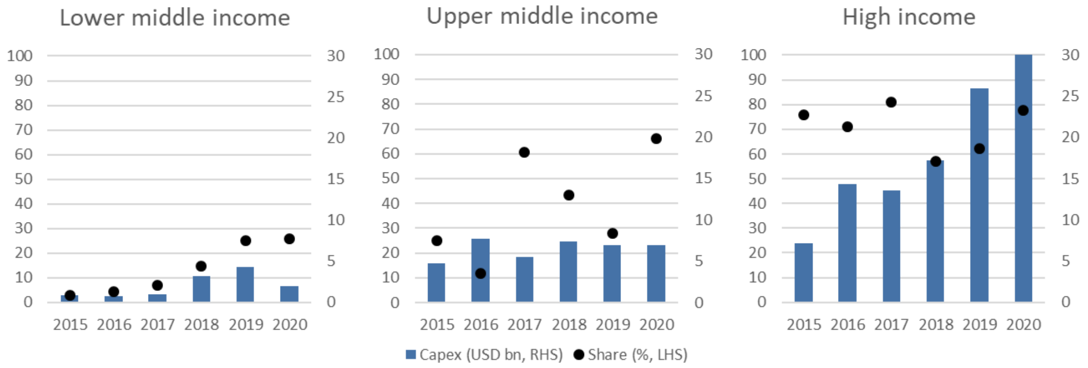
A closer look at FDI flows reveals that the contribution of foreign investments to renewables relative to fossil fuels is growing rapidly, not only in OECD countries but increasingly also in developing regions like Southeast Asia and Sub-Saharan Africa. The stock of FDI in renewables constitutes a sizeable share of overall greenfield FDI in a number of developing countries, including Panama, Uruguay and Guatemala, Lao PDR, Ethiopia, South Africa and Kenya (OECD, 2019a).

The renewable energy sector has demonstrated considerable resilience in upper middle income countries (UMICs) since the beginning of the Covid-19 crisis. The latest data on greenfield FDI from the Financial Times' fDi Markets database demonstrate that in UMICs almost 70% of total greenfield FDI in the energy sector went into renewables over January to May 2020, more than doubling its share compared to the same months in 2019 (Figure 11). In LMICs, investments in renewables are still less frequent in general, and have dropped considerably in the first five months of 2020. High income economies have continued to expand the trend toward renewable energy both in absolute and relative terms (the share of renewables is now at approximately 80% of total energy investment, up from 60% in 2019). Amid a collapse in demand for energy earlier in 2020 as a result of lockdown measures, renewable energy was the only source that posted a growth in demand by about 1.5% relative to Q1 2019 (IEA, 2020). This was largely due to the priority given to renewables in the grid over other sources of electricity, as well as the additional output of new wind and solar projects that were completed over the past year.

Despite the resilience of renewables in terms of both FDI flows and energy demand during the first half of 2020, the pace of renewable power capacity additions in 2020 will likely slow down due to disruptions in global supply chains, construction delays, a decline in installation activity, and importantly, currently low prices of oil and gas(IEA, 2020). The diffusion of energy-saving innovation and technology to domestic firms of developing countries could therefore be hampered in the short run by industrial shutdowns and a decline in MNE activities. However, renewable electricity generation is still expected to rise by nearly 5% in 2020, making renewables the energy source the most resilient to the Covid-19 crisis.

Figure 11. Greenfield FDI in renewables by income group

Capital investment over January to May of each year, 2015-20



Note: Greenfield FDI is defined as capital expenditure (CAPEX)
Source: OECD based on Financial Times' fDi Markets database

3. The investment and development cooperation communities could join forces to respond to the crisis and build back better

The Addis Ababa Action Agenda (AAAA) underscored the need for a holistic approach to financing the 2030 Agenda: it called on all available resources, domestic and foreign, public and private, in support of the Sustainable Development Goals (SDGs). A gradual growth of FDI is thus essential, particularly to ensure a smooth phasing out of Official Development Assistance (ODA).). Enhancing the qualities of FDI, coupled with adequate domestic resource mobilisation, can thus help developing countries to continue to develop and reduce dependency on development cooperation while remaining on an inclusive and sustainable growth path (OECD, 2020a; Piemonte, 2019).

The current drop in FDI could strain resources necessary for development and prolong the dependence on ODA of transitioning countries – at a time when ODA is also under stress – or it could create financing gaps in these economies. Beyond financing, and as shown in Section 2, FDI can be an important contributor to sustainable development. FDI can enhance productivity and innovation, create quality jobs and develop human capital, and raise living standards and environmental sustainability – but all these positive contributions are currently challenged by the Covid-19 crisis.

