CHINA’S OUTWARD FOREIGN DIRECT INVESTMENT

China is rapidly becoming an important source of outward foreign direct investment (OFDI). Starting from virtually no OFDI in 1979, the initial year of China’s open door policy, China has accumulated over US$ 90 billion of OFDI. China’s OFDI flow and stock now stand as the 4th and 6th largest, respectively, among developing countries.

Most of the increase in China’s OFDI has taken place since 2000 (see figure) when China officially initiated a ‘go global’ strategy to promote its OFDI. This facilitated OFDI by relaxing controls on outward capital flows and simplified administrative requirements.

Even though China’s OFDI has risen 19 fold since 2000, its OFDI stock accounts for only 0.6 per cent of global OFDI, and relative to GDP, it lags far behind the world average. China’s official OFDI statistics may, however, underestimate the actual volume of outward flows. China’s FDI stocks as reported by OECD countries in their respective inward FDI statistics are on average 40 per cent higher.

Continued on page 2
Among developing countries, however, China has become a leading source of FDI in Africa. These investments are geographically diversified, reaching 48 countries in the continent. While accessing natural resources is a motivation for Chinese investors, market-seeking investment is also a prominent motivation for Chinese enterprises investing in Africa, especially in the manufacturing and the construction sectors.

RECORD LEVELS OF FDI REACHED IN OECD COUNTRIES

FDI outflows from the OECD area in the first three quarters of 2007 are close to record levels, and year totals are expected easily to exceed the peak reached in year 2000. By September 2007, 12 OECD countries, including the United States, Japan, Italy, Spain and Australia had already exceeded their record levels. Over the same period, FDI inflows to the OECD area were equivalent to 791 billion US dollars. The recent slowdown in economic growth in the United States, an uncertain global outlook and tighter liquidity conditions may act to dampen OECD area FDI flows in 2008.

For further reading on this topic: OECD-China work on international investment

www.oecd.org/daf/investment/china
OECD total FDI inflows for the first nine months of 2007 reached USD 791 billion while outflows over the same period rose briskly to reach USD 1150 billion (see Table).

As a result of these developments, total net OECD outflows in the first three quarters of 2007 amounted to USD 359 billion. This is the highest level of net outflows ever recorded from the OECD area and is a sign of the broadening geographic distribution of FDI towards non-OECD countries.

The main recipients of inward FDI in the OECD area are G7 countries. In France, inflows have risen sharply over the past few years, and for the three quarters of 2007 have already surpassed all previous records. Other major recipients of FDI during the same period include the USA, the UK and Canada.

OECD East European economies have moved from being relatively closed to international investment 15 years ago to one of the most dynamic regions of the OECD area.

The main OECD countries for outward FDI remain France, Germany, Italy, Japan, Spain, the UK and the United States. Together they account for nearly two thirds of the OECD total.

FDI flows foster closer economic integration and act as a driver of globalisation. OECD Central and East European economies, for instance, have moved from being relatively closed to international investment 15 years ago to one of the most dynamic regions of the OECD area.

The inward stock of FDI to the Czech Republic, Hungary, Poland and Slovakia has on average over the past decade grown by 23 per cent each year. The inflows have been substantial in the car manufacturing and assembly sector and led to a significant increase in car production in these economies.

Policy analyses aimed at understanding the forces driving these developments depend on reliable and comparable FDI statistics. The period ahead will see an improvement in the quality of FDI data. This follows the recent decision by statisticians from the OECD and national statistical agencies to adopt a new methodology for compiling FDI data (see box). Implementation is expected in 2010 for 2009 data.

For further reading on this topic: OECD work on FDI statistics

www.oecd.org/dae/investment/statistics

HOW DOES TAXATION AFFECT FOREIGN DIRECT INVESTMENT?

Most governments aim to offer a competitive tax environment for inward and outward FDI. At the same time, there is a need to ensure that an appropriate share of tax is collected from multinational enterprises. A new OECD report on the tax effects on FDI analyses the policy issues in this area.

