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SDG Investment Trends Monitor

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PRIORITY ACTIONS TO ACCELERATE SDG INVESTMENT

The action packages outlined in this issue of the SDG Investment Trends Monitor and elaborated below build on UNCTAD's Investment Policy Framework for Sustainable Development, The Action Menu for Investment in the SDGs (various editions) and policy recommendations in recent issues of UNCTAD's World Investment Report and other publications.

1. Re-orienting investment promotion strategies of host countries.

Sustainable development projects should become a priority of the activities of investment promotion and facilitation pursued by host countries through their Investment Promotion Agencies (IPAs), Special Economic Zones (SEZs) and other relevant business development organizations.

i. *Investment incentive schemes* can be restructured specifically to promote investment in SDG-related projects. Investment incentives can incorporate sustainable development considerations by encouraging corporate behavior in line with the SDGs. A transformation is needed to move incentives from purely "location-focused" (aiming to increase the attractiveness of a location) towards increasingly "SDG-focused", aiming to promote investment for sustainable development. A reorientation of investment incentives policies (especially regulatory incentives) towards sustainable development would necessitate a phasing out of incentives that may have negative social or ecological side effects, in particular where such incentives result in a "race-to-the-bottom" with regard to social or environmental standards.

Another area where the "race-to-the bottom" has affected progress on the SDGs by hampering domestic revenue mobilisation (SDG 17.1) is harmful tax competition, resulting in very low and often zero corporate income tax rates on foreign profits of MNEs. A move from profit-based fiscal incentives like tax exemptions and tax holidays to expenditure-based incentives – reducing the after-tax cost of capital, including for example investment allowances and accelerated depreciation – would help preventing erosion of domestic revenues and have more sustainable, long-term impact on SDG investment. This transition is ever more urgent in light of the effects of the ongoing global tax reforms, expected to reduce the effectiveness of profit-based incentives as tools to attract FDI (see *WIR22,* chapter III for a discussion of the implication of the global minimum tax on FDI)

ii. *Special Economic Zones* can become incubators and catalysts of the new generation of SDG investment. The concept of *SDG model zones* mainstreamed by UNCTAD could serve as a reference for this new type of SEZs tailored around the sustainable development imperative (chapter IV of *WIR19*; UNCTAD, 2021a). SDG model zones feature three key elements: i. A strategic focus on attracting investment in "SDG-relevant" activities; ii. The highest levels of ESG standards and compliance and iii. Promoting inclusive growth through linkages and spillovers.

iii. Promotion and facilitation of investment in sustainable development should include the marketing of *SDG project pipelines* – pre-packaged and structured projects with priority consideration and sponsorship at the highest political level (UNCTAD, 2018; UNCTAD, 2023). This requires specialist expertise and dedicated units – *"SDG project development agencies"* that can plan, package and promote pipelines of bankable projects, and design SDG-oriented incentive schemes and regulatory frameworks. The promotion and facilitation of SDG related projects go hand in hand with *tracking, monitoring and reporting of SDG impact*.

While prioritizing SDG-related projects, host countries through their IPAs and SEZs should define related indicators and targets to report on. Effective monitoring and evaluation allow them to continually adapt and fine tune their SDG facilitation services and invest resources in those that bring about the greatest SDG impact. It is important to have baselines of reference to be able to report progress. Partnerships to generate and collect data will be key.

iv. A *strategic approach to digitalization* of investment promotion can strengthen host countries' SDG investment facilitation efforts. To date, most digital tools adopted by host countries to attract investment relate to their investment promotion functions, such as marketing and investor targeting. Increasingly, and in line with wider e-government efforts to focus on investment facilitation, digital processes and tools are used across the entire investment cycle. They focus on information provision, streamlining of administrative procedures and tracking data.

Host countries should ensure that SDG data is included in their investment facilitation digital tools and processes. This involves adding categories and information about investors and their SDG-related activities in client relationship management (CRM) systems, including information about suppliers working in SDG sectors in online supplier matchmaking platforms, or mainstreaming SDG-relevant data in virtual selection tools. IPAs can also ask questions related to the challenges and opportunities of conducting SDG-related investment in their online investor surveys. In this regard, digital tools therefore have the potential to contribute to evidence-based policy recommendations to strengthen the enabling environment for SDG investment (UNCTAD, 2023).

