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IN THIS ISSUE

OECD FDI OUTFLOWS AND INFLOWS REACH RECORD HIGHS IN 2007 BUT LOOK SET TO FALL IN 2008

PAGES 1-3

THE NEW OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT ENTERS INTO FORCE

PAGE 4

OECD MINISTERS ADOPT DECLARATION ON SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES

PAGE 5

OECD GLOBAL FORUM ON INTERNATIONAL INVESTMENT AND THE OECD JOURNAL FOR INVESTMENT POLICY

PAGE 6

SELECTED INVESTMENT PUBLICATIONS

PAGE 7

CALENDAR OF EVENTS AND NEWS IN BRIEF

PAGE 8

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OECD FDI OUTFLOWS AND INFLOWS REACH RECORD HIGHS IN 2007 BUT LOOK SET TO FALL IN 2008

Between 2006 and 2007, FDI outflows from OECD countries increased by over 50% from US\$1.2 trillion to a record US\$1.82 trillion (see table). This was US\$580 billion higher than the previous record outflows in 2000. It also represented the fastest rate of year-on-year growth (52%) since the FDI boom years of 1998 (59%) and 1999 (61%).

Eight countries more than doubled their outward investment in 2007. Four of them were EU countries. The United Kingdom had the largest increase in absolute terms (US\$230 billion) followed by Italy (US\$90.8 billion), Austria (US\$31.4 billion), and Finland (US\$8.6 billion). The other four countries were Korea (US\$15.3 billion), Iceland (US\$12.5 billion), New Zealand (reaching a record high of US\$2.8 billion), and Turkey (US\$2.1 billion).

Inward flows into OECD countries also maintained strong growth in 2007, increasing from US\$1.05 trillion to US\$1.37 trillion, a 31% increase. And while this represents a new record for OECD inflows, it was only slightly higher than the previous inflow record of US\$1.29 trillion set in 2000.

FDI inflows into Spain increased by more than 80% in 2007, helped by a large Italian investment in the electricity sector. Foreign investment into Japan was exceptionally high by historical standards, increasing from a record low of US\$-6.5 billion to US\$22.5 billion. This was largely due to significant investments in the financial sector and the capitalisation of foreign subsidiaries in Japan engaged in real estate investment. Inward investment into Switzerland reached a record high US\$40 billion, a 50% increase over 2006. This was mainly accounted for by a large foreign takeover of a Swiss pharmaceutical company. Similarly, the takeover of ABN-AMRO by Fortis, Royal Bank of Scotland and Banco Santander boosted FDI inflows into the Netherlands to an all-time high US\$99 billion from US\$8 billion in 2006 (excluding FDI transiting through special purpose entities – see also next article on the new Benchmark Definition).

Continued on page 2

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OECD FDI OUTFLOWS AND INFLOWS continued...

Despite the generally strong overall growth of FDI inflows into the OECD as a whole, 14 countries experienced negative net inflows between 2006 and 2007, including the United States. Given the relatively stronger growth of outflows compared with inflows, net OECD outflows (outflows minus inflows) increased to US\$450 billion, almost three times higher than in 2006.

The United States held its position as the top OECD investor and recipient of foreign investment with US\$333 billion in outflows and US\$238 billion in inflows, despite a slight decline from 2006. The United Kingdom was in second position with US\$230

billion in outflows and US\$186 billion of inflows, followed by France, which doubled both its outflows (US\$225 billion) and inflows (US\$158 billion).

Record FDI flows were helped by the relative decline in the dollar

The new records set in 2007 for both OECD inflows and outflows were helped by the fall in the United States dollar against most other major currencies. For example, the average Euro:Dollar exchange rate decreased from around 0.80 to 0.73 between 2006 and 2007. As a result, inward and

outward FDI flows to and from the OECD Euro Zone countries measured in US dollars were approximately 9% higher than they would have been if exchange rates had remained at 2006 levels. It is difficult to isolate the ultimate impact of exchange rate shifts on overall FDI flows due to difficulty of separating their accounting effects (e.g. a change in the nominal dollar value of essentially equivalent assets) from their dynamic economic effects (e.g. a change in investment flows resulting from changes in asset values) and other important factors, such as the financial turmoil that began in mid-2007.