The unprecedented situation of the ongoing pandemic should be used as an opportunity to reflect on how investment policymakers and the donor community can work together on a three pronged agenda of action:

1. mitigate the impacts of the economic collapse on health systems and livelihoods;
2. contain the drop in FDI to developing countries; and
3. build back better by ensuring that new and existing investments are aligned with the SDGs and the Paris agreement on climate change.

3.1. Mitigating the impacts of the economic collapse on livelihoods

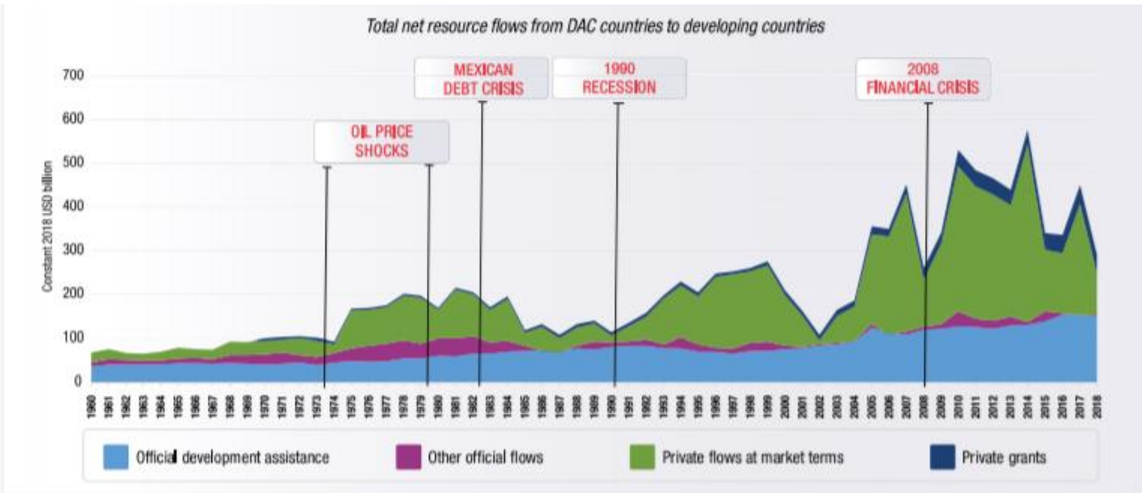
As a financing buffer during the crisis, development cooperation plays a key role to mitigate impacts

Previous sections have pointed out severe repercussions of the crisis on investment and global economic activity as well as on jobs, skills, gender equality and livelihoods more broadly. Besides containing and rebuilding sustainable investment, policymakers and donors are concerned with immediate and longer term crisis responses at the national and international level to mitigate the impacts of the economic collapse on livelihoods.

As FDI and other sources of financing fall, development cooperation – and ODA in particular – can be a crucial countercyclical flow. ODA has historically been the most stable and predictable source of external financing for developing countries (Figure 12). Whilst all sources of development finance are under pressure due to the crisis, and ODA disbursements could also be threatened as economies contract, ODA is likely to maintain this role of stability and will provide important funding to mitigate impacts on livelihoods.

Donors recognise the crucial role ODA plays in supporting developing countries' response to the pandemic and have committed to "strive to protect ODA budgets" during the crisis (OECD, 2020b). Various development cooperation partners are scaling up their efforts: through its "Team Europe" initiative, the EU has committed USD 20 billion to developing countries as part of its global response to Covid-19 supporting partner countries and fragile populations (EUEA, 2020).

Figure 12. Historically, ODA is the most stable external resource for developing countries



Source: OECD

Donor support to protect livelihoods is also – and particularly – needed in more advanced developing countries that are less protected by ODA

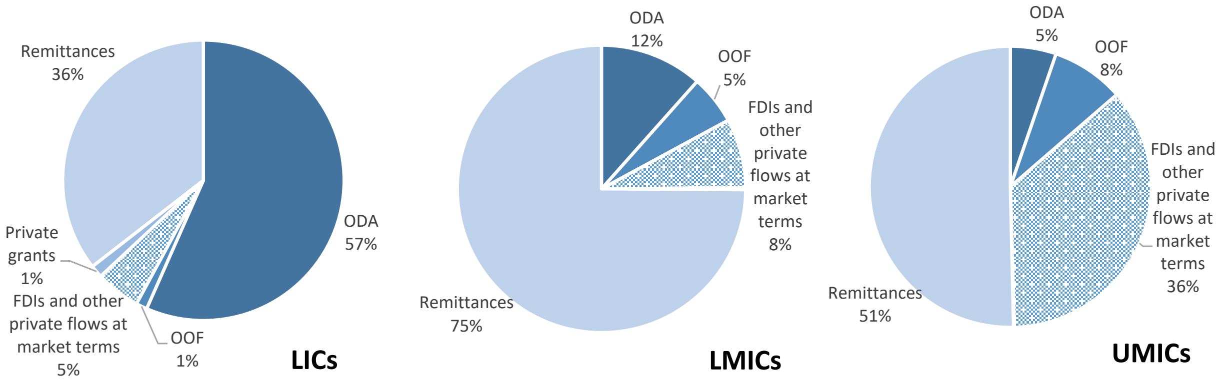
As countries develop, their external financing scenario changes gradually: ODA phases out while other sources of financing phase in. Highly dependent on public external support (mainly ODA) in early stages of transition, countries progressively move towards private financing – including FDI (Figure 13). FDI represents a much larger component of the external financing mix in upper middle-income countries (UMICs) (36% from 2014-18 compared to 5% for low income countries, LICs).

