INVESTMENT NEWSLETTER
May 2006, Issue 1

Promoting investment for growth and sustainable development worldwide

I am pleased to introduce the first issue of the tri-annual Investment Newsletter. Its purpose is to share with the wider investment policy community and other stakeholders the results of the OECD Investment Committee’s work. This issue focuses on recent policy analyses and new tools designed to enhance the positive contribution of investment for growth and sustainable development worldwide.

FDI has been one of the main drivers of the long up-swing in global economic performance and the buoyant world economic outlook. Last year saw a further up-tick in FDI inflows to the OECD area to reach near record levels. The first article summarises the latest FDI trends in OECD countries. The momentum in international investment appears to be continuing through 2006. However, new obstacles to foreign takeovers could negatively affect the business climate. Countries can have legitimate security and other sovereign concerns, but must remain vigilant against disguised protectionism. Open and transparent investment regimes are essential for sustained growth and prosperity.

FDI outside the OECD area is also growing quickly, including among major new players. The Investment Committee has several long-standing co-operation programmes with non-member partners aimed at fostering a mutually beneficial dialogue and supporting efforts to strengthen its policies in line with OECD best practices and instruments. The second article summarises the messages from the 2006 OECD Investment Policy Review of China.

Ensuring investment for sustainable development requires, as one of the key elements, governments engaging in dialogue and sharing “best practices” for nurturing a favourable environment for attracting both foreign and domestic investment. The Investment Newsletter reports on two new policy and diagnostic tools designed to achieve these objectives. The first concerns the Policy Framework for Investment, a tool providing a checklist of policy issues for consideration by any government interested in creating an environment that is attractive to all investors and in enhancing the development benefits of investment to society. The second concerns a Risk Awareness Tool that helps companies to identify some of the special risks that arise from investing in weak governance zones.

We trust you will find the Investment Newsletter informative and we look forward to your comments and suggestions on the content and style.

Manfred Schekulin
Chair, OECD Investment Committee
Recent FDI trends in OECD countries

Foreign direct investment inflows to OECD countries in the second half of 2005, estimated at 379 billion US dollars, reached their highest level since 2000. Outflows, at USD 401 billion also picked up in the second half of 2005 from a low level in the previous half-year, but nevertheless stood at a level comparable with previous years.

In 2005, FDI inflows to the OECD area are estimated to have reached near record levels...

With data for only two countries missing, the OECD total FDI inflows for the year 2005 have been estimated at USD 584 billion, which is high by past standards. Total outflows were around 696 billion USD, a non-trivial decline from 2004.

OECD countries remain major net exporters of direct investment capital. In 2005 net outflows stood at USD 112 billion. This is below the historically high net outflows of USD 294 billion in 2004, but still sizable compared with the figures of the previous decade.

...with the UK and the US attracting about half the total inflows.

The largest individual recipients of inward FDI in the second half of 2005 were the United Kingdom and United States. The United Kingdom, which had already recorded strong FDI inflows in the first half of the year, attracted an additional USD 112 billion in 2005:S2. This reflects, among other things, sizeable cross-border mergers and acquisitions. In third place, Canada received USD 23 billion and Italy (USD 23 billion).

The country-specific outward investments in 2005:S2 are harder to interpret than inflows. The United States’ outflows totaled USD 252 billion, reflecting the divestiture of many US-based multinational enterprises to avoid large amounts of capital from their foreign subsidiaries. Conversely, the Netherlands 2005:S2 outflows were huge, mostly because of the recategorization of one large transaction within the balance of payments. Looking beyond this, the largest outward investor in the second half of the year was Japan (USD 67 billion) followed by the United Kingdom (USD 45 billion) and Italy (USD 32 billion). In fourth place Japan, traditionally a large outward investor due to its current account surpluses, recorded direct investment outflows of USD 27 billion in the second half of 2005.

Table 1. Inward Foreign Direct Investment (USD billion)

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Figure 1. FDI flows in the OECD area (USD billion)

2005 outward investment trends are harder to interpret...

The country-specific outward investments in 2005:S2 are hard to interpret owing to a couple of data abnormalities. The United States’ outflows turned sharply negative in the second half of the year, reflecting changes in corporate taxation that induced US-based multinational enterprises to withdraw large amounts of capital from their foreign subsidiaries. Conversely, the Netherlands’ 2005:S2 outflows were huge, mostly because of the reclassification of one large transaction within the balance of payments. Looking beyond this, the largest outward investor in the second half of the year was France (USD 67 billion) followed by the United Kingdom (USD 45 billion) and Italy (USD 32 billion). In...
New investment policy review of China

The Investment Committee has been co-operating with China on investment policies since 1995. The first Investment Policy Review of China was published in 2003. The 2003 Review proposed that the most effective way for China to attract more and better FDI was to entrench a transparent and non-discriminatory rules-based regulatory framework for investment. This theme has been further developed in the Investment Committee’s latest Review of China. It is in response to a request from the Chinese government to support its efforts to rejuvenate the industrial base in North-East China.

