

FDI Qualities Indicators

Measuring the sustainable development impacts of investment



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Foreign direct investment (FDI) can play a crucial role in making progress toward the Sustainable Development Goals (SDGs). From the viewpoint of the host country, it can enhance growth and innovation, create quality jobs and develop human capital, and raise living standards and environmental sustainability, for instance. By linking domestic firms to multinational enterprises (MNEs), it serves as a conduit for domestic firms to access international markets and integrate in global value chains (GVCs).

However, realising these positive contributions to sustainable development is not a given. Maximising benefits and minimising potential risks associated with FDI may not be a primary concern for profit-seeking investors and may not receive sufficient attention by policymakers seeking to attract investment. While, in principal, FDI has the potential to advance sustainable development, private sector incentives and both home and host country policies require careful consideration as they play a critical role in realising this potential.

How FDI relates to sustainable development in different country and policy contexts is still unclear. The OECD launched the FDI Qualities initiative in 2018 in an effort to fill this information gap. The initiative is an important element of the OECD Action Plan on the SDGs (OECD, 2016) and provides new evidence for discussion at the OECD and other international policy fora.¹ The objective of the initiative is to equip policy makers with an actionable tool to mobilise FDI that maximises inclusive and sustainable growth and supports progress towards the SDGs. It focuses on how foreign (as opposed to domestic) investors can contribute to sustainable development, beyond the financing they bring, by spreading knowledge.

FDI impacts depend crucially on host country policies. The FDI Qualities initiative is about measuring the contribution of foreign investment to sustainable development and identifying policies to maximise the positive impacts and to avoid or minimise potential negative impacts. The initiative includes four pillars: Indicators; Policy Toolkit; Policy Dialogue and Implementation. The first FDI Qualities report develops the pillar on Indicators.

The FDI Qualities Indicators

FDI Qualities Indicators describe how foreign investment relates to specific aspects of sustainable development in host countries. They are structured around three Ps of the 2030 Agenda (i.e. prosperity, people and planet) which broadly capture economic, social and environmental sustainability. An in-depth assessment of all 17 SDGs, and their corresponding targets, is used to identify the full spectrum of FDI Qualities – that is, areas where FDI may contribute to achieving the SDGs. This assessment further considers the extent to which FDI's potential for advancing the SDGs is reflected in the OECD Policy Framework for Investment, including related frameworks and guidelines, such as the OECD Guidelines on Multinational Enterprises and the OECD Policy Guidance for Investment in Clean Energy Infrastructure.

The FDI Qualities Indicators currently focus on five clusters derived from the 3Ps; namely, productivity and innovation, employment and job quality, skills, gender equality, and carbon footprint (Table 1). These clusters have been selected through a participatory process including various stakeholders in the FDI Qualities Policy Network.² For each of the five clusters, a number of different outcomes were identified and used to produce indicators that relate them to FDI or activity of foreign MNEs, allowing for comparisons both within and across clusters so as to identify potential sustainability trade-offs.

Table 1. FDI Qualities by sustainability cluster and outcomes

| Cluster | Objective | Outcomes |
|------------------------------|---|---|
| 1. Productivity & innovation | Provide information on the extent to which foreign MNEs and their linkages with domestic firms, enable productivity growth and enhance innovation capacity through knowledge and technology transfer. | Labour productivity; labour productivity growth; product innovation; process innovation; R&D expenditures; use of foreign technologies; |
| 2. Employment & job quality | Explore how FDI relates to employment and job quality in host countries. Job quality is essential to ensure that employees can work productively. | Job creation per unit of FDI; employment growth; wages; job security (temporary work); worker safety (injuries) |
| 3. Skills | Investigate to what extent foreign MNEs invest in human capital and skills, directly through in-house worker and manager trainings, and indirectly through knowledge transfers to domestic firms. | Skill intensity; on-the-job training; technical skill shortage/surplus |
| 4. Gender equality | Examine how FDI is associated with gender equality in host economies. | Gender employment gap; gender wage gap; female top managers (female empowerment); women entrepreneurship |
| 5. Carbon footprint | Study the extent to which FDI relates to carbon footprint, and how FDI is contributing to the low-carbon energy transition. | CO ₂ emissions; energy efficiency; renewable energy |

Taking into account the country context, policymakers can use FDI Qualities Indicators to assess how FDI supports national policy objectives, where challenges lie, and in what areas policy action may be needed. Indicators also allow for cross-country comparisons and benchmarking against regional peers or income groups, which can help to identify good practices and make evidence-based policy decisions. An important value added of the FDI Qualities Indicators is that they reveal cross-country differences in how FDI relates to sustainable development. Existing studies touch upon some of the outcomes covered in this report, but generally only examine one dimension of sustainability, offering only a partial view of FDI's contribution to sustainable development, without revealing important cross-country and cross-cluster differences.

FDI affects socio-economic and environmental outcomes through various channels, both directly through the activities of foreign firms, and through spillovers that arise from market interactions. The indicators covered in this report cannot disentangle direct FDI impacts and spillovers, but provide some direction on what mechanisms are at play for a given outcome. The indicators use both firm- and industry-level data sources.