2. Formulating a new generation of international investment treaties and guarantees

At the international investment policy level, the goal is to make international investment agreements (IIAs) proactive in mobilizing and channeling investment to the SDGs.

i./ii Most IIAs – especially those from the "old generation" – still remain silent on environmental and social issues (UNCTAD, 2022). Only recent agreements start dealing with sustainability issues, but primarily from the perspective of *maintaining regulatory space for environmental and social purposes* or *prohibiting lowering of social and environmental standards* as a mean of competing for investment.

iii. While this is an important aspect for supporting SDGs, IIAs could do more by *promoting and facilitating investment in SDGs* in a proactive manner. This includes, for example, *mainstreaming SDGs* as an overarching objective of the agreement or a commitment of contracting parties to particularly encourage and facilitate investment in SDGs. These are issues both for the negotiation of new IIAs and the renegotiation of existing agreements. Systematic reform of IIAs can help to orient the new generation of IIAs towards sustainable development (UNCTAD, 2020).

iv. Other measures at the international policy level include facilitating SDG investments through *investment insurance and guarantees*.

3. Establishing global partnerships.

The investment run up to the SDGs must see the contribution of all relevant stakeholders. Partnerships such as for example the Global Alliances for sustainable investment promotion between Special Economic Zones (GASEZ) are crucial to the success of SDG investments.

i. *Global Alliances* for Sustainable Investment Promotion can be established among a wide range of stakeholders involved in SDG investment, including for example SEZs, IPAs and stock exchanges. The Global Alliance of Special Economic Zones (GASEZ) provides an example of such SDG-oriented partnerships (https://gasez.org/). Established in 2022 by UNCTAD and 7 SEZ associations, it aims to advance a new generation of SEZs that contribute to sustainable development and promotes close collaboration between SEZs and IPAs. It also seeks to undertake technical cooperation programs to modernize SEZs and promote SDG Model Zones.

ii. *"Global One-Stop Shops"* for SDG investment solutions can pool investment advisory and training instruments of all international organizations and multilateral development banks on a single platform, with easy access by recipient countries and development stakeholders. They could help to support LDCs, advising on, for example, investment guarantee and insurance schemes or the set-up of SDG project development agencies. Coordinated efforts and knowledge cross-fertilization to enhance synergies for SDGs are imperative.

iii. The most frequent constraint faced by potential investors in sustainable development projects is the lack of concrete proposals of *sizeable, impactful, and bankable projects.* Investment in SDG sectors are complex, typically more complex than investment in traditional commercial projects. Investment projects such as in infrastructure, energy or health, may require a process where political priorities need to be defined, regulatory preparation is needed (for example planning permissions and licenses, market rules) and feasibility studies carried out. Therefore, aggregation and packaging are necessary.

Digital tools can be very effective in this respect, allowing investors to access online pools of bankable SDG projects. These pipelines would be structured repositories of investment opportunities that align with – and are supportive of – sustainable development goals. They will report all the key information needed to prospect investors including on partners, technical aspects, financial structures and regulations and feature built-in devices for broad finance and for experts mentoring.

iv. *Partnerships between governments of small vulnerable economies (SVEs), private investors (MNEs), and multilateral development banks* are aimed at promoting investments in SDG sectors of specific strategic interest to SVEs – such as infrastructure, a manufacturing industry or even a value chain segment, depending on the economy. In such "triangular" partnerships, stakeholders would work together to identify the bottlenecks for private investment, and jointly develop public-private solutions to develop the strategic sector, bearing in mind wider socioeconomic, long-term implications. In particular, the partnership would aim at raising long-term, sound and sustainable investment in SDGs, but also at promoting investment in surrounding economic and social infrastructures.

4. Enhancing regional and South-South investment.

In an increasingly fragmented global economic and investment landscape, geographic and geopolitical considerations are gaining prominence as drivers of investment decisions. Global and national commitments to SDG-investment must be complemented by regional and South-South cooperation.

i./ii A key area of cooperation is the development of *regional and sub-regional industrial clusters and regional value chains*, with particular focus on SDG-related and/or highly strategic sectors. Not only would strengthening regional footprints in these areas push SDG investment but it would also provide options to address vulnerabilities of global values chains (*WIR20*). These concerns have become more pressing as a result of the GVC disruptions triggered by the recent global crises. Some examples of SDG-critical sectors that would benefit from the establishment of regional industrial clusters and regional supply chains are pharmaceuticals and food and agriculture. Limited access of developing countries and LDCs to such vital goods and services takes a high toll on SDGs, among others SDG 1, SDG2 and SDG 3.