China has become one of the world’s leading destinations for FDI. However, while cross-border mergers and acquisitions are the dominant form of global FDI flows, they remain a relatively small, albeit growing part of FDI flows into China. The 2006 Review evaluates the progress made in developing an effective institutional framework for cross-border M&A in China, takes stock of remaining obstacles, and offers policy options to address them.

China can benefit from more open policies on cross-border mergers and acquisitions

China’s industrial heartland in the North-East has a high concentration of state-owned enterprises (SOE) in need of restructuring and technological upgrading. Cross-border M&A can play a larger part in economic development, especially the restructuring of SOE in China’s old industrial heartland in the North East as well as the rest of China, alongside other forms of FDI.

China has adopted some FDI opening measures

The 2003 Review of China recommended open and transparent rules-based investment policies in order to enable China to attract more and better FDI. These options included further relaxation of remaining foreign ownership restrictions, streamlining of foreign investment project approval procedures, and better protection of intellectual property rights and stronger rule of law.

Since 2003 China has adopted some FDI opening measures, reflecting policy options recommended in the Review, particularly in the streamlining of project approval procedures. In 2003 China also promulgated landmark legislation on cross-border M&A.

Obstacles to cross-border M&A remain

The OECD’s preliminary findings on the investment climate in North-East China indicate that a number of obstacles to cross-border M&A persist in the region and in China as a whole. The regulatory framework for cross-border M&A remains fragmentary, over-complex and incomplete. The Chinese government continues to close off so-called “strategic assets” to cross-border M&A without specifying which sectors are defined as strategic, or why. Foreign ownership restrictions persist and are not wholly transparent; a recent revision of the Catalogue for Guidance of Foreign Investment Industries shows no significant liberalization and additional sectoral restrictions not listed in the catalogues have been announced. Cross-border M&A approval procedures are cumbersome and time-consuming. There is a lack of transparency and disclosure in potential cross-border acquisition targets, reflecting poor corporate governance in Chinese enterprises, rendering effective due diligence difficult or impossible. Chinese methods of valuing a company differ significantly from OECD Member common practice. The largely off-market ownership structure of Chinese listed enterprises and the closure of the A share market to foreign investors make takeovers difficult. The competition framework within which M&A transactions are conducted is inadequate; there is no competition law providing for formal merger control and current merger review does not conform to international best practices in terms of substantive standards and review procedures.

Open policies towards cross-border M&A can benefit domestic as well as foreign investors

More open policies towards cross-border M&A can benefit foreign investors; they can also benefit domestic investors, who face many of the same problems. Domestic enterprises often seek merger or acquisition with a foreign partner to obtain new technology, management techniques, markets and debt cancellation. It is as much in their interests to complete the cross-border M&A transaction as it is in the interests of the foreign investor. Restrictions on foreign ownership which limit cross-border M&A can therefore also be a problem for such domestic enterprises. In addition, many generalised institutional obstacles affect all domestic enterprises just as much as foreign-invested enterprises, for example the widespread lack of corporate transparency.

Recommended policy responses

The Investment Policy Review invited the Chinese authorities to consider a number of policy responses to these challenges, including: further relaxation of foreign ownership restrictions; increased regulatory transparency; adopting internationally-standard and transparent merger notification procedures; further improving corporate governance; and fully opening capital markets to foreign investor participation. These policy responses may be facilitated by initially implementing them on a pilot basis and then spreading them to the rest of the country if and when they prove successful. North-East China may be an appropriate location for such pilot projects.

For further reading on this topic:

OECD-China co-operation in the field of international investment: www.oecd.org/daf/investment/development
Despite positive trends in the past decade, business investment and enterprise development continue to fall short of development needs. Realisation of this has led to renewed interest in the growth agenda and the importance of private investment for promoting the broad-based and sustained growth that will help drive poverty reduction. The objective of the Policy Framework for Investment (PFI), which was endorsed by the 2006 OECD Ministerial, is to mobilise private investment that supports steady economic growth and sustainable development. Drawing on good practices from OECD and non-OECD countries, the Framework proposes a set of questions for governments to consider in ten policy fields identified in the 2002 UN Monterrey Consensus in Financing for Development as critically important for the quality of a country’s environment for investment. Its core purpose is to encourage policy makers to ask appropriate questions about their economy, their institutions and their policy settings in order to identify their priorities, to develop an effective set of policies and to evaluate progress.

