



# Development Co-operation Report 2016

THE SUSTAINABLE DEVELOPMENT GOALS  
AS BUSINESS OPPORTUNITIES



The Development Assistance Committee: Enabling Effective Development

## The challenge: How can foreign direct investment fulfil its development potential?

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International investment, and in particular foreign direct investment, has an important role to play in helping to achieve the Sustainable Development Goals. It can be a powerful international mechanism for mobilising the tangible and intangible assets (such as capital, technology, skills, access to markets) that are essential for sustainable growth and development.

Yet to fulfil this potential, foreign direct investment must increase substantially; it must be geared as much as possible towards sustainable development; and it must take place within a framework of international investment law and policy that is enabling, yet at the same time respectful of host governments' own legitimate public policy objectives.

Foreign direct investment flows reached their peak in 2007 at around USD 2 trillion, dropping to USD 1.2 trillion by 2009 as a result of the international financial crisis. While this represents a relatively small share – about 10% – of gross domestic capital formation, in individual countries this share can be even higher than domestic investment.

To help meet the investment needs of the future, these flows have to increase substantially. There is no apparent reason why they could not do so over the longer term, say to a level of USD 4 or 5 trillion annually.

How to get there? Improving the economic determinants, the principal factors governing investment decisions, is fundamental. Official development assistance will continue to be important, especially for the least developed countries, including to leverage higher foreign direct investment flows. This is a long-term challenge.

However, national regulatory frameworks and investment promotion efforts can be improved in the short term, especially in the least developed countries.

The first challenge is to increase foreign direct investment through a concerted international effort to help developing countries, and especially the least developed among them, to improve their foreign direct investment regulatory frameworks and investment promotion capacities. At present, there is no such international effort – along the lines of the Aid-for-Trade Initiative and especially the Trade Facilitation Agreement – in the area of foreign direct investment. But in a world of global value chains, these trade arrangements can help only so much, precisely because they address only one side of the task, namely to increase trade. But a concerted international effort for foreign direct investment, such as an international Aid-for-Investment Initiative or even a Sustainable Investment Facilitation Understanding, could help developing countries, and especially the least developed among them, rapidly to improve their regulatory frameworks as well as their capacity to promote investment – thereby helping to increase investment flows to developing countries.

Encouraging higher foreign direct investment flows is, however, not enough.

The second challenge is to promote foreign direct investment that is geared as closely as possible towards sustainable development: “sustainable foreign direct investment for sustainable development”. This presents the challenge of defining “sustainable foreign direct investment”. A first approximation could be: commercially viable investment that makes a maximum contribution to the economic, social and environmental development of the host country and takes place in the context of fair governance mechanisms, as established by host countries and reflected, for instance, in the incentives they offer. Yet any definition needs to be operationalised. So this challenge would also involve developing an indicative list of sustainability characteristics to be considered by governments seeking to attract sustainable foreign direct investment (and to encourage sustainable domestic investment). Such a list would also be a helpful tool for international arbitrators considering (as they should) the development impact of investments, as well as for identifying the mechanisms – beyond those deployed to attract foreign direct investment in general – that encourage the flow of sustainable investment and increase its benefits for host countries.

The third challenge is to reform the international investment law and policy regime. National foreign direct investment rule making increasingly takes place in the framework of international investment law and policy. For this reason, it is important to ensure that the international investment regime constitutes an enabling framework for encouraging the flow of sustainable foreign direct investment, while at the same time allowing governments to pursue their legitimate public policy objectives. This requires asking several questions, including: How can the objective of sustainable development be made the lodestar of the international law and policy regime? What are the implications of such a concept for the regime's rights and obligations? How will this affect the mechanism for settling disputes between investors and states? This last function is central to the regime and gives it its strength, yet it is precisely the existing dispute-settlement mechanism that is strongly questioned – especially by non-governmental organisations, but also by a number of governments. Any reform needs to address this challenge adequately to avoid threatening the very legitimacy of the regime.

In conclusion, governments need to find ways and means to increase sustainable foreign direct investment flows within a reformed international investment law and policy regime to realise the sustainable development potential of this investment.