...but the outlook for 2008 is less positive

While 2007 was a record year for both OECD outflows and inflows, sharp declines are expected in 2008. According to preliminary data, United States outward investment decreased and inward investment growth slowed down in the first quarter of 2008 compared to the last quarter of 2007. This was primarily due to a slowdown in intercompany loans but also in equity financing. A similar slowdown was observed in several other OECD countries in the first quarter of 2008.

A slowdown in international mergers and acquisitions (M&A), which make up a significant share of FDI, during the first half of 2008 also suggests sharp declines for OECD FDI flows in 2008. Although FDI flows and international mergers and acquisitions are measured differently, the relationship between these two measures of international activity is historically very close – almost one-to-one, and with a high level of statistical predictability (see chart). Based upon this relationship, and assuming that the sharp slowdown in M&A activity in the first half of 2008 carries through the second half, a projection for 2008 indicates that OECD FDI inflows could fall by around US\$335 billion (24%) and outflows by around US\$680 billion (37%) from their 2007 levels (see chart). ►

Foreign Direct Investment, billion US\$

	Inflows			Outflows		
	2006	2007	% change	2006	2007	% change
Australia	18.9	23.6	24.8	23.8	25.7	7.9
Austria	6.2	30.7	395.6	9.7	31.4	225.3
Belgium	63.9	39.1	-38.9	56.2	51.9	-7.7
Canada	69.0	107.4	55.6	45.2	49.5	9.3
Czech Republic	6.0	9.1	51.7	1.5	1.3	-9.1
Denmark	3.6	11.3	214.6	8.5	16.2	91.0
Finland	5.5	8.5	54.6	3.2	8.6	172.7
France	78.2	158.0	102.0	121.4	224.6	85.1
Germany	55.2	50.9	-7.7	94.8	167.5	76.7
Greece	5.4	1.9	-64.3	4.2	5.3	28.1
Hungary	6.8	5.6	-17.9	3.6	4.1	13.7
Iceland	4.0	3.8	-3.1	5.3	12.5	134.6
Ireland	-0.9	25.9	na	14.7	22.1	49.6
Italy	39.3	40.2	2.4	42.1	90.8	115.7
Japan	-6.5	22.5	na	50.2	73.5	46.4
Korea	3.6	1.6	-56.7	7.1	15.3	114.4
Luxembourg	125.0	118.8	-4.9	110.7	181.9	64.3
Mexico	19.2	23.2	20.8	5.8	8.3	43.4
Netherlands	8.0	99.5	1145.5	47.1	31.2	-33.9
New Zealand	8.0	2.9	-64.2	0.4	2.8	650.9
Norway	6.5	0.6	-90.7	21.1	11.2	-47.1
Poland	18.9	17.6	-7.1	8.9	3.2	-63.6
Portugal	11.3	5.6	-50.2	7.0	6.2	-10.8
Slovak Republic	4.2	2.9	-31.3	0.4	0.2	-44.7
Spain	26.9	53.4	98.5	100.3	119.6	19.3
Sweden	23.1	18.8	-18.6	22.0	36.7	66.4
Switzerland	26.3	40.4	53.7	69.9	51.0	-27.1
Turkey	19.9	22.0	10.3	0.9	2.1	127.4
United Kingdom	147.7	186.0	25.9	79.5	229.9	189.3
United States	242.0	237.5	-1.9	241.2	333.3	38.2
Total	1045.1	1369.2	31.0	1206.6	1817.9	50.7

Notes: data are converted to US dollars using average exchange rates.

Sources: OECD International Direct Investment Database and MEI.