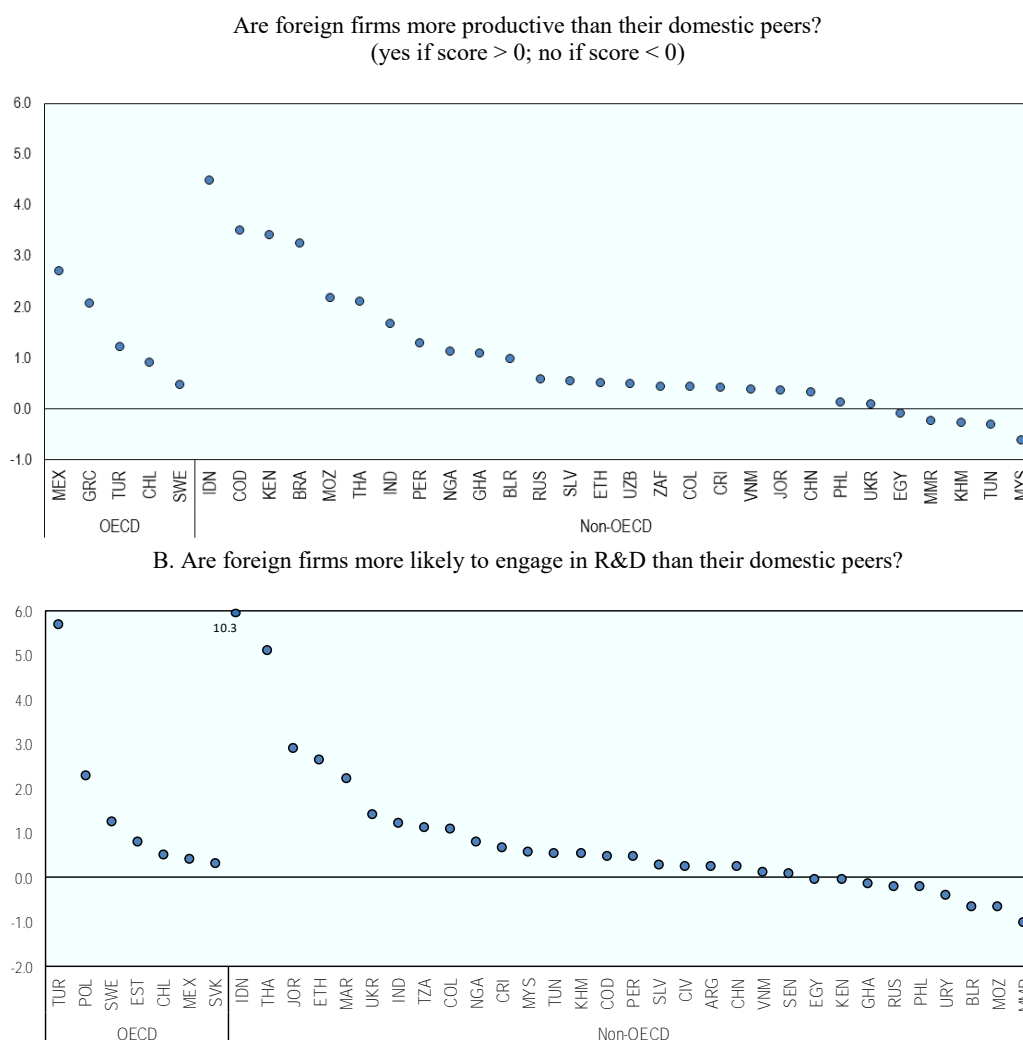
FDI supports productivity and innovation gains in OECD countries

The first cluster of country-level indicators measure how FDI relates to productivity and innovation, and may thereby support or weaken progress towards SDGs 8 and 9. Broadly speaking, FDI is associated with higher labour productivity and innovation than the national average in OECD countries, and relatively lower productivity and innovation in developing countries. In other words, foreign activity is more prevalent in sectors that are capital- and R&D-intensive in advanced economies, while it is more prevalent in labour-intensive and less innovative manufacturing industries in developing countries.

The results also suggest that FDI-attracting sectors often experience higher growth in labour productivity and R&D intensity than other sectors, although the findings are more mixed across income groups. The observed productivity and innovation advantage in FDI-dominated sectors may be a result of foreign firms outperforming domestic firms (Figure 1). This may be expected, as affiliates of foreign multinationals have access to advanced technologies and managerial knowhow from their global branches, which allows them to produce more efficiently and invest

more in innovation than domestic firms. Foreign firms also tend to be larger and more capital-intensive than their domestic counterparts, further explaining their performance premium.