UMICs are projected to suffer the most from the Covid-19 crisis (OECD, 2020f and 2020g). These countries are highly dependent on external private financing (including FDI) – which is currently falling (see Section 1.2), more open to international trade and thus subject to demand shocks and less protected by ODA-like flows (compared to LICs and lower middle income countries, LMICs, that receive relatively more ODA, which plays a protective role in face of the crisis, and have subsistence economies more resilient to external shocks).

In this sense, responding to the crisis and mitigating impacts of falling trade and investment requires solutions and donor support tailored to the different stages of development. More advanced countries that have been phasing out ODA could be in particular need of donor support to mitigate crisis impacts on jobs and livelihoods.

Figure 13. UMICs are the countries most affected by decreases in FDI

Disbursements, 2014-18, 2019 prices



Source: Author's calculations based on CRS database (ODA, OOF flows, private flows) https://stats.oecd.org/Index.aspx?DataSetCode=CRS1; DAC database (private flows) https://stats.oecd.org/Index.aspx?ThemeTreeId=3; World Bank database (remittances) https://databank.worldbank.org/source/world-development-indicators.

Donors can provide vital support to strengthen social protection schemes

Given the impact that the fall in FDI and disrupted GVCs will have on employment, the role of social protection is of critical importance to protect the livelihoods of households in developing countries. Social safety nets have been a key component to immediate response to the Covid-19 pandemic, including in developing countries. According to the Gentilini et. al. (2020), 190 countries have implemented, adapted or planned over 900 social protection measures during the crisis, often in the form of cash transfers. Other schemes emerging from government fiscal support packages to date include prohibitions on laying off workers, guarantees to pay all or a portion of wages or commitments to invest in worker skills and training (OECD, 2020n). However, these efforts will be difficult to continue in the medium to long-term due to severe fiscal constraints.

Donors can help to ensure the continuity of social protection measures as the pandemic and its economic consequences drag on. Moreover, donor funds can be critical in introducing social protection measures in countries where the necessary social infrastructure does not exist. This is the case for countries in sub-Saharan Africa, which as a region, expanded the number of social protection beneficiaries by only 2% compared to 15% in South Asia and East Asia and the Pacific (Gentilini et. al., 2020). France has been leading the way with its proposal of a Global Fund on Social Protection, which would serve as temporary social safety nets for times of crisis.

Donors can work with MNEs and other companies in designing innovative and alternative solutions to conventional social protection measures. In countries that have no or only a weak social insurance system, which will fail to identify and target the unemployed, job retention schemes can be an effective tool to channel government support to vulnerable households.

Since women will be disproportionately affected by the drop in investment levels and its economic implications, donor programmes that are designed to enhance female empowerment through job training and credit facilitation can be of particular importance during this time of crisis. Donors can build on the variety of existing tools and programmes that have already been developed and customize them to the current context. For example, donors can strengthen their focus on women that have been employed in sectors that are particularly affected by the crisis such as consumer goods and tourism.

3.2. Containing the drop in FDI to developing countries

Donors should continue supporting investment climate reforms

When it comes to containing the drop in FDI and MNE operations, the role of development cooperation also varies across countries' level of development. Countries transitioning from lower to upper middle incomes are relatively more exposed to a fall of global FDI flows and reduced activities of MNEs, as compared to low income countries which depend little on FDI (see above Figure 13).

A strong investment climate, in line with the guidance provided by the OECD *Policy Framework for Investment* for example, is a prerequisite to contain and increase investment flows in transition economies and should be promoted from an early stage of development (OECD, 2015).