Taxation is one of many factors that influence decisions by multinational enterprises on where, how much and when to invest. Empirical studies estimate that a 1 percentage point increase in the tax rate on FDI decreases FDI by 3.7%. And there are some signs that the sensitivity of FDI to taxation is increasing, as lower non-tax barriers to FDI increase the mobility of capital.

Measurement issues complicate analysis of tax effects on FDI. Estimates depend, for instance, on what tax rate is used. Yet it is uncertain whether for MNEs it is statutory ‘headline’ corporate tax rates, average effective tax rates (AETRs), measuring the average tax burden on investment projects, or marginal effective tax rates (METRs), assessing the tax burden on the last unit of capital invested, that matter most to investment decisions. What is sure is that these tax rates vary both within and across OECD countries (see Figure).

Tax rates are also sensitive to tax planning by MNEs. OECD work shows that the effective tax rate on FDI can be significantly reduced depending on the interplay between home and host country tax systems, how FDI is financed, and how earnings are paid out. In other words, relevant tax rates on FDI depend on a complex set of considerations that are difficult to account for in constructing representative tax burden measures.
A low tax burden does not compensate for a weak investment environment.

How does taxation affect FDI?

Many countries have recently reduced their statutory corporate tax rate to encourage investment. This is a simple tax change to introduce, is readily observed, is directly relevant to investors, improves capital allocation efficiency when combined with reforms to broaden the tax base, and limits incentives for tax avoidance.

There are some signs that the sensitivity of FDI to taxation is increasing, as lower non-tax barriers to FDI increase the mobility of capital.

However, such reductions are expensive in terms of revenue foregone, may be seen as unfair, and may create pressures to reduce personal income tax rates as well. Some countries have preferred to target tax relief to certain mobile sectors or activities, to encourage investment at lower tax revenue cost.

Governments are also trying to improve the business friendliness of their tax administration by improving transparency, predictability and timeliness in the application of tax rules. And other taxes, such as energy taxes, payroll taxes and non-profit related business taxes matter too.

Overall, investors look for countries offering a coherent policy framework. FDI decisions also depend on market access, a predictable and non-discriminatory legal and regulatory framework, macroeconomic stability, skilled and responsive labour markets and well-developed infrastructure. When these conditions are weak, lowering business taxes cannot be expected to improve and may indeed weaken the investment climate.

Governments interested in creating a coherent policy environment that is attractive to all investors, and in enhancing the economic benefit of investment to society can use the Policy Framework for Investment. This is a new policy tool developed by OECD and non-OECD economies that identifies the main policy issues and the key linkages between policy areas that are important for improving investment conditions. Taxation is one of the 10 policy areas covered.

For further reading on this topic:
Also visit: www.oecd.org/taxation

Pressure on governments to reduce tax rates will continue, although countries providing access to large established markets may be better placed to resist this pressure. Increased vigilance by policy makers to limit artificial shifting of the tax base to no or low tax jurisdictions can also be expected. At the same time, approaches in the treatment of inbound and outbound investment can be expected to vary across countries, reflecting different country circumstances and attributes. In this context, the sharing of experiences in addressing these challenges will help policy makers refine the scope of their national tax systems.

Statutory and effective corporate tax rates, 2005

Source: OECD Secretariat.
Mobilising Investment in Africa’s Water Infrastructure

Africa has the lowest drinking water and sanitation coverage in the world. Estimates of the investment needed to improve coverage are equivalent to US$20 billion per annum over the next two decades; more than double current outlays. A NEPAD-OECD Africa Investment Initiative roundtable organised in Lusaka last November was the first of several planned high-level dialogues aimed at developing from the OECD Principles for Private Sector Participation in Infrastructure practical guidance for governments wishing to engage the private sector in the development and management of water and sanitation infrastructure.