iii. Another important area for regional and South-South cooperation for SDG investment is the *development of cross-border infrastructure* where collaboration between geographically closed countries is paramount to the effective realization of projects (*WIR21*).

iv. Existing regional economic cooperation initiatives and regional trade, investment and industrial collaboration frameworks and agreements could evolve towards *regional SDG investment compacts.* Such compacts could focus on reducing barriers and facilitating investment and on establishing joint investment promotion mechanisms and institutions.

5. Enabling innovative financing mechanisms and reorienting financial markets.

No source of financing alone is sufficient to cover the financing gap. Rather, all sources of financing need to be mobilized simultaneously, including through innovative financing mechanisms.

i. Financing synergies between *public and private* actors (PPP), joint ventures between *domestic and foreign* companies and project financing schemes involving *traditional and institutional investors* are all key instruments to enlarge the financing pool and enable risk-sharing.

ii. *Blended finance* can leverage development financing to mobilize private capital for the SDGs. Blended finance also has the potential to channel private capital where it is most needed – towards lower income, most vulnerable and conflict affected countries, that would not normally be targeted without the support of development partners. Effective complementary instruments include credit lines, bonds, de-risking instruments such as guarantees and insurance, hedging, grants, and technical assistance.

iii. *Digital finance* is critical to effectively align available financing with SDG priorities. It supports the push for investment into SDGs along at least three key dimensions: more and better data on SDG risks and impacts, cheaper and more inclusive accessibility of financial services, and innovative products and services. Major beneficiaries will be more marginalized and vulnerable categories – such as women or MSMEs from lowest income countries that are generally excluded from the traditional financial channels.

iv. Sustainable financing can take place only when financial markets are oriented towards the SDGs. *Sustainable stock exchanges* provide listed entities with incentives and tools to improve transparency on ESG performance, and allow investors to make informed decisions on responsible allocation of capital (SSE Initiative, 2016; SSE Initiative, 2019; UNCTAD, 2021b). More generally, *sustainability reporting initiatives* align capital market signals with sustainable development, thereby mobilizing responsible investment in the SDGs. Integrated reporting on the economic, social and environmental impact of private investors is a first step towards encouraging responsible behavior by investors on the ground. It is also an enabler of other initiatives aimed at channeling investment into SDG projects and maximizing impact. For example, where investment incentives are conditional upon criteria of social inclusiveness or environmental performance, such criteria need clear and objective measurement.

6. Sustaining SDG investment in recurrent crises

Global crises are pushing the global economy back on the path to the achievement of the SDGs. As global crises become increasingly recurrent, SDG investment strategies need to account for prospects of "permanent emergency" – or in the best case "permanently high risk and uncertainty" – and adopt resilience as a guiding principle

i. As overall resources become more limited, *a prioritization of the most critical issues and most cost-effective measures* is more needed than ever. This applies both to national budgets but also to international development financing initiatives.

ii. The recognition of the increasing frequency of systemic crises and of their devastating effects on SDG progresses highlights the need to make the global socio-economic and geo-political context stronger and safer. In that respect, *investment in (national, regional, and global) resilience* and preparedness must be part of the overall SDG financing strategy (*WIR21*).

iii. One of the possible consequences of the recent crises is *the restructuring of GVCs*, including trends towards the re-shoring of international capital flows or their diversion to closer countries – either geographically (near-shoring) or geopolitically (friends-shoring) (*WIR20*). Recent rising geopolitical fragmentation is already affecting patterns of FDI (chapter 4 in IMF, 2023). As international capital flows are major sources of external financing of the SDGs, it is important to factor in the consequences of these macro-trends for investment into SDGs – in terms of increased risks but also opportunities.

iv. *Geopolitical factors* are becoming key drivers of investment location decision of multinational enterprises. Risk considerations related to geopolitical uncertainties and future crisis should be a core component of the new generation of SDG investment promotion and facilitation strategies. For example, the highest emphasis should be placed on the role of insurance and investment guarantees.

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For further information, please contact
Mr. James X. Zhan
Director
Investment and Enterprise Division UNCTAD

diaeinfo@unctad.org   +41 22 917 57 60

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