**What does the PFI cover?**

Apart from macroeconomic stability, political predictability, social cohesion and upholding the rule of law, which are pre-conditions for sustainable development, the PFI task force selected ten policy domains, based on an assessment of the strength of the linkages between each policy field and the investment environment. The ten policy domains cover:

- Investment policy;
- Investment promotion and facilitation;
- Trade policy;
- Competition policy;
- Tax policy;
- Corporate governance;
- Responsible business conduct;
- Human resource development;
- Infrastructure and financial sector development; and
- Public governance.

The Policy Framework for Investment: towards better investment climates

The Framework is not a volume of ready-made prescriptions, nor is it binding. Rather, it is a flexible tool with which to frame and evaluate the policy challenges countries face in pursuit of development. Its purpose is to encourage policy makers to ask appropriate questions about their economy, their institutions and their policy settings in order to identify their priorities, to develop an effective set of policies and to evaluate progress.

Private investment brings economic and social benefits, but these do not accrue automatically or evenly across countries.

The economic and social benefits of private investment, both domestic and international and in its many forms, from physical assets to intellectual capital are widely recognised. Private investment expands an economy’s productive capacity, drives job creation and income growth, and in the case of international investment, is a conduit for the local diffusion of technological and enterprise expertise and spurs domestic investment, including through the creation of local supplier linkages. Such benefits can act as a powerful force for development and poverty eradication. Yet, while many countries have succeeded in achieving high rates of domestic private investment and attracting substantial international investment as an integral part of their development strategy, others have not been as successful in realising the benefits of investment. The benefits of investment do not necessarily accrue automatically or evenly across countries, sectors and local communities. Countries’ continuous efforts to strengthen national policies and public institutions, and international co-operation, to create sound investment environments matter most.

Sound investment environments matter most.

The PFI is a tool, providing a checklist of policy issues for consideration by any government interested in creating an environment that is attractive to all investors and in enhancing the development benefits of investment to society, especially the poor. In this way, the Framework aims to advance the implementation of the United Nations Monterrey Consensus, which emphasised the vital role of private investment in effective development strategies.

The Framework is a tool to assist governments to improve their investment environment.

The Framework should be seen in the broad context of the UN Millennium Declaration and recent multilateral efforts to strengthen the international and national environments in which business is conducted, including the Doha Development Agenda and the Johannesburg Declaration on Sustainable Development. In common with those initiatives, it promotes transparency and appropriate roles and responsibilities for governments, business and others with a stake in promoting development and poverty reduction, and builds on universally shared values of democratic society and respect for human rights, including property rights.

It was developed by a multilateral task force...
The OECD, working with non-members, partner organisations, donors and stakeholders, will assist in methodologies, including indicators of progress, and institutional capacity building for the effective use of the Framework in light of different circumstances and needs.

The Framework is a component of the OECD Initiative on Investment for Development, launched in Johannesburg in November 2003, which received support at OECD Ministerial level. The Framework builds on the OECD’s experience and instruments dealing with the different policy areas that are covered and its Committees’ global and regional dialogue with non-member economies. It complements recent OECD initiatives directed to governments and the business sector, including the OECD Guidelines for Multinational Enterprises revised in 2000, and can work in synergy with the OECD Development Assistance Committee’s Policy Guidance for Donors on using ODA to Promote Private Investment for Development, which is another component of the OECD Initiative.

The Framework and its scope will be reviewed by the OECD and its non-member partners and stakeholders in light of experience with its use, to strengthen its effectiveness over time.

For further reading:

OECD work on investment for development: www.oecd.org/daf/investment/development

OECD Policy Framework for Investment.


A risk awareness tool for MNEs in weak governance zones

Weak governance zones are defined as countries where governments are unable or unwilling to assume their responsibilities. Companies recognise that they represent some of the most difficult investment environments. The Investment Committee has developed a Risk Awareness Tool that helps companies to identify some of the special risks that arise in these environments. It covers such topics as obeying the law and observing international instruments; political activities; knowing clients and business partners and speaking out about wrongdoing.

Weak governance zones represent some of the most challenging investment environments in the world.

The failure of public sector institutions that characterise weak governance zones often lead to broader failures in political, economic and civic institutions that, in tum, creates the conditions for endemic violence, crime and corruption and that block economic and social development. About 14 per cent of the world’s people live in such areas, notably in sub-Saharan Africa.