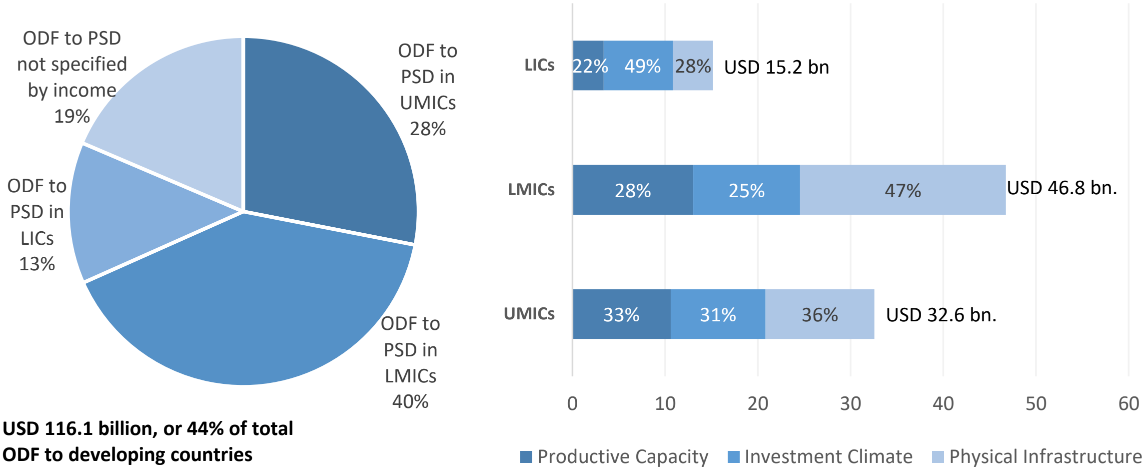
As countries reach higher levels of income, private investment plays an increasingly important role in financing their development, and the need and demand for ODA declines. However, this transition and substitution of financing sources needs to be anticipated and prepared for to ensure that both the quantity and quality of financing remains sufficient to avoid development setbacks.

Donors can help public authorities in these countries to improve the general framework conditions that could reduce costs, risk and uncertainty for market participants (e.g. business regulations, financial framework, trade policy, and the labour market), in addition to other private sector development (PSD) efforts such as improving productive capacity (e.g. economic diversification, integration into regional and global value chains, and value chain upgrading) and developing infrastructure.

Donors are highly engaged in supporting PSD in developing countries – including with support for investment climate reforms, as illustrated by the example of Investment Policy Reviews in Cambodia (Box 4) and Myanmar, for example. Approximately 45% of total ODF supported PSD in 2017-18 (Figure 14): Low income countries (LICs) received 13% of all PSD aid, where almost half was spent on investment climate reforms. Lower middle income countries (LMICs) received 40% of the total support for PSD and about one quarter was used for improving the investment climate. Upper middle income countries (UMICs) benefited from 28% of the total PSD support and used one third for investment climate reforms. Notable from the data is the small absolute and relative amounts of ODF flowing towards private sector development in LICs (just 13%); this mirrors the relatively small amount of foreign and other private investment they receive (Miamoto and Chiofalo, 2017).

Figure 14. ODF to Private Sector Development (PSD) by income grouping

USD billion disbursements, 2017-18, 2019 prices



Source: OECD based on Creditor Reporting System (CRS) database, https://stats.oecd.org/Index.aspx?DataSetCode=CRS1

Box 4. Donor support for a strong and coherent investment climate in Cambodia

In the area of the investment climate, European development partners have been providing technical co-operation for public financial management in Cambodia in order to strengthen macro-economic stability and trade policy, with the EU and Sweden providing support for revenue mobilisation, economic statistics, external audit, budget transparency, external oversight through the parliament and anti-corruption. The EU and Sweden also collaborate with Switzerland on improving public governance and service delivery at the provincial level by strengthening the capacity of district and municipal administrations.

Development partners also support the area of responsible business conduct (RBC), particularly in the garment industry, which is the largest contributor to growth in Cambodia. Examples include a programme by Sweden – implemented by the ILO and a Swedish trade union, IF Metall – to improve industrial relations by building capacities of the government, trade unions and factory owners, as well as in ameliorating working conditions in factories. By sharing common interests, Sweden and ILO are particularly active in this area, partly to support H&M’s efforts as an ethical and cost effective investor in Cambodia. In addition, the Better Factories programme – financed by Agence Française de Développement (AFD), Germany, Netherlands, and the United States, and implemented by the ILO – monitors factories and trains managers and workers. It provides guidance and advice on factory improvements that help enterprises preserve profits while respecting workers' rights. Australia and others also fund Better Work Cambodia, in collaboration with the ILO and IFC, which brings together all levels of the garment industry to improve working conditions and to respect labour rights while boosting the competitiveness of businesses.

Source: OECD (2018e)

Regulatory reforms to facilitate sustainable investment should be prioritised – and donors can bring in the expertise and resources to help this process

As countries are moving towards economic recovery, governments are ever squeezed by limited resources to fulfil public objectives – not least due to fewer tax revenues and extensive expenditures in order to reduce the bleeding and initiate the recovery. In this context, priority of reform efforts will need to be in areas that are fiscally the least costly while being most effective to attract new investments. Donors are urged to help policymakers in developing countries to advance such reform processes.