Figure 1. Productivity and innovation outcomes of foreign and domestic manufacturers



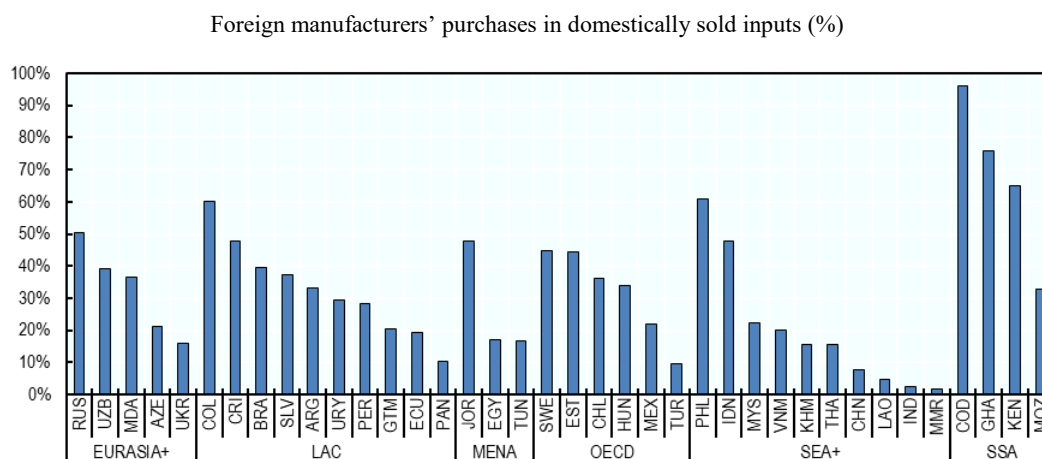
Source: OECD (2019)

The indicators also shed light on the potential for productivity and innovation spillovers of FDI through linkages with domestic firms. Domestic firms require sufficient absorptive capacities to benefit from FDI presence and the associated knowledge and technology transfers that occur through supply chain linkages. Absorptive capacities are typically measured in terms of performance gaps between foreign and domestic firms. The results show considerable variation across countries, with performance gaps that are substantial in some countries and negligible in others (Figure 1). Differences in absorptive capacities have important implications for policy makers. Countries with greater absorptive capacities may aim to facilitate linkages and technology transfer, while countries with lower capacities could focus on the development of a stronger supplier base in the first place.

Another way to evaluate the potential for FDI spillovers is to measure the extent of local sourcing of foreign firms, which may be a policy objective in itself as it creates a market for

domestic firms. Domestic linkages are also likely to facilitate knowledge and technology transfers from the foreign affiliate to its domestic supplier. The analysis reveals that foreign investors purchase a large share of domestically sold intermediate inputs, both in OECD and non-OECD countries, although the extent of these linkages varies considerably by country (Figure 2).

Figure 2. Domestic supply chain linkages of foreign affiliates



Source: OECD (2019)

Overall, the indicators reveal considerable variation in FDI's contribution to productivity and innovation. This heterogeneity has different implications for countries at different stages of development. For example, in countries at early stages of the industrialisation process, a policy objective may be to expand investments in lower value added sectors where producers benefit from a comparative advantage. The objective may be to move up the value chain within those sectors into more complex activities. Conversely, more advanced emerging economies may aim to attract FDI in higher value added sectoral value chains to advance the industrialisation process. A more detailed analysis of a country's development stage and policy context is necessary to further interpret the results and derive policy recommendations.

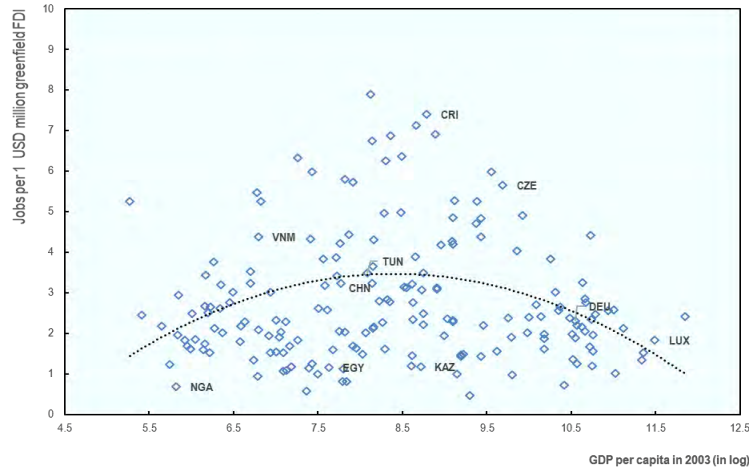
FDI creates jobs and enhances wages but not necessarily other working conditions

The second cluster examines how FDI relates to labour market outcomes of host countries. According to SDG 8, both the quantity and quality of jobs created matter to ensure that all citizens can work productively and receive fair compensation. The cluster includes indicators that identify how FDI is associated with job creation and employment growth, wages and non-wage working conditions (i.e. job security and occupational safety at work).

