# Sound investment policies for sustainable economic development

## International development institutions can help encourage investment in next year's Sustainable Development Goals

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Foreign direct investment can help improve access to basic infrastructure such as water supply, roads, electricity and sanitation

Countries worldwide are convinced that foreign direct investment (FDI) can contribute to sustainable economic development, inclusive growth and poverty alleviation. This is why countries seek to attract foreign investment and why liberalisation, promotion and facilitation dominate the investment policy landscape.

At the same time, policymakers are aware of the potential risks to economic stability from unfettered and uncontrolled capital flows. Recent experience has shown that financial crises can rapidly wipe out development gains that have taken decades to attain. Many countries are now revisiting their entry conditions for investment, and strengthening the related regulatory environment.

Moreover, there is greater realisation that the degree to which FDI makes a lasting contribution to equitable and balanced economic growth depends on wider policies and strategies. These can help to create the links with the domestic economy that build productive capacity, especially in developing countries. Investment policies also need to respond to other challenges related to sustainable development, namely persistent global imbalances, climate change, food and energy security, and poverty reduction. Furthermore, FDI can also help to improve the local population's access to basic infrastructure (such as roads, electricity, water supply and sanitation), education and health services.

Commitment to meeting these challenges will be reflected in the Sustainable Development Goals (SDGs) currently under discussion by the international community for the post-2015 agenda, when the UN Millennium Development Goals expire. Due to be adopted next year, the SDGs are expected to pursue a development agenda encompassing environmental and social sustainability as well as economic growth. This new set of goals will make mobilising investment for sustainable development an even greater priority.

Against this background, it is a positive sign that developing countries and transition economies have been gaining a larger share of global investment flows, both as recipients and sources. Recent United Nations Conference on Trade and Development (UNCTAD) statistics on investment show that FDI inflows to developing economies are now exceeding those to developed countries. Furthermore, FDI outflows from developing countries and transition economies now account for almost 40 per cent of global investment.

Nonetheless, there remains huge untapped potential for private investment into economic sectors and activities relevant to the SDGs. Development strategies and related policies face the challenges of alleviating existing constraints for such investments, mobilising new financial resources, channelling investment into SDG sectors and activities, and ensuring positive sustainable development outcomes of these investments.

### Moving beyond low-cost labour

At the same time, it is not easy for countries, in particular developing countries, to find, defend and strengthen their place as an investment destination in a globalised economy. It is less problematic for countries that have a natural competitive advantage, such as mineral resources, or are attractive to investors because of their sheer market size. However, countries that have traditionally attracted FDI due to low labour costs face a dual challenge of keeping such investment from moving elsewhere and ensuring that FDI feeds into broad-based economic development. Low-cost labour is a mixed blessing. It continues to help many developing countries attract FDI and can open up new business opportunities when other jurisdictions become more expensive as investment locations. But, given that wages tend to rise with economic development, depending on low labour costs to encourage FDI is not a sensible long-term strategy. Moreover, relying only on cheap labour-induced FDI prevents host countries from moving up the value chain.

To become more attractive for higher-value FDI, governments need to put more emphasis on enhancing domestic productive capacities. Education and training are key. Both play an important role not only in manufacturing and services, but also in improving the


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efficiency of agricultural production. Within development strategies, there also can be a case for targeting specific industries or activities with comparative advantages that improve the chances of integration into international value chains.

The need to align national investment policies with SDGs implies a stronger focus on quality investment. This requires that governments improve their regulatory framework for environmental and social protection and that they vigorously enforce respect for human rights, core labour rights and safety regulations, among others. It also means governments should put more emphasis on policies to promote low-carbon FDI. Many developing countries have the advantage of attractive natural conditions for investment in renewable energies. In addition, it is necessary to promote and strengthen corporate social responsibility.

***Many countries are now revisiting their entry conditions for investment***

Countries may also have legitimate reasons for restricting FDI in individual sectors as part of their development strategies. These can include the protection of infant industries, the wish to build national champions, concerns about a crowding out of local actors, and national security interests in sensitive industries and critical infrastructure.

However, vigilance is needed to ensure these policies do not become a pretext for investment protectionism – a risk that is particularly high during economic and financial crises. International policies play an important role in promoting investment into SDGs. Through their technical advice and financial support, international development institutions can significantly contribute to shaping an enabling framework for such investment. Furthermore, international investment agreements can help increase legal stability, predictability and thereby investor confidence in host countries. However, still more could be done to strengthen the sustainable development dimension of these treaties, in particular through a better balancing of rights and obligations in treaty provisions, by preserving sufficient regulatory space for host countries and by a greater emphasis on social and environmental concerns in relation to FDI.

Published in June, UNCTAD's *World Investment Report 2014* is devoted to the question of how to enhance the role of private investment for the SDGs and is proposing a global action plan for investing in SDGs. ■