A new OECD tool aims to help companies meet these challenges...

For international business, weak governance zones represent some of the most challenging investment environments in the world. This new OECD Risk Awareness Tool aims to help companies -- including small and medium size enterprises -- meet these challenges. There is clearly a demand for such a tool and the business sector itself supports such work.

The issue of investing responsibly in weak governance zones has been raised many times with the OECD Investment Committee and the National Contact Points (NCPs) in the context of implementing the OECD Guidelines on Multinational Enterprises. Support for an OECD initiative in this area has also come from the G8 – the 2005 G8 Gleneagles Summit Communiqué calls for “developing OECD guidance for companies working in zones of weak governance”.

...reinforcing and complementing other initiatives

The OECD Risk Awareness Tool is one of many initiatives that have been undertaken in a variety of international, regional, national and sub-national settings to help the citizens of weak governance zones find solutions to their problems. These include: the Extractive Industries Transparency Initiative; the OECD Development Assistance Committee’s Guidelines on Helping Prevent Violent Conflict and the work of its Fragile States Group; the International Budget Project; the Voluntary Principles on Security and Human Rights; the United Nations Convention against Corruption; the UN Global Compact’s Conflict Guidelines and the Wolfsberg Anti-Money Laundering Standards. These initiatives draw on the distinctive competencies of many organisations – home and host governments, international organisations, companies and business associations, trade unions and NGOs. With the development of its Risk Awareness Tool, the OECD seeks to reinforce and to complement these efforts.

The Tool is based on the premise that a durable exit from poverty will need to be driven by the leadership and the people of the countries concerned – only they can formulate and implement the necessary reforms. Companies play important supporting roles and this Tool seeks to raise awareness of these roles and to help companies play them more effectively.

Governments have a role to play

With respect to the role of governments in establishing an appropriate policy framework, the OECD Investment Committee will work with all interested governments to advance the shared goal of continuous improvement in public policy. The Policy Framework on Investment proposes practical considerations in ten policy areas that help to create the domestic conditions for private investment to flourish (see next article).

The Investment Committee will cooperate with all governments – including those representing weak governance zones – with a view to improving the effectiveness of public policy and creating a pathway to sustained economic development and greater well-being for their citizens.

The Investment Committee will respond to the interest of companies, NGOs and trade unions in the development of this instrument, the contributions they have made to its development and their continuing interest in its use. The Committee also expresses its desire to work with them to promote the use of this Tool and, in particular, to continue to work with them to develop a more extensive resource guide for companies wishing to identify sources of practical experience in meeting the challenges this Tool is intended to address. It also proposes to use the Risk Awareness Tool in the OECD dialogue with non-member countries.

Note: National Contact Points are government offices (sometimes involving participation by business, trade union and NGO representatives) that are located in each of the 39 countries adhering to the OECD Guidelines for Multinational Enterprises. They are charged with promoting the OECD Guidelines among multinational enterprises operating in or from the country in question.

For further reading on this topic:

OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones, forthcoming.

OECD work on corporate responsibility: www.oecd.org/daf/investment/cr.
Selected Investment Committee publications

Investment for Development
Investment for Development provides a record of the OECD Investment Committee’s co-operation programmes with non-member economies and their results. These extensive co-operation activities are organised around three dimensions: global events, regional initiatives and dialogue with individual countries. This report documents how these initiatives help to strengthen implementation capacities and best practices among non-members, drawing on the broad applicability of the principles and expertise the OECD has developed in the area of international investment, including the positive contribution of responsible international business.

Annual Report on the OECD Guidelines for Multinational Enterprises
Focus on: Corporate Responsibility in the Developing World
The Guidelines are recommendations on international business conduct in such areas as labour, environment, consumer protection and the fight against corruption. The recommendations are made by the adhering governments and, although they are not binding, governments are committed to promoting their observance. This book provides an account of what the 39 adhering governments have been doing to enhance the contribution of the OECD Guidelines for Multinational Enterprises to the improved functioning of the global economy. The publication also provides an overview of corporate responsibility in the developing world.

International Investment Law: A Changing Landscape
International investment agreements reinforce domestic liberalisation and underpin legal security for investment. Recently, a "new generation" of bilateral and regional investment agreements has emerged, together with a growing body of jurisprudence. This publication includes four surveys on legal and policy issues arising from international investment agreements. These are: the role of transparency and third party participation in investor-state dispute settlement procedures; the concept of a "Fair and Equitable Treatment Standard" and elements of its content, based on jurisprudence and state practice; a survey on "Indirect Expropriation and the Right to Regulate" which identifies main criteria found in investment agreements and used by tribunals to articulate the difference between the two concepts; and a survey on "Most-Favoured Nation Treatment" which reviews accepted principles to interpret the application of this provision in investment agreements.