...with negative implications for developing country inflows

Most inward FDI into developing countries comes from OECD outward FDI. This trend continued in 2007, as the developing countries matched the record level of outward FDI from the OECD with record levels of inward FDI (see chart), reaching US\$471 billion in 2007, an increase of almost 30% over the previous record of US\$368 billion set in 2006. The BRICS (Brazil, China, India, Russia, and South Africa) account for approximately 50-60% of developing country inflows.

The chart projects the possible implications of a decline in OECD outflows in 2008 for developing country inflows. Based upon the historical relationship between developing country inflows and changes in OECD outflows, the projected 37% drop in OECD outflows in 2008 could be expected to result in a decline of around 40% for developing country inflows to around US\$280 billion from their 2007 record US\$470 billion, barring other offsetting factors.

Factors that could improve the outlook for 2008 include the possibility that “the worst is over”, in which case our assumption that international M&A (and by extension, FDI performance) will be just as sluggish in the second half of 2008 as it was in the first half is too pessimistic. Another possibility is that the structural shift in recent years which has seen the share of FDI flows between developing countries increase will serve to mute the impact of any eventual slowdown in outward FDI flows from the OECD.

Notwithstanding these and other factors that might improve the FDI outlook, including strong economic growth in emerging markets, growing global economic uncertainty, suggest that the relevant question is not

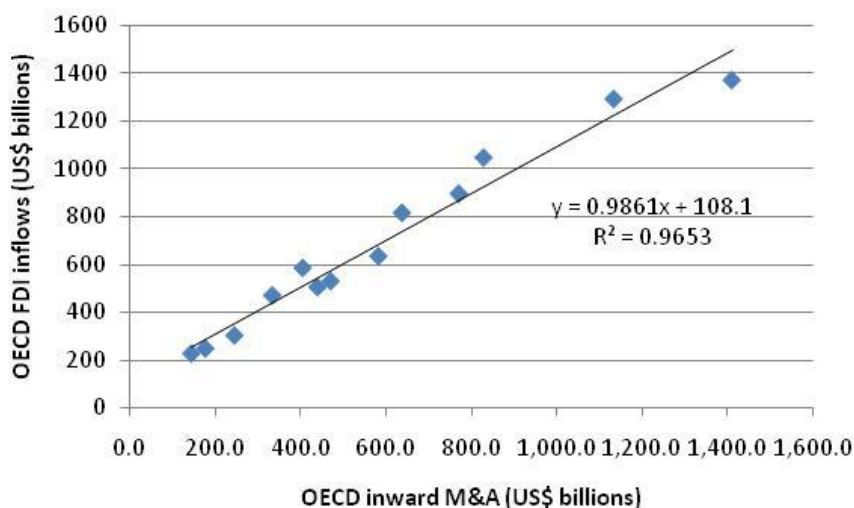
whether OECD FDI flows will retreat from the records achieved in 2007, but rather by how much. ■

For further reading on this topic:

OECD work on FDI statistics

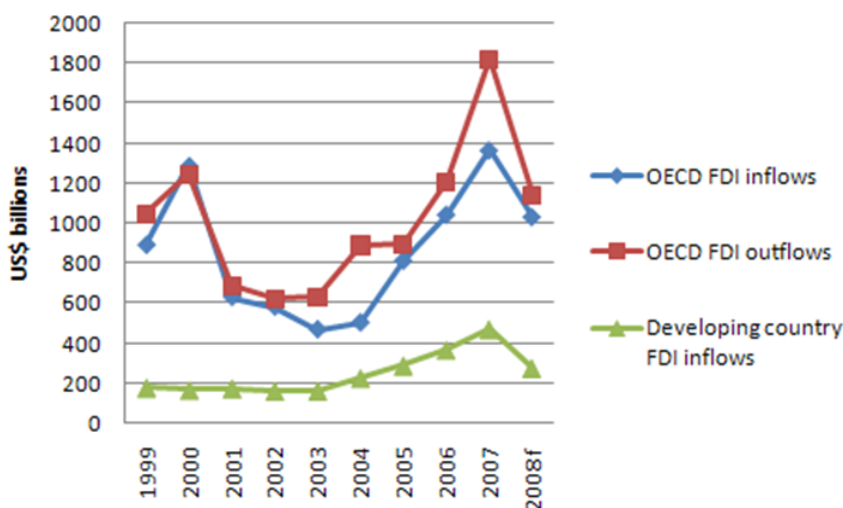
www.oecd.org/daf/investment/statistics

The relationship between OECD FDI inflows and OECD inward M&A, 1995-2007



Source: OECD and Dealogic 2008.

FDI inflows and outflows, 1999-2007, and 2008 forecast



Source: OECD and estimates calculated by OECD Secretariat using 2008 data supplied by Dealogic. Developing country flow data through 2007 from World Bank (2008) Global Development Finance.

THE NEW OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT ENTERS INTO FORCE

This May, after two years of intensive work, the OECD completed the 4th edition of its *Benchmark Definition of Foreign Direct Investment*. The *Benchmark Definition* is the internationally accepted standard used for FDI statistics. The revision introduces new data breakdowns and statistical treatments that better reflect today's complex international business structures. In particular, the new *Benchmark Definition* provides methods for classifying different types of FDI (e.g. mergers and acquisitions, greenfield investments) and for identifying the ultimate investor.

One of the most significant improvements brought in by the new *Benchmark Definition* concerns capital in transit. Multinational enterprises (MNE) increasingly set up complex international structures to manage their financing. In many cases they use the services of so-called Special Purpose Entities or SPEs (e.g. holding companies, shell companies, brass-plate companies, and financing subsidiaries). The transactions that flow through these entities distort FDI statistics in three ways:

- By overstating inward and outward FDI for the country hosting SPEs;
- By overstating overall FDI through double counting; and
- By confusing the ultimate origins and destinations of FDI.

The following examples illustrate the profound impact the new *Benchmark Definition* will have on the quality of FDI statistics collected by all countries that use this international standard.

Capital in transit via resident Special Purpose Entities

The example of Luxembourg's FDI statistics demonstrates well how economic analysis can be hampered when the data do not distinguish between capital in transit and genuine FDI (FDI excluding capital in transit, see table below). FDI plays a major role in the Luxembourg economy, with FDI stocks (excluding SPEs) representing 120% of GDP (2005), on average six times higher than in the OECD area. Luxembourg already applies the new recommendations of the *Benchmark Definition* to segregate capital in transit through SPEs, enabling an accurate examination of the role of FDI in the economy. If it did not, Luxembourg's FDI figures would be highly distorted. For example, in 2006 96% of inflows passed through SPEs, such that without the distinction between capital in transit and genuine

FDI, Luxembourg's reported FDI inflows would be overstated by a factor of almost 30 and would add over US\$100 billion of virtual FDI to global FDI statistics. Other countries where SPEs are resident are also expected to provide the same breakdowns, although in most other countries the importance of SPEs is less significant than in the present example.

Loans between fellow enterprises

Loans may transit between fellow enterprises (sister companies) which have a common parent but have little (or no) equity stake in each other. These are in many cases treasury centres which transit funds on behalf of their parents generally for the round-tripping of domestic financing or for capital in transit. Preliminary calculations suggest that FDI flows measured under the new *Benchmark Definition* could be as much as three times lower than flows measured under traditional methods. ■

For further reading on this topic: OECD (2008), *Benchmark Definition of Foreign Direct Investment*, available at www.oecd.org/daf/investment/statistics

The example of Luxembourg – FDI flows adjusted for capital in transit via SPEs
(US\$ billion)

	Outflows				Inflows			
	2004	2005	2006p	2007e	2004	2005	2006p	2007e
FDI including capital in transit through SPEs	84	125	111	182	79	116	125	119
FDI capital in transit through SPEs	77	116	107	130	73	110	96	155
FDI excluding capital in transit through SPEs	7	9	4	52	5	6	29	-36

e = estimate; p = provisional

Source: OECD International Direct Investment Database.