The World Bank's 2019 Global Investment Competitiveness survey, which was conducted with affiliates of MNEs in 10 developing countries just before the pandemic struck, shows that almost 85% of the respondents consider the legal and regulatory environment as important or critically important for their decisions to invest (Figure 15). The legal framework for investment ranks ahead of considerations such as low taxes and low input costs and it is particularly important for larger firms.

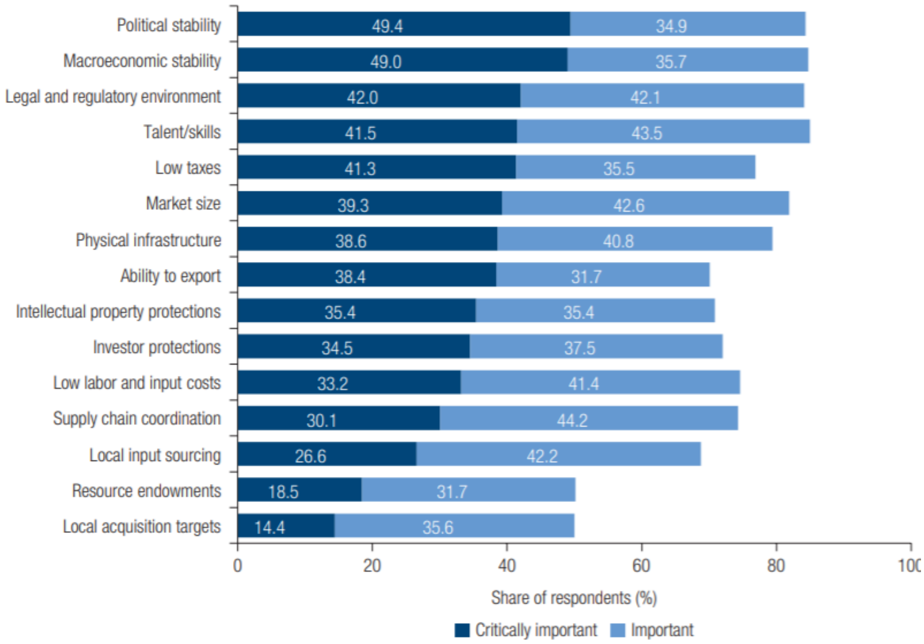
The same survey showed that more than half of the respondents experienced declines in either investment, jobs created or productivity due to protectionism and economic nationalism in trade and investment during the pre-crisis period (World Bank, 2020). This is supported by recent OECD research showing that an open and coherent domestic and international legal framework for investment will also help to reduce divestment risks (Borga et al., 2020).

Investment and donor communities should therefore keep and enhance their commitments to create open and predictable environments for investment. Efforts to facilitate sustainable investment should be intensified, which includes essentially the provision of clear, transparent and stable regulatory conditions for investment, and measures to retain and augment existing investment and policies to strengthen its positive impact in their societies. Investment promotion agencies (IPAs) should thereby continuously align efforts with market signals and changing investor preferences and needs, particularly in times of economic uncertainty (OECD, 2020r, and World Bank, 2020). Donors can support by embedding experts in local IPAs to help build capacity and provide technical assistance on the investment climate, such as the JICA (Japan International Cooperation Agency) Project on Supporting Investment Promotion in Africa.

Policy action is also required at the international level. Efforts by a group of countries, under the WTO Structured Discussions on Investment Facilitation for Development, urge for a set of practical measures concerned with improving the transparency and predictability of investment frameworks, streamlining procedures related to foreign investors; and enhancing coordination and cooperation between stakeholders such as host and home country governments, foreign investors, and domestic corporations as well as societal actors (IISD, 2019). The future of the agreement is not yet clear but will be discussed at the next WTO ministerial meeting, which has been postponed due to the Covid-19 outbreak earlier this year.

Figure 15. Factors determining the decisions to invest

Share of affiliates of foreign MNEs considering a given factor as (critically) important for their decisions to invest



Note: Affiliates of MNEs were surveyed in 10 developing countries: Brazil, China, India, Indonesia, Malaysia, Mexico, Nigeria, Thailand, Turkey and Viet Nam.
Source: From World Bank's 2019 Global Investment Competitiveness Survey in World Bank (2020).

Donor support in the form of capacity building and technical assistance can play a role in equipping local institutions with the tools that are necessary to implement the reform. For example, donors can work with IPAs and developing country governments to improve the enabling environment for sustainable investment. Increased donor support would also be relevant in the area of aid-for-trade. The United Kingdom, for example, enhanced its aid-for-trade programme by providing tailored support through its Trade and Investment Advocacy Fund and World Bank's Trade Facilitation Support Programme.[9]

3.3 Building back better: rebuilding investment for sustainable development

Donors can partner with the private sector to catalyse sustainable investments

Development partners are increasingly using development cooperation to leverage private investment for sustainable development. As shown in Figure 15 above, almost 50% of total donor support goes to efforts to develop the private sector. This is important because Official Development Finance (ODF) is relatively small in scale (less than USD 0.2 trillion per year) and stands against very high investment gaps for the developing countries to achieve the SDGs (approximately USD 2.5 trillion per year, corresponding to pre-crisis estimates). With the Covid-19 crisis, this gap is being increased dramatically (see Section 1).