International Investment Perspectives
International Investment Perspectives is an annual publication. Each issue includes an update of recent trends and prospects in international direct investment and provides analysis of investment policy questions of topical interest. The special focus of this edition is devoted to policies bearing on the investment climate and is based on the analytical work underpinning the Policy Framework for Investment. The remainder of the publication addresses challenges arising from the Monterrey Consensus’ emphasis on international investment, especially foreign direct investment, as a key source of financing development. One article looks into the experiences with private participation in infrastructure, including development agencies’ efforts to promote it. Another addresses in detail Vietnam’s experience with more than a decade of using development assistance as a tool for enhancing its investment climate.

Several options are available for obtaining publications:
- Additional information and links can be found via the investment portal on the OECD website: www.oecd.org/investment
- Subscribers and readers at subscribing institutions can access the online edition via the online library: www.sourceoecd.org
- Non-subscribers can purchase the PDF e-book and/or paper copy via our Online Bookshop: www.oecd.org/bookshop
- Government officials can find the PDF e-book via the publication locator on OLISET: www.oecd.org/OLISET
- Accredited journalists can obtain password access via the Newsroom: www.oecd.org
Forthcoming events

Fourth Quarter 2006

**NEPAD-OECD Africa Investment Initiative Launch Event**

The NEPAD-OECD Africa Investment Initiative aims to mobilise private investment for poverty reduction, job creation and sustainable development, by supporting African countries own efforts to advance national reform agendas, regional and international policy dialogue, policy implementation and capacity building.

The first phase of the Initiative involves a stocktaking of progress in investment policies in the region. An expert meeting, tentatively scheduled for September and hosted by Senegal, is being organised. The event will establish a comparative inventory of available information on regulatory measures and policies regarding investment in selected African countries. This information could be used as a basis for self assessment and as a means for building capacity to participate in the African Union Peer Review Mechanism.

Further information on the Initiative can be found at: [www.oecd.org/investment/development](http://www.oecd.org/investment/development)

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6-7 November 2006

**Global Forum on International Investment**

“International investment and the public interest: the case of infrastructure”

This year’s annual OECD Global Forum on International Investment (GFII) will take place in Istanbul on 6-7 November 2006. Preceding the Forum, participants will have an opportunity to also take part in an OECD/Turkey Investment Roundtable.

The main individual topic will be international investor participation in infrastructure. Governments around the world are increasingly inviting international investment into their infrastructure sectors, to leverage public finance and in order to reap efficiency gains. Not all projects have been successful. The GFII will discuss the experiences so far and try to establish success criteria, including regarding the domestic investment climate, modes of public-private co-operation and responsible business conduct.

Investment policy using the PFI will be the organising theme of the forum. Participating countries will be invited to present their investment climate and policies, applying the PFI by ways of self-assessment and encouraging peer discussions and comparisons with the experiences of other relevant countries.

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News in brief

**Middle East North Africa (MENA) Investment Ministerial Meeting 2006**

Organised within the framework of the MENA-OECD Investment Programme, the first MENA Investment Ministerial Meeting took place at the Dead Sea in Jordan on 13-14 February 2006. Participants acknowledged the need for transparency and predictability of national policies, laws, regulations, administrative practices and statistics affecting foreign and domestic investment.

Ongoing efforts by MENA economies and OECD countries to boost investment in the Middle East and North Africa took a significant step forward with the announcement by 16 Arab nations of their intention to pursue reform policies aimed at improving the environment for business in the region.

In a 19-point Declaration, Ministers and senior representatives of MENA countries set out common principles and good practices for encouraging investment.

The Declaration can be downloaded at: [www.oecd.org/mena/investment](http://www.oecd.org/mena/investment)

**Symposium on Making the Most of International Investment Agreements**

A symposium on Making the Most of International Investment Agreements: A Common Agenda was recently organised jointly by ICSID, OECD and UNCTAD. Its purpose was for non-governmental actors to share their perspectives on emerging investment arbitration issues identified by governments and their international organisations; to explore and advance the agenda which developed and developing country parties to investment agreements have in common; and to consider ways for the three organisations and other interested institutions to best work together and respond to the needs of their members and the investment community.

Further information and background documentation can be found at: [www.oecd.org/daf/investment/agreements](http://www.oecd.org/daf/investment/agreements)