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Research Report

How can an international framework for investment facilitation contribute to sustainable development?

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How Can an International Framework for Investment Facilitation Contribute to Sustainable Development?

Summary

The implementation of the 2030 Agenda for Sustainable Development requires enormous global investment. In developing countries alone, its realisation requires investment of \$4 trillion a year (UNCTAD, 2014). Since the public sector in developing countries is often unable to mobilise sufficient domestic resources, the private sector is needed to help fill this gap. One of the key sources is foreign direct investment (FDI), which not only brings capital into developing countries but also advanced technologies and managerial know-how. It is critical that governments have policies in place to attract FDI, and to harness its advantages by enhancing its contribution to sustainable development. This can be done by establishing linkages between foreign and domestic firms, improving the absorptive capacity of local businesses, and strengthening governance capacities in order to improve environmental and social conditions.

Since 2017, a group of emerging and developing countries has been driving discussions at the World Trade Organization (WTO) on the establishment of an international investment facilitation framework (IFF), which should help to increase FDI flows. Investment facilitation covers a wide range of areas, all with a focus on encouraging investment to flow efficiently and for the greatest benefit of host countries. In the light of the 2030 Agenda, a focus on the attraction of more FDI is necessary but not sufficient; it is also important to focus on the qualitative contribution of FDI to economic growth in host countries that is socially just and environmentally friendly.

Many developing countries would benefit from attracting more FDI to support their sustainable development, but they remain outside the structured discussions at the WTO. Often, they fear a loss of policy space to pursue domestic developmental strategies. Our research shows that developing countries have implemented fewer investment facilitation measures than have developed countries, and would thus face higher implementation costs in order to comply with an IFF. Furthermore, in light of the non-reciprocal nature of global investment flows, although developing countries would benefit from their own investment facilitation reforms, they would not benefit equally from those of their negotiation partners.

An IFF can make four key contributions to sustainable development: it can help attract and retain FDI, enhance the quality of FDI in light of national strategies, build domestic institutions, and enhance international cooperation. In order to realise this potential, we make six recommendations:

1. Bridge the implementation gap by providing capacity building.
2. Strengthen developing countries' negotiation capacities.
3. Respect the policy space of developing countries.
4. Focus special and differential treatment on longer implementation periods.
5. Include a commitment by home countries to support their investors' responsible-business conduct.
6. Establish international cooperation mechanisms and increase inclusivity by supporting multi-stakeholder processes.

The emerging policy debate about investment facilitation

Investment facilitation is different from traditional approaches to international investment governance, which is constituted by a dense network of more than 3,000 international investment agreements (IIAs). While IIAs provide foreign investors with far-reaching legal rights and access to international arbitration, thereby in effect substituting for domestic investment-related frameworks, investment facilitation aims at improving domestic frameworks. Investment facilitation deals less with the substance of investment-related policies and regulations but rather with how they are implemented and applied. Investment facilitation thus refers to 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 the host- and home-country governments, foreign investors, domestic corporations, and societal actors. Investment facilitation can be distinguished from investment promotion. The latter is about promoting a country or a region as an attractive investment destination, whereas investment facilitation is about making it easy for investors to establish or expand their businesses in the host country.

Policy discussions about investment facilitation have picked up speed in recent years. Brazil, since 2015, has promoted a new type of cooperation and facilitation investment agreement (CFIA). So far, Brazil has signed ten CFIA with developing countries from Africa and Latin America. The issue of investment facilitation has been discussed by the G20 and has been included in the Guiding Principles for Global Investment Policymaking, adopted in 2016, and forms part of the G20 Compacts with Africa, launched in 2017.

Since then, the focus of international discussions on investment facilitation has shifted towards the WTO. In April 2017, a group of 17 emerging and developing country members, the so-called "Friends of Investment Facilitation for Development" (FIFD), proposed an Informal WTO Dialogue on Investment Facilitation for Development. In the run-up to the 11th Ministerial Conference of the WTO in Buenos Aires, Argentina, several proposals on investment facilitation were submitted to the WTO by developing-country members. At the Ministerial Conference, in December 2017, 69 WTO members adopted a joint Ministerial Statement calling for the start of "structured discussions with the aim of developing a multilateral framework on investment facilitation". The structured discussions started in March 2018, and several rounds have taken place with the aim of identifying possible elements of a potential international IFF. At the end of 2018 the stock-taking exercise was completed and in the first half of 2019 the structured discussions focused on text-based examples with a view to developing possible elements of a multilateral framework.