Donors should reinforce their efforts to partner with private investors to catalyse private investments that support a sustainable recovery and achieving the SDGs. In this context, blended finance is "the strategic

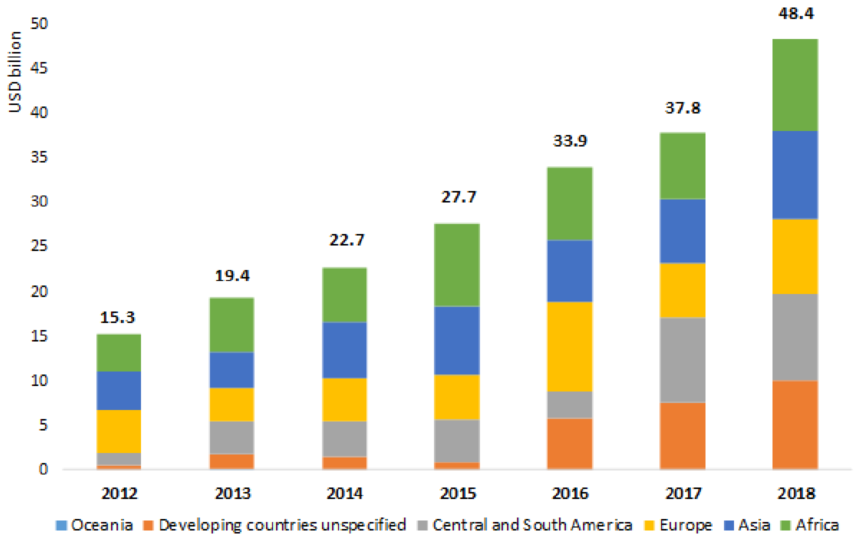
[9] https://www.gov.uk/government/news/the-united-kingdom-announces-two-covid-19-response-services-for-eligible-developing-countries-to-help-combat-the-impact-of-the-virus-on-international

use of development finance for the mobilisation of additional commercial finance towards the SDGs in developing countries" (OECD, 2017). The role of blended finance in mobilising private finance for development outcomes has been gaining prominence: USD 205.1 billion of private finance was mobilised by development finance between 2012-18, with an acceleration between 2017-18 (Figure 16); 17 members of the OECD Development Assistance Committee (DAC) now engage in blending; and 167 facilities were launched between 2000-2016 to pool finance for blending (OECD, 2018a, 2020c).

Whilst donors should work to increase the use of blended finance during the recovery, they also need to increase the understanding and transparency of these flows and to ensure least developed countries (LDCs) are not left behind. Of all the private finance mobilised by official development finance interventions between 2012 and 2017, only USD 9.3 billion, or 6%, went to LDCs, whereas over 70% went to middle-income countries (OECD, 2019[15]).

Figure 16. Private finance mobilised by official development finance, across regions

current USD (2012-2018)



Source: OECD (2020d), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm

Donors can also facilitate and accelerate technological adoption. Official development finance was transformational for many countries in their digital revolution and donors can continue to play an important role as developing countries undergo technological progress which will be a key requisite in attracting FDI in a post-Covid environment. For example, the CDC Group, the UK's development finance institution, pioneered investments in Africa's mobile network, which spearheaded the technological transformation of the continent. The number of mobile phone users increased from almost none in the early 2000's to more than 400 million in 2017 (Runde, Bandura and Ramanujam, 2019).

Donors can help finance the expansion of digital technologies that are critical to maintaining competitiveness despite continued social distancing measures and to attracting investment in sectors that have proven to be resilient during the crisis. Donors can also explore the use of other tools, such as de-risking instruments and guarantees, to help build a more sustainable investment environment.

Recovery efforts to attract investment should be conditional on sustainability criteria

Besides mitigating some of the immediate impacts on jobs and livelihoods, government stimulus packages may provide the conditions to rebuild some of the more systemic investment flows and advance an agenda for more sustainable investments to build back better. If sustainable and long-term development is the priority of national and international policymaking, financial support as well as tax and other incentives for investment should be conditional on ambitious, well-defined and transparent criteria aligned with the SDGs. In this regard, EU's recently agreed EUR 750 billion pandemic recovery plan, embedded in its EUR 1 trillion seven-year budget, is an encouraging example. EU recipient countries will need to commit to economic reforms, rule of law and climate objectives – even though all these conditions have been watered down by the end of EU leaders' historic negotiation in July 2020 and it remains to be seen how these schemes will be implemented to attract new private investment.