Governments devote ample resources to attract FDI with the hope that it will create new employment prospects. The indicators confirm that greenfield FDI projects generate jobs, but unevenly across countries. The extent of job creation varies with level of development and economic structure. FDI projects in mining or biotechnology (capital-intensive) generate fewer jobs per dollar invested than those in garment manufacturing or healthcare (labour-intensive), for instance. Consequently, greenfield FDI in Costa Rica or in the Czech Republic create around 6 jobs per million dollar invested, three times as many as in Kazakhstan or Luxembourg (Figure 3). The indicators do not provide a complete picture of FDI effects on job creation, as they do not capture whether foreign takeovers of domestic firms create or destroy jobs across countries.

Figure 3. The FDI-jobs relationship is conditional on economic development

Estimated number of jobs created per one million USD of (announced) greenfield FDI projects



Source: OECD (2019)

The behaviour of foreign affiliates with respect to labour demand is typically similar to that of domestic businesses. In few countries, foreign firms are more responsive to short-term business fluctuations in terms of employment adjustments, particularly in cases of expansion. Over longer time spans, and when taking into account the possibility of spillover effects on domestic firms, greenfield FDI relates positively to employment growth; but this does not apply to all countries. In the OECD, the positive FDI-employment growth relationship is stronger in countries where medium-tech industrialisation processes are, or have been, stronger and more sustained.

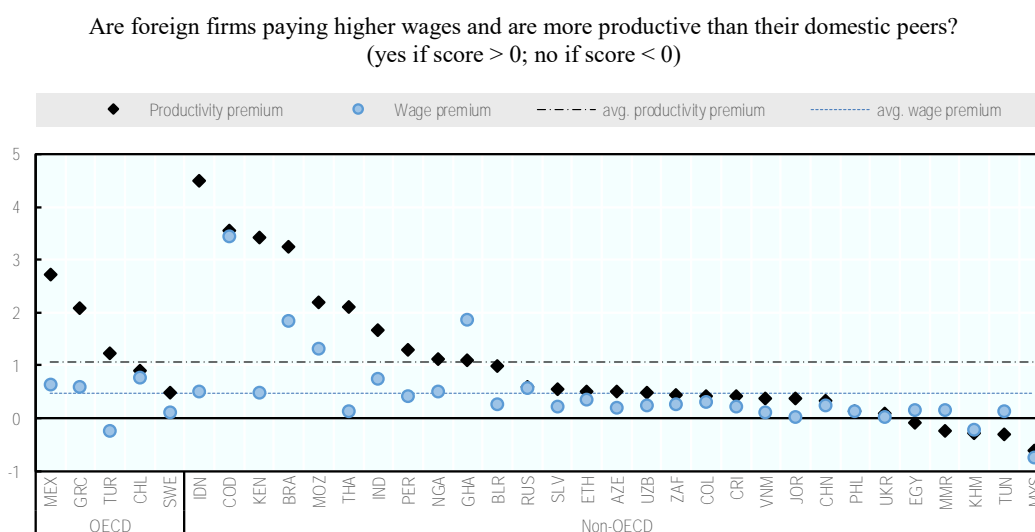
The OECD 2018 Jobs Strategy and other international frameworks explain that while creating more jobs is crucial, their quality equally matters for inclusiveness. The indicators confirm a well-documented result: an average foreign affiliate pays higher wages than an average domestic business. Beyond this common finding, a more relevant result in the context of this report is that vast variations exist in the foreign wage premium across countries, partly because the indicators reflect the plethora of factors behind the premium, such as firms' higher productivity, larger size, more skilled workforce, or greater product market power. The results also challenge the presumption that foreign companies always pay higher salaries. There is less evidence of a foreign wage premium at the bottom of the wage distribution.

If foreign businesses can enhance living standards, excessive wage dispersion with domestic firms may nevertheless hamper inclusive growth by raising overall wage inequality. In addition, the results confirm, to some extent, that positive, productivity-driven, spillovers of FDI on the wages of domestic firms may be more limited in countries with wider wage dispersions between the two groups of firms. Conversely, local souring by foreign firms amplifies wage spillovers.

The indicators also show that MNE activity is concentrated in sectors that typically pay lower wages in developing countries while the opposite result holds in most of the OECD. As for jobs, the level of industrialisation appears to be another crucial factor driving the FDI-wage relationship: more advanced countries tend to attract FDI in highly paid services, while less advanced countries attract FDI in labour-intensive, low-skill, and low-wage industries. The dichotomy between developed and developing countries may reflect differences in the size of the informal sector, which, if accounted for, would provide more precise indicators of FDI concentration in higher or lower wage industries.

The indicators on wages provide a consistent picture relative to those on productivity: generally, the higher is the foreign productivity premium, the larger is the wage premium (Figure 4). This supports the notion of productivity as an engine for enhancing living standards, but only to a certain extent. Across countries, foreign firms are twice as productive as domestic firms, but they pay only 50% higher wages. This implies that the foreign firm performance premium does not fully translate into wage benefits for workers. MNEs are typically active in highly-concentrated markets – which in turn can generate rents. Such productivity-related rents, and the extent to which they are shared between owners and workers, can be due to policy pitfalls, such as barriers to competition.