Population growth, migration to urban areas and inadequate investment in infrastructure development are contributing to a growing number of people without access to drinking water in sub-Saharan Africa. Even if the region were to reach the water and sanitation Millennium Development Goals, some 234 million people would still lack access to safe drinking water by 2015, and 317 million to improved sanitation.

To meet the tremendous investment needs, more than 16 African countries have sought private sector involvement to develop their water and sanitation infrastructure since 1990.

Private sector participation in the water and sanitation sector poses specific risks however. High initial investment outlays, long payback periods and the fixed and specific nature of the infrastructure generate high contractual risk. Investors also face foreign exchange and sub-sovereign risks, since projects are frequently contracted at the local government level.

Moreover, because water is a basic need there are important social and political repercussions. These justify political involvement, often in the form of control over the setting of tariffs. But when tariffs do not reflect the full reality of costs, under-investment is likely one of the consequences.

Improving the balance between policy objectives, managing the risks and expanding feasible investment opportunities are challenges that governments and investors alike face in improving access to water and sanitation.

Optimising the contribution of the private sector requires a clear understanding of “who does what and where” from upstream resource extraction to service delivery, and a sound investment climate based on transparent and predictable regulatory and policy frameworks.

The experiences so far with private sector involvement in the development and management of water and sanitation infrastructure have been diverse, both in terms of the types of involvement and their performance.

The OECD is examining these experiences to distil the lessons learnt and to develop practical guidance for governments on how to catalyse private sector participation better and improve understanding of their respective roles and responsibilities. The framework for this work is the OECD Principles for Private Sector Participation in Infrastructure (see box).

OECD Principles for Private Sector Participation in Infrastructure

The OECD Principles for Private Sector Participation in Infrastructure aim to assist governments to make the most of private sector involvement in infrastructure development for the benefit of society. They cover five main issues:

i) deciding on public or private provision of infrastructure services;

ii) establishing an enabling policy framework for investment;

iii) enhancing the public’s acceptance and the government’s capacities to implement agreed projects;

iv) making the cooperation between the public and private sectors work; and

v) communicating government’s expectations about responsible business conduct to their private partners.

This work is part of a broader OECD water project, the results of which will be delivered to the 5th World Water Forum in Istanbul in March 2009.

For further reading on this topic:
OECD (2006), Principles for Private Sector Participation in Infrastructure
www.oecd.org/daf/investment/ppp

Lusaka Roundtable background paper on the application of the Principles to water and sanitation, available at:
www.oecd.org/daf/investment/africa
SERVICES TRADE AND FDI IN REGIONAL TRADE AGREEMENTS

Trade and investment are closely connected economic activities. Recent work at the OECD has examined the types of interactions between investment and services chapters in 20 regional trade agreements and the implications for investment protection and liberalisation. This article summarises the main findings.

Since the mid-1990s rule-making in international trade and investment as embodied in regional trade agreements (RTA) can be classified into two broad categories:

- **NAFTA-inspired agreements** where investment disciplines are lodged in the investment chapter and there is limited interaction with the services chapter; and
- **GATS-inspired agreements**, where investment disciplines are divided between the services and the investment chapters, with as a result more prevalent interactions between the two.

The favoured choice of approach depends on a number of factors. A country’s administrative capacity, its past approach to regional trade agreements and the pace at which a country wishes to liberalise, all play a part.

The level of investment protection is determined by the scope and coverage of the investment protection provisions and not by the type of interaction between the two chapters. In both types of RTAs, investment in services industries may benefit from the protections provided by the investment chapter, such as on expropriation, transfers, compensation for losses or investor-to-state dispute settlement. As investment provisions vary from one RTA to another, some countries have decided to maintain a former Bilateral Investment Treaty alongside the more recently negotiated RTA.