The issue of investment facilitation provides a challenge for the WTO and its members. Attempts to include investment

in the Doha Development Agenda, as part of the so-called Singapore Issues, failed due to the resistance of developing and emerging countries at the 2003 Ministerial Conference in Cancun. Investment rules are only selectively included in WTO agreements. The agreement on Trade-Related Investment Measures (TRIMs) prohibits the use of certain trade-restricting performance requirements, and the General Agreement on Trade in Services (GATS), among others, provides for the possibility of making commitments on market access and national treatment covering the commercial presence of foreign investors.

The particular political economy of negotiations on investment facilitation provides another challenge to WTO members because it generally does not allow for a reciprocal exchange of commitments, as is the case in negotiations about reduction of barriers to trade and investment. Investment flows involving developing countries are often not reciprocal. Developing countries potentially benefit from implementing investment facilitation commitments at home by receiving more inward FDI. In light of the fact that most developing countries do not have sizeable outward FDI, they do not benefit from the implementation of similar commitments by their negotiation partners. Furthermore, the DIE Investment Facilitation Index shows that developing countries have fewer investment facilitation measures in place compared to developed countries (Figure 1) and thus face a higher implementation gap when signing up to an IFF.

The structured discussions on investment facilitation at the WTO are mainly driven by a group of emerging and developing countries comprising large economies such as Brazil and China but also smaller economies such as Chile and Colombia. Despite this fact, many developing countries are hesitant about joining the discussions on investment facilitation. This may, in part, be a result of a principled opposition to the expansion of the WTO agenda beyond initial Doha Round issues. In addition, many developing countries fear a reduction of space to implement developmental policies, and the high implementation costs associated with the need to reform domestic investment-related frameworks. Furthermore, part of their reluctance stems from the fact that they are unsure about the scope of a potential IFF, and the possible benefits for the sustainable development of their own domestic economies.

How can an investment facilitation framework contribute to sustainable development?

Against this background there is an urgent need to put sustainable development higher on the agenda of investment facilitation discussions at the WTO. There are at least four ways in which international investment facilitation efforts can contribute to sustainable development.

First, investment facilitation can help to attract and retain FDI. This focus is important as foreign investment can augment productive capacities, create jobs and enable the transfer of technology and managerial know-how. It is similarly

important, however, to ensure an alignment of foreign investments with domestic sustainable development strategies. Investment facilitation can help enhance the contribution of established investment to sustainable development by helping to retain it. A central component of investment facilitation should therefore be “aftercare” measures to retain existing FDI. In fact, an investor must stay in a host country for some time if it is to engage with the local (business) community and make meaningful contributions to sustainable development. The importance of aftercare is underlined by the fact that 60% of the OECD countries’ FDI outflows are actually reinvestments. Well-capacitated investment promotion agencies are a central stakeholder, not only helping to attract FDI but also supporting long-term engagement with the local economy in developing countries.

Second, while it is important for developing countries to attract foreign investment, focusing on the size of the inflow is not sufficient. There is also the need to enhance the *quality* of FDI and its contribution to the three dimensions of sustainable development (economic, social and ecological). The sustainability orientation of investment facilitation is important to avoid negative externalities that can result from foreign investment projects in weakly regulated policy environments. An IFF should therefore be designed in such a way that it helps to preserve national policy space and to implement laws and regulations that enhance the contribution of FDI to domestic economic development while improving environmental and social conditions.

Third, in order to enhance the contribution of foreign investment to sustainable development, investment facilitation should help to improve institutions and administrative capacities in developing countries. Examples include the improvement of intra-ministerial coordination and cooperation,

which is essential in light of the complexity of the sustainability agenda. The establishment of focal points can help to assist foreign investors in obtaining information about investment-related economic, social and environmental laws and regulations. Furthermore, having a national ombudsman can help mitigate conflicts between foreign investors and host country governments that may occur in light of the need to adopt environmental and social regulations.