Figure 4. Foreign firms’ wage and productivity premia in OECD and emerging countries



Source: OECD (2019)

Job quality is not limited to wages, it includes other aspects of working conditions. The behaviour of MNEs has at times raised public concerns over their impact on working conditions due to, for instance, the greater bargaining power they enjoy over unions and governments, or their lower core labour standards. The indicators seek to provide a broader picture of job quality by examining the relationship between foreign firms, temporary work and occupational safety, and provide some evidence that FDI is associated with lower job security. The observed relationship could reflect MNEs concentration in sectors with more exposure to global trade fluctuations, or in areas under special regulatory regimes with more flexible labour rules, such as special economic zones. An implication is that more analysis on FDI effects on non-wage working conditions is necessary.

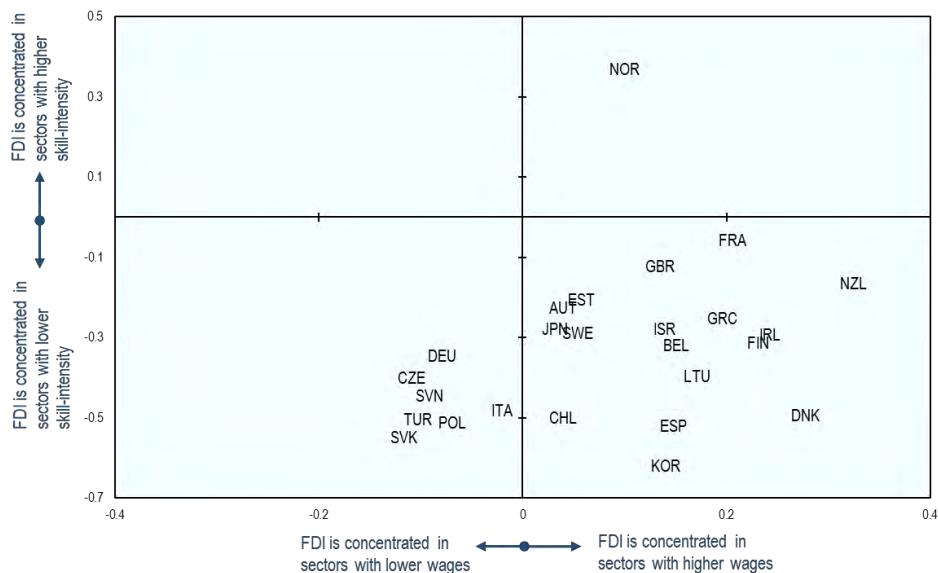
Positive labour market effects of foreign firms operations are often linked to their performance, an aspect that does not justify developing specific policies for them. Even so, investment and labour market policies can play a crucial role in cushioning or amplifying FDI effects on labour market outcomes, including distributional effects. For instance, FDI impacts on host country wages may be magnified by policies that promote labour mobility. Future work on FDI Qualities aims to provide a comprehensive policy framework for countries to maximise positive impacts of FDI on their labour market while mitigating potential adverse effects, in line with the OECD 2018 Jobs Strategy and the Guidelines for Multinational Enterprises.

FDI prevails in sectors with lower shares of skills and trained workers

Skills upgrading is fundamental for sustainable development (SDG 4). Skills are an important production factor that enables innovation and facilitates knowledge transfer. FDI can support skills development both by offering training opportunities to employees or suppliers and by affecting the demand for technical and managerial skills in the host country. The following cluster of indicators examines the relationship between FDI and skills-related outcomes.

The indicators overwhelmingly show that, in OECD countries, FDI is concentrated in sectors that employ fewer skilled workers (i.e. managers, technicians and experts), relative to the national average (Figure 5, vertical axis). This includes manufacturing, construction and transport services, which tend to have higher shares of unskilled and semi-skilled blue collar jobs. OECD countries with strong industrial bases, like Germany, Turkey and the Czech Republic, host FDI with the weakest skill-intensity levels, which is also associated with lower average wages in these sectors (Figure 5, horizontal axis). Across countries, the more FDI is concentrated in skill-intensive sectors, the more countries also benefit from FDI in high-wage sectors.

Figure 5. FDI association with wages and skill-intensity in the OECD



Source: OECD (2019)

A closer look at manufacturing firms offers a more nuanced picture. Foreign firms are not inherently different from domestic firms in employing skilled workers, rather it is a country's comparative advantage that determines the skill intensity of the FDI it attracts. Countries with large and relatively cheap labour forces tend to attract considerable FDI in labour-intensive and low-skilled manufacturing activities (e.g. garments, food processing), while countries with large heavy manufacturing industries like Mexico and Brazil attract FDI in more capital-, skill- and technology-intensive manufacturing activities (e.g. chemicals, machinery and equipment).

Attracting FDI in low-skilled activities is not necessarily a negative outcome if foreign firms can expand and upgrade workers' skills in these sectors, for instance by offering training or supplier development opportunities. Foreign firms may also induce domestic companies to invest more in training by increasing competitive pressures. Nonetheless, the indicators show

that foreign firms do not necessarily provide more on-the-job training to their workers, and that in the majority of OECD countries, FDI is concentrated in sectors with lower shares of trained workers.