NAFTA- and GATS-inspired approaches to RTAs have different implications on the level of investment liberalisation achieved:

- **NAFTA-inspired agreements** tend to favour a higher level of investment liberalisation. This stems from their advantage in terms of the number of sectors covered by non-discrimination disciplines and the degree of transparency and predictability through a “one-shot” liberalisation encompassing all sectors and a “ratchet” mechanism that locks in future reforms;
- **GATS-inspired agreements** are often favoured by countries that want to preserve flexibility and progressiveness in their liberalisation, while they reform and establish new regulatory frameworks.

The differences between the two approaches, however, should not be overstated. An ambitious level of investment liberalisation in a GATS-inspired agreement is possible by taking commitments in additional sectors or by increasing the transparency of schedules. And some recent GATS-inspired agreements take a flexible approach, offering a combination of positive and negative listing.

Both types of agreement provide scope for future liberalisation. Flexibility exists in NAFTA-inspired agreements through reservations on existing and future non-conforming measures, and GATS-inspired agreements can include provisions on future liberalisation.

The most-favoured nation (MFN) clause is a common provision found both in the investment and trade in services chapters of RTAs. The clause requires a party to a given agreement to provide investors and investments from the other party treatment “no less favourable” than that it accords to investors and investments of any party or non-party to the agreement.

How the MFN clause is applied differs between NAFTA- and GATS-inspired agreements. GATS-inspired agreements tend to prevent the MFN rule from applying to third parties through a regional economic integration organisation (REIO) exception clause. In NAFTA-inspired agreements the MFN rule can apply to future agreements that might contain better treatment for investors. However some countries have listed reservations in specific sectors limiting the extension of any possible better treatment. In the light of this, one can question the effectiveness of the MFN rule with respect to investment liberalisation in creating a level playing field between investors from various Parties.

For further reading on this topic:


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... there has been a rapid expansion in the number of regional agreements combining investment and trade in services rules, mainly in the form of free trade areas.

Under these two approaches there has been a rapid expansion in the number of regional agreements combining investment and trade in services rules, mainly in the form of free trade areas. Moreover, the pace of their introduction has picked up since 2000. Over 40 per cent of the cumulative total of regional trade agreements has come into being since 2000. Mexico, Chile, Singapore, the U.S. Australia and New Zealand are leading in terms of agreements concluded, and EFTA, the EU and ASEAN stand out as the most active country groupings.

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DID YOU KNOW...

... that the Policy Framework for Investment – the most comprehensive multilaterally backed approach to date for improving investment - is now available in Chinese?

Download the translation at: [www.oecd.org/dae/investment/pfi](http://www.oecd.org/dae/investment/pfi)
Investment for Development: 2007 Annual Report

*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.


This Annual Report provides an account of the actions the adhering governments have taken over the 12 months to June 2007 to enhance the contribution of the *Guidelines* to the improved functioning of the global economy. This publication also contains the results of the 2007 OECD Roundtable on Corporate Responsibility which focused on the OECD *Guidelines for Multinational Enterprises* and the financial sector.

**FORTHCOMING:**

**International Investment Law:**

*Understanding Concepts and Tracking Innovations*

International investment agreements set ground rules for how host governments treat foreign investors. This publication provides an unparalleled source of information on four key issues: the definition of investor and investment; the interpretation of umbrella clauses in investment agreements; coverage of environmental, labour and anti-corruption issues; and the interaction between investment and services chapters in selected regional trade agreements.

**FORTHCOMING:**

**Benchmark Definition of Foreign Direct Investment, Fourth Edition**

Recording comprehensive, comparable and up-to-date statistics on Foreign Direct Investment is a prerequisite for economic analysis and policy making. The Fourth Edition of the OECD *Benchmark Definition*, fully consistent with the IMF *Balance of Payments Manual*, Fifth Edition, provides operational guidance on how FDI data should be compiled to meet internationally agreed standards. It reviews the main statistical concepts and definitions of FDI, the valuation of FDI flows and stocks, and issues related to specific transactions and entities. Practical solutions are proposed and concrete examples are used wherever possible.
The theme of this year’s conference is “Best practices in promoting investment for development”. The two day event will focus on the political economy of investment policy reform, the development of a user’s toolkit for the Policy Framework for Investment and on selected systemic issues. The opening session will be co-chaired by Mr. Angel Gurría, OECD Secretary General and Dr. Supachai Panitchpakdi, UNCTAD Secretary General.