Developing country governments, in support of development partners, can use existing standards to condition recovery support and navigate numerous legal, ethical and political hazards associated with recovery funds (OECD, 2020n). Commitments to internationally-recognised RBC standards and instruments can help ensure that benefits of fiscal support measures are shared equitably, and that businesses receiving fiscal support are appropriately managing their broader environmental, social or governance risks (OECD, 2011 and 2018b).

Donors can help governments to uphold responsible business conduct at all times

Responsible business conduct is not only key during crises and their recoveries but also to ensure that investment is more resilient to any future crisis and maintains societies' sustainability objectives. For example, investors with strong RBC risk management frameworks are better equipped to identify, assess and address risks in their supply chains. Companies with strong health and safety standards reduce their exposure to health risks and businesses that carry out RBC due diligence have more visibility and trust in their international supply chain operations.

Economic crisis triggered by global environmental and social risks will nonetheless happen again and might even increase in frequency and become more severe. Businesses, governments – including development partners – should therefore be prepared for such shocks and it is important that they treat environmental and social issues together with financial considerations to be more resilient to future crises. The Green Recovery Alliance – setup earlier in 2020 by 12 EU environment ministers, 79 Members of the European Parliament, 37 CEOs and business associations, as well as environmental groups, trade unions and think tanks – is a symbolic example of this endeavour. By providing a strong regulatory and legal environment and adequate institutions – such as national contact points which give access to a non-judicial grievance mechanism –, governments can facilitate the transition to RBC practices of investors and thus more resilient and sustainable economies. Donors can help develop capacity within governments to promote RBC and among businesses to engage responsibly.

Investment policy needs to be coordinated with policies in other domains to enable investment impacts on sustainable development

In the current context, new investment for sustainable development could be scarce. It is therefore time – more than ever – to help re-deploy the mass of existing FDI and activities of affiliates of MNEs towards sustainability objectives and to attract quality investments that support sustainable development. For that purpose, investment policy departments in national governments cannot work in silos, but need to fully understand and align policy efforts with those of other public agencies as well as actions of the private sector, development partners and civil society.

Set in different contexts and at different stages of development, countries will have different priorities, resources – including Official Development Finance – to leverage FDI to advance sustainable development. Adequate policy choices to maximise FDI's contribution to sustainable development therefore depend on host country conditions (e.g. market access, labour market conditions, including wage levels and availability of skilled labour, taxation, industrial structure), the type of FDI (e.g. greenfield vs. M&A), and motives for investment. In order to support governments in their efforts to align policies and institutional setups to enhance investment impacts on specific aspects of sustainable development, the OECD has committed to develop the *FDI Qualities Policy Toolkit* over the next two years, as a deliverable for the Minister Council Meeting (MCM) in 2022 (Box 5).

Box 5. Enabling FDI diffusion channels to boost sustainable development: a Policy Toolkit

The forthcoming *FDI Qualities Policy Toolkit* will provide directions on what institutions and policies – public and private – are needed and should engage coherently to enhance FDI's role in addressing pressing challenges of inequality, job creation and decent work (job quality, skills), gender equality, productivity (particularly of local SMEs) and the climate crisis. It will clarify different diffusion channels of FDI impacts, map and profile the national and sub-national policies supporting specific outcomes, identify the key institutional players involved in these policies and illustrate institutional configurations to leverage FDI for sustainability impacts in the selected areas. The development of the *Toolkit* will build on the *FDI Qualities Indicators* (OECD, 2019a) and the *Policy Framework for Investment* (OECD, 2015).

Donors can support policy coherence to improve qualities of investment with tailored solutions to the different stages of development

The involvement of donors in prioritising reforms is key. As discussed above, donors are fully involved in helping developing country governments to improve their investment climate. They also help Investment Promotion Agencies, and use ODA to mobilise private finance. They are thus best placed to inform what policy alignments and institutional changes would be needed to boost investment impacts on sustainable development and how to balance soft (qualitative) and hard (quantitative) dimensions of ODA to unlock new investment opportunities, depending on the stage of development.

In UMICs, building back better means implementing policies and measures that could attract, at the very least, previous levels of investment but with greater resilience to future crises (more sustainable and inclusive, thus avoiding socio-economic set-backs, perpetuating quality and quantity of jobs, e.g., putting accent on investment qualities). On the other hand, in LICs and LMICs, where external investment was almost absent or low before the crisis, building back better would require creating the appropriate ecosystems to make external investment emerge (and remain), resiliently.