Lastly, foreign firms can also affect imbalances of technical skills (i.e. programming, installation), whether shortages or surpluses. Shortages of skills exist when the supply of qualified workers is insufficient in the labour market, potentially slowing down productivity, innovation and technology absorption. Surpluses of skills are observed when skills are underutilised. Surpluses are often associated with unemployment and, in the long term, may reduce aggregate income and productivity. In general FDI is concentrated in sectors with higher skill surpluses. However, by expanding activity where skills are abundant (and investing little where skills are scarce) FDI may contribute to attenuating skill imbalances.

Further analysis is needed to confirm the robustness of these results but they invite for more thinking with regard to the role of policy in linking investment to skills and human capital development.

FDI does not always improve gender equality

Gender disparities and discrimination persist in the labour markets of both OECD and developing countries, where women tend to work in lower-value added service jobs, and are paid less than men, on average. Women are also under-represented in the business sector and are less likely to reach high-pay senior positions.

Through their activities, foreign firms can enhance gender equality in host countries. By increasing the demand for female labour foreign firms can put upward pressure on women's wages and contribute to reducing the gender employment and wage gaps. Foreign firms can also support gender balancing in senior management through, for instance, corporate policies that help reconcile work-life balance, or activities aimed at developing leadership and managerial skills of women. Foreign firms can further support women entrepreneurship in host countries, by creating new business opportunities for female-owned businesses, or by helping improve their performance. The following cluster of country-level indicators measure how FDI relates to gender equality, and may thereby support or weaken progress towards SDGs 5.

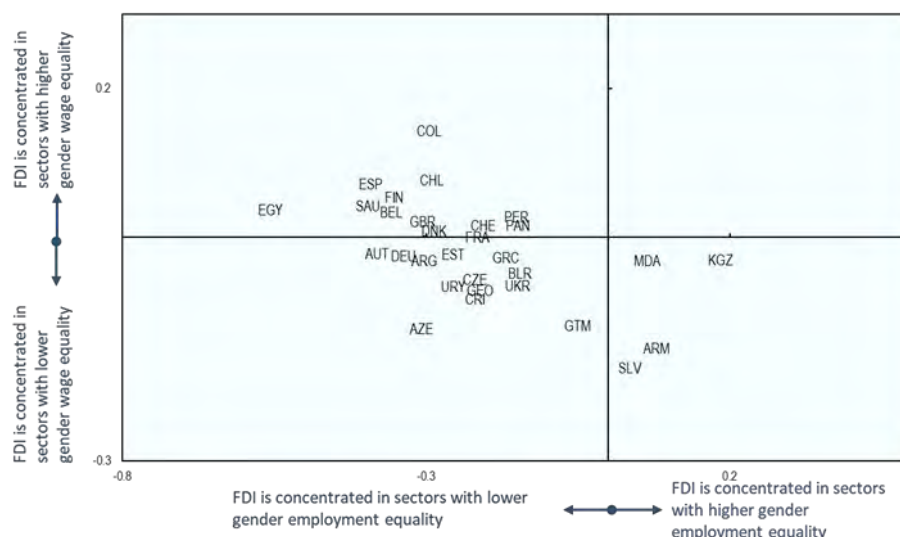
In terms of employment equality, FDI tends to be concentrated in sectors with lower shares of women employees, including the typically male-dominated construction, finance and transport sectors. A closer look at manufacturing firms, however, suggests that, particularly in developing countries, FDI is positively related to women's employment, as a result of large-scale activities in the typically female-dominated and labour-intensive garment and food industries. While intensive female employment in these industries has been an important avenue for women to enter the labour force, it may exacerbate the gender gap if it perpetuates gender-specific labour roles, with women participating only in low-skill low-wage jobs. This may warrant policy action to support training and skills upgrading opportunities targeting women.

The second and related set of findings describes the link between FDI and the gender wage gap. FDI is concentrated in sectors with higher pay gaps between men and women, notably manufacturing, finance, and business activities. Large differences are nevertheless observed across countries, especially in the OECD. Existing studies also report mixed evidence, suggesting that country-specific and sector-specific factors might play an important role.

Combining the indicators for wage equality and employment equality suggests that there is an inverse relationship between the wage and employment dimensions (Figure 6). This is likely because the distribution of FDI across industries plays a large role in its association with gender outcomes, rather than inherent differences across domestic and foreign employers. Sectors with relatively higher female employment tend to be lower-skilled and lower-wage, while sectors

with high-skilled and better paid jobs tend to be male-dominated. Thus, countries with large female-dominated industries, which attract substantial foreign investment, tend to exhibit a higher wage gap; whereas countries that attract high-skilled or capital-intensive investment exhibit less of a wage gap but a larger employment gap, as very few women are employed in these higher-paid jobs. In both cases upgrading women’s skills and facilitating their access to higher-paid activities can serve to reduce gender disparities.