Further information on the GFI can be found at: www.oecd.org/investment/gfi-7.

Contact: Mike Gestrin  
Tel: +33(0)145247624

31 MARCH 2008, LONDON, UNITED KINGDOM  
Conference on Sovereign Wealth Funds in the Global Investment Landscape: Building Trust

The OECD has been asked by the G7 Finance Ministers and the other OECD members to develop guidance for recipient countries’ policies toward investment from SWFs to help them reconcile security concerns relating to foreign-government controlled investors with the goal of promoting freedom of investment. This project complements efforts underway in the International Monetary Fund (IMF) to develop voluntary best practices for SWFs.

Organised by the City of London and the OECD with the participation of the IMF, this conference will address the following topics: Investment by SWFs: benefits and concerns; Practice and perspectives of SWFs as investors; and Recipient country policy responses. The discussions will provide inputs, including from SWFs themselves, into the OECD project. In April 2008, the Investment Committee will provide a progress report on its work. The objective is to have a report, including recommendations, completed by mid-2009.

Further information on the conference can be found at: www.oecd.org/daf/investment/loi.

Contact: Kathryn Gordon  
Tel: +33(0)145249842

27-28 MARCH 2008, PARIS, FRANCE  
OECD Global Forum on International Investment

The OECD Global Forum on International Investment (GFI) is the annual meeting of a global network of policy makers, academics, business leaders, labour representatives, and members of civil society dealing with the policy challenges of international investment.

NEPAD-OECD AFRICA INVESTMENT INITIATIVE, LUSAKA ROUNDTABLE

On 27-28 November 2007, in partnership with NEPAD, a roundtable on “Strengthening Investment Climate Assessment and Reform in NEPAD Countries” was held in Lusaka, Zambia.

The aim of the roundtable was to develop policy capacity building tools that will help NEPAD countries improve the investment related content of Africa’s peer review process (APRM) and to support implementation of investment climate reform policies, with a specific focus on the investment environment conditions conducive to attracting investment for development in the water and sanitation sector.

For a summary of the results of the discussions and information on the Initiative, visit www.oecd.org/daf/investment/africa.

Contact: Jonathan Coppel, Tel: +33(0) 145241447

SECOND MENA-OECD MINISTERIAL MEETING

Held in Cairo on 28 November with the participation of the Prime Minister of Egypt, Ahmed Nazif and the OECD Secretary-General, Angel Gurría, the meeting drew about 80 delegations from MENA and OECD countries, as well as international organisations and over 1,000 participants from Egypt and throughout the MENA region.

A number of tangible outcomes resulted from this meeting, including a mandate for the second phase of the MENA Investment Initiative.

For a summary of the discussions and information on the MENA-OECD Investment Programme, visit: www.oecd.org/mena/investment

Contact: Alexander Böhmer, Tel:+33(0)145241912

REGIONAL CONSULTATION ON PRIVATE SECTOR PARTICIPATION IN WATER AND SANITATION INFRASTRUCTURE

On 5 March 2008, the OECD and the Asian Development Bank held a joint expert meeting on beneficial private sector participation in the water and sanitation sector, with a focus on Asian country experiences.

The meeting aimed to advance the debate on private sector participation in the water and sanitation sector by providing a forum for participants to discuss and better define the key elements of a beneficial partnership. Following the recent Lusaka roundtable, it provided a further opportunity to discuss the draft OECD guidance on private sector participation in water and sanitation infrastructure, building on the experience of Asian countries.

For further information on the water investment project, visit www.oecd.org/daf/investment/water.

Contact: Céline Kauffmann, Tel: +33(0)145249333