Solutions need to be tailored to a country's level of development. The OECD Transition Finance Country Diagnostic (TFCD) of Solomon Islands in 2019 has shown, for example, that this small island developing state (SIDS)-LMIC which is scheduled to graduate from the least developing country (LDC) category could mainly benefit from a strengthened development co-operation–investment nexus and renewed dialogue between donor and investment communities. This would help the country implement a business-friendly environment conducive to more (and better) development. Indeed, the work conducted shows that, while facing the loss of concessional financing preferences and favourable trade agreements because of its upcoming LDC graduation, Solomon Islands has to remove entry barriers to private investments in promising sectors such as logging, mining and tourism, and reduce market uncertainty (e.g. corruption).

The case of Vietnam, also the subject of a TFCD, shows that the country has been highly successful in attracting large volumes of foreign investment, which has helped integrate the country into global value chains (OECD, 2018c). However, the gap between the burgeoning FDI flows and an underdeveloped domestic private sector remains considerable, while private investment is often promoted to the detriment of the environment. In this sense, ensuring the quality of private sector resources requires re-thinking and re-designing the ecosystem for private finance (Kim and Poensgen, 2019).

At the other end of the scale, in Chile, a middle-income country that recently graduated from the DAC list of ODA recipients (2018), the transition finance work demonstrated that the country continues to benefit from concessional financing (concessional loans) to investment projects even if it was able to secure credit at competitive conditions to such projects/industry. This fact raises questions on the indispensability of ODA loans at this stage of development, instead of allocating ODA resources to more pressing objectives such as the fight against inequalities and environmental problems (e.g., investment quality).

Overall, the transition finance work stream has provided evidence on the need for a better understanding, cohesion and co-ordination of the donor and investment communities across the development continuum, delimiting concrete avenues of collaboration and developmental opportunities.

Investment tax incentives may help build back better – but donors and policymakers need to invest in better understanding their use and impacts

Investment tax incentives have become frequently used instruments across the world with the aim of attracting investment in specific activities and regions. Ongoing discussions around potential changes to the international tax rules, particularly in the context of the global anti-base erosion (GloBE) proposal by the Inclusive Framework on BEPS, may have an impact on the use of tax incentives in the future. As countries are moving toward the recovery from the Covid-19 crisis, tax incentives for investment are seen by many policymakers as an important tool to build back better.

The net benefits of tax incentives, taking into account forgone tax revenue, are not well understood however. While they have the potential to attract investment with positive spillover, they are not always aligned with objectives to enhance domestic resource mobilisation and tax cooperation as outlined in the 2030 Agenda. If poorly designed, they may also limit effectiveness in attracting new investment and come at a substantial cost to a country: they may induce distortions across the economy by treating taxpayers unequally, and may result in windfall gains for projects that would already have taken place in absence of the incentive. In addition, competition to attract investment with tax incentives may lead to increasingly generous and less effective tax incentives that increase the complexity of the tax system and may even incentivise business to engage in profit shifting (OECD, 2020y).

Donors, together with investment and tax policymakers, could support broader data collection on investment tax incentives, contributing to filling existing information gaps, increasing transparency, and providing support to countries in reviewing the alignment of incentives with investment, tax and sustainable development objectives. Donors can also work with IPAs and tax authorities in developing countries to build capacity in domestic tax systems to better understand, design and implement investment tax incentives that support sustainable development.[10]

Adjusting the international regime for investment could complement domestic policy objectives related to sustainable development

The international investment regime may play an important role in efforts to maximise the contribution of FDI on sustainable development, or reduce the sustainability risks and costs associated with it. While many studies have sought to establish a link between international trade and investment agreements and greater FDI flows for recipient countries, few efforts have been made to establish how these agreements influence the qualities and resilience of FDI and how different designs may modulate or enhance this influence. In

[10] On 14 October 2020, the OECD is organising webinar among delegates of the Investment Committee and the Working Party No. 2 on Tax Policy Analysis and Statistics to exchange views and potential sensitivities on the topic of investment tax incentives.

this context, it is important for investment policy makers to consider whether and how international investment agreements can support efforts to enhance the qualities of FDI and contribute more actively to regulating business responsibilities.

Existing research has focussed almost exclusively on the effects of trade and investment agreements on FDI quantities and finds limited evidence of impacts in this regard (Pohl, 2018; Mistura et al., 2019). 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 such as environmental and labour standards, anti-corruption, human rights and public health, among others. The broader set of impacts of trade and investment agreements on business responsibilities are also likely to be relevant to this inquiry. 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).[11]

Further research is needed in these areas to provide policy guidance as to whether and how free trade agreements, and particularly international investment agreements can support sustainable investment, including during crisis periods. Donors can support this endeavour of better understanding the role of investment agreements by fostering policy dialogue, for example. As developing countries are adjusting their agreements, donors can support them by building negotiating capacity and technical assistance.

[11] See comments from public consultation here: http://www.oecd.org/investment/public-consultation-on-business-responsibilities-and-investment-treaties.htm. See draft agenda for Conference on Business Responsibilities and Investment Treaties here: http://www.oecd.org/investment/conference-investment-treaties.htm

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