Figure 6. Contribution of FDI to gender equality in wages and employment



Source: OECD (2019)

Another set of indicators considers FDI’s association with women empowerment in the workplace, measured as the extent to which they are represented in the workforce in senior management positions, and with women entrepreneurship. The analysis does not indicate any significant difference across foreign and domestic firms in terms of empowering women to assume top managerial roles and female ownership, again suggesting that foreign and domestic firms are not inherently different in terms of their contribution to gender outcomes. At the same time, manufacturing FDI appears to prevail in sectors with greater women participation in top managerial roles and with larger shares of business owned by women. The sectors explaining these associations are once again the female-dominated food and garment industries. This suggests that to some extent FDI in low-skilled, labour-intensive and female dominated activities also supports women’s empowerment and entrepreneurship.

FDI supports decarbonisation and efficiency improvements of the energy sector

Environmental risks are perceived as the gravest global threats in the next decade, especially extreme weather events, climate change policy failures, and the accelerated pace of biodiversity loss. A global economy reliant on fossil fuels and the resulting rising greenhouse gas (GHG) emissions, now 50% higher than their 1990 level, are creating drastic changes to the climate. The annual average financial losses from tsunamis, tropical cyclones, flooding and wildfires related to rising global temperatures amount to hundreds of billions of dollars.

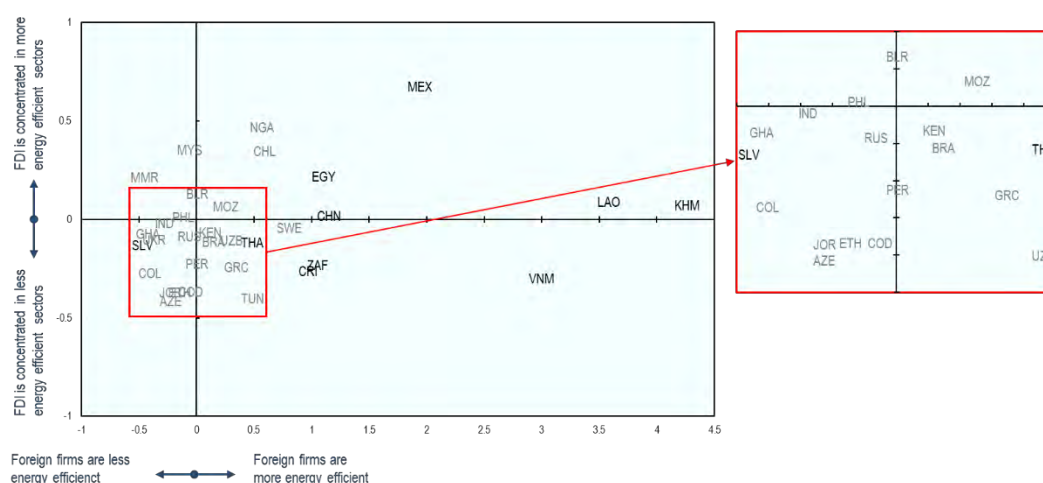
Against this backdrop, global energy demand is expanding well above the rate of deployment of clean energy resources, which are only slowing down the growth of fossil fuel use and CO₂ emissions and not reversing them. Energy efficiency and renewable energy are seen as the twin pillars of sustainable energy policy. Improvements in energy efficiency have been the biggest

contributor to reduced energy use since 2000 and the main factor behind the flattening of global energy-related GHG emission trends since 2014. But continuing improvements in energy efficiency are not enough. A substantial increase in the production and uptake of renewable energy across the world is imperative to curb rising CO₂ emissions in meeting energy demands.

The last cluster examines how FDI relates to climate change mitigation (SDG13) and access to sustainable energy (SDG7), focusing on FDI's carbon footprint and its contribution to renewable energy infrastructure. The mechanisms through which FDI is expected to affect carbon footprint include increasing the scale of economic activity; affecting the structure of economic activity; inducing the adoption of new energy-saving technologies; and influencing the uptake of clean energy sources.

Across the board, FDI prevails in industries that are cleaner in terms of CO₂ emissions, and more efficient in terms of energy use. The few exceptions include countries where fossil fuels constitute a large share of both GDP and inward FDI. This may be explained by the fact that in resource-rich countries, fossil fuels offer lucrative investment opportunities in extraction and energy transformation; and these heavily capital- and energy-intensive activities tend to attract large multinationals with the requisite capacity for such investments. Thus, for countries that rely heavily on fossil fuels as a source of income, FDI might exacerbate this dependence, and consequently their carbon footprint.

Figure 7. FDI and improvements in energy efficiency



Note: Indonesia (10.9, -0.3) is omitted to aid visibility. Black labels indicate statistical significance.