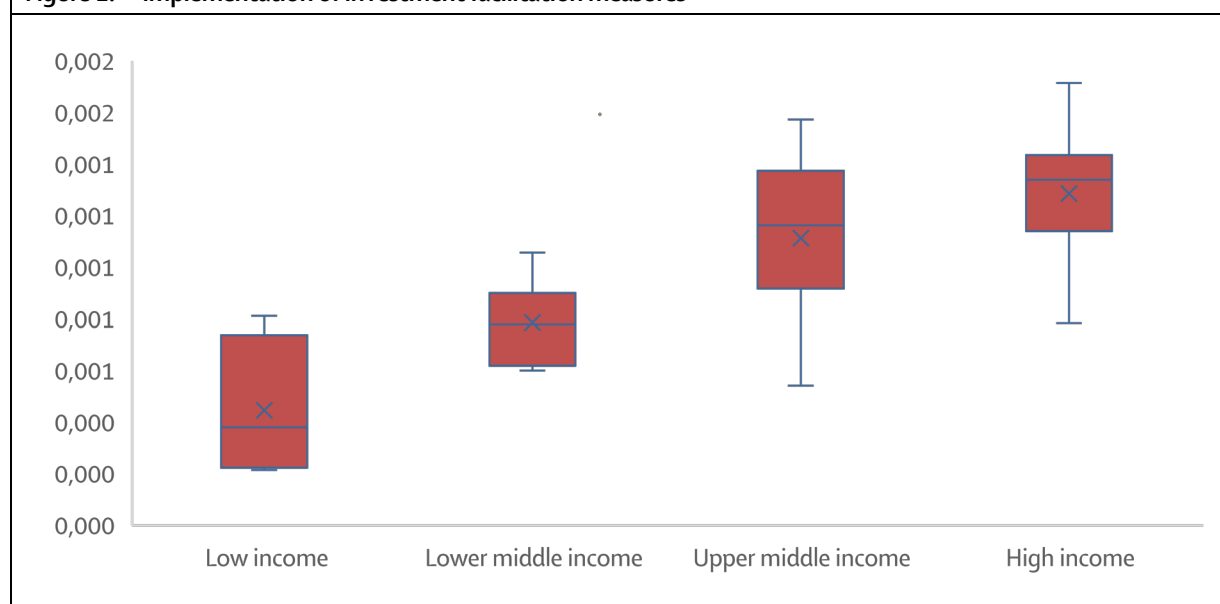
Fourth, an international IFF can help to enhance domestic-level and international cooperation. Enhancing the contribution of FDI to the three sustainability dimensions depends on an alignment and coordination of different line ministries and governmental agencies. In addition, governments interested in facilitating sustainable investments benefit from multi-stakeholder engagement, including by investors, investment promotion agencies and civil society, which can help ensure that investment facilitation measures are designed to tackle sustainable development challenges on the ground.

Policy recommendations

In order to enhance the contribution of an emerging IFF to sustainable development in developing countries, the following six recommendations should be taken into account by actors involved in current discussions in the WTO and other multilateral, regional and bilateral fora.

First, poor countries are in need of support and capacity building by the international community to enable them to meet the challenge of improving their domestic institutions and thereby enhancing the contribution of foreign investments to sustainable development. This support is especially important because of the large gap in the implementation of investment facilitation measures in developing countries.

Figure 1: Implementation of investment facilitation measures



Source: DIE Investment Facilitation Index (IFI), forthcoming. The IFI ranges from 0 to 2 and quantifies the level of implementation of 117 investment facilitation measures in 67 WTO members that have signed the Ministerial Statement on Investment Facilitation. The charts show the range of the level of implementation and the mean. The boxes indicate the second and third quartile.

Such support should be built into an eventual international framework, based on the model of the WTO Trade Facilitation Agreement whereby the implementation of commitments by developing countries is made conditional upon support by developed countries.

Second, in order to effectively participate in the negotiation of an IFF, developing countries need additional support by the international community in the form of negotiation training and support to enhance negotiation capacity.

Third, an international framework on investment facilitation should respect the policy space of developing countries that is needed to support sustainable development. International investment facilitation commitments should therefore focus on the application of laws and regulations and less so on their substance. This focus on process-related, rather than substantive, issues should be made clear in the text of the agreement.

Fourth, special and differential treatment provisions should focus on longer implementation periods, coupled with mandatory implementation support by the international community, rather than fully fledged exemptions of certain groups of measures. After all, due to the particular non-reciprocal

nature of a potential IFF, developing countries only benefit from membership of an international framework if they engage in comprehensively implementing the provisions of an IFF.

Fifth, an IFF should entail commitments by home countries to encourage their investors to act in accordance with international guidelines for responsible business conduct, such as the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, and should ensure that foreign investors respect the domestic laws of host countries. Such commitments by home countries should be incorporated in an IFF.

Sixth, commitments to intensified international cooperation should be a cornerstone of an IFF as a means to share best practices on investment facilitation measures that are particularly helpful in promoting sustainable development, and to support the implementation of the framework. Furthermore, in order to support sustainable development while taking into account different country contexts and development strategies, a potential international IFF should be inclusive, and should support multi-stakeholder processes in developing countries, including business and civil society.

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