Source: OECD (2019)

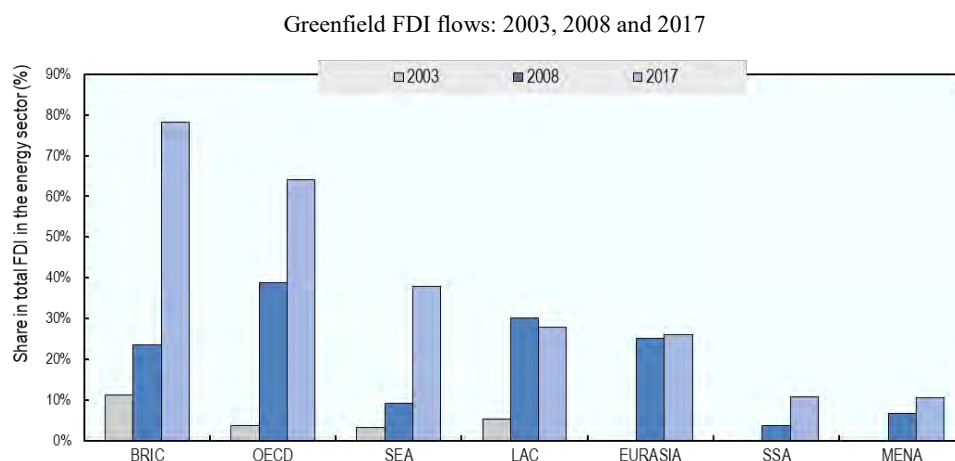
A closer look at manufacturing firms provides further evidence that foreign firms are more energy efficient than their domestic counterparts (Figure 7, horizontal axis). Countries like China, Mexico and Egypt, host foreign firms that are more energy efficient than their domestic counterparts on average, and also operate in manufacturing sectors with higher average energy efficiency (such as electronics). In these countries FDI is associated with improvements in energy efficiency, which is amplified if energy-saving technologies are diffused to domestic firms. Conversely, in countries that host foreign firms that are relatively less energy-efficient and also operate in manufacturing industries that are more energy-intensive, like mining-related manufacturing activities, existing FDI is associated with a deterioration of energy efficiency. In countries like Viet Nam and Thailand, where foreign firms are relatively more energy efficient than domestic peers but operate in manufacturing sectors that are more energy-intensive (such as garment manufacturing), these firms may be bringing energy efficiency

improvements to these sectors if domestic firms are able to absorb their energy-saving processes.

While increasing energy efficiency is essential for mitigating climate change in the long run, the forces driving up energy demand are outpacing progress on energy efficiency, resulting in accelerating global energy use. Thus, a critical avenue to curb greenhouse gas emissions in the immediate term and meet growing energy demands is to increase production and use of renewable energy, and foreign investors can play an important role in this respect. The stock of foreign investments in renewable energy relative to fossil fuels, accumulated over 2003-2017, was substantial, particularly for OECD and BRIC economies. A closer look at FDI flows reveals that the contribution of FDI 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 (Figure 8).

Comparing FDI in renewables to the extent of emissions of the energy sector across 88 countries shows that for a majority of countries FDI is still concentrated in fossil fuels and the energy sector is still significantly polluting in terms of CO₂ emissions. In these countries policy can play an important role in creating greater incentives for investments that help transition to low-carbon energy infrastructure, reforming fossil fuel support measures or correcting regulations that weaken the business case for investment and innovation in low-carbon infrastructure.

Figure 8. FDI in renewables is a significant share of energy investments across regions



Source: OECD (2019)

Using FDI Qualities Indicators for evidence-based policy analysis

The five clusters of FDI Qualities Indicators provide an overview of general trends and complexities of the relationship between FDI and different aspects of sustainable development. The indicators provide evidence of both positive and negative FDI qualities, and of significant variation across countries. Broadly speaking, the analysis points more systematically to positive FDI impacts on economic and environmental sustainability dimensions areas than social dimensions. However, the indicators are insufficient for explaining all the observed differences across countries, and FDI's contribution to advancing the SDGs is not always clear-cut. Framework conditions and country contexts are crucial determinants of the socio-economic and environmental impacts of FDI and policy can amplify or mitigate these impacts.

While further analysis on country and policy contexts is required, a country-level FDI Qualities assessment sheds some light on the relationship between FDI and specific outcomes, triggering

dialogue and facilitating the identification of policy priorities and possible trade-offs. FDI Qualities Indicators already serve as a practical tool in ongoing country reviews, including the OECD Investment Policy Reviews (Egypt, Indonesia and Thailand) and a new series of country-level assessments on FDI Qualities and Impacts.

Subject to funds, the second pillar of work on FDI Qualities will involve the development of a policy toolkit on how to maximise the sustainable development impacts of FDI, starting with the five clusters of FDI Qualities indicators. Once the policy framework components are developed, policy guidance on how to foster a specific SDG-related objective through private investment will be further strengthened and more structured.

Notes

¹ OECD work on FDI qualities was initiated jointly with the World Bank Group (Lejarraga and Ragoussis, 2018).

² The FDI Qualities Policy Network is a multi-stakeholder group that engages in policy dialogue and technical discussions on specific project activities, and includes policymakers, private sector, civil society, and experts from the OECD, other international organisations and academia.

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