OECD MINISTERS ADOPT DECLARATION ON SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES

At the OECD Ministerial Council Meeting on 4-5 June 2008 in Paris, Ministers of OECD countries*

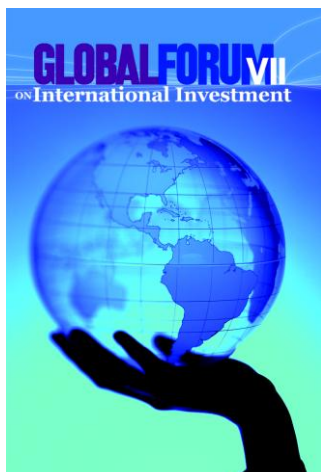
- Welcomed the constructive contribution that Sovereign Wealth Funds (SWFs) make to the economic development of home and host countries. To date they have been reliable, long-term, commercially-driven investors and a force for global financial stability.
- Recognised that if SWF investments were motivated by political rather than commercial objectives, they could be a source of concern, and that legitimate national security concerns could arise.
- Welcomed international discussions involving SWFs, their governments and recipient governments. These increase understanding, contribute to mutual trust and confidence, and help avoid protectionist responses that could undermine economic growth and development.
- Noted that the home countries of SWFs and SWFs themselves can enhance confidence by taking steps to strengthen transparency and governance in the SWFs.
- Supported the work of the IMF on best practices for SWFs as an essential contribution and the continuing coordination between the OECD and the IMF.
- Noted that the OECD for its part has been working on best practices for recipient countries. Together the IMF and OECD will help preserve and expand an open international investment environment for SWFs while safeguarding essential security interests.
- Welcomed the Report by the OECD Investment Committee on SWFs and Recipient Country Policies**, which reflects inputs from both OECD and emerging economies, and looked forward to future work, including peer monitoring of policy developments and broader consideration of foreign-government controlled investments.
- Based on this Report, Ministers endorsed the following policy principles for countries receiving SWF investments. These principles reflect long-standing OECD commitments that promote an open global investment environment. They are consistent with OECD countries' rights and obligations under the OECD investment instruments.
 - ◆ Recipient countries should not erect protectionist barriers to foreign investment.
 - ◆ Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
 - ◆ Where such national security concerns do arise, investment safeguards by recipient countries should be:
 - transparent and predictable,
 - proportional to clearly-identified national security risks, and
 - subject to accountability in their application.



* Ministers of Chile, Estonia and Slovenia also adhered to this Declaration in the name of their government on 5 June 2008.

** This report was developed at the request of the G7 Finance Ministers and the other OECD members to develop guidance for recipient countries' policies toward investments from sovereign wealth funds (SWFs). It is the result of the work of the thirty OECD countries, the ten non-member countries adhering to the OECD investment instruments, four other non-members participating in the project and the European Commission. The report also benefited from consultations with SWFs and business and social partners. A final report on the broader freedom of investment project will be completed in the first half of 2009. The process of peer surveillance established under the project will be strengthened to continue to monitor investment policy developments at national level in light of the agreed principles of transparency, predictability, proportionality and accountability and of countries' commitments under the OECD investment instruments.

For further reading on this topic: OECD work on freedom of investment: www.oecd.org/daf/investment/foi



OECD GLOBAL FORUM ON INTERNATIONAL INVESTMENT

The theme of the 7th OECD Global Forum on International Investment (GFI-7) was “Best practices in promoting investment for development: Pursuing a common agenda”.

This annual event, organised by the OECD Investment Committee and co-sponsored by UNCTAD, took place on 27-28 March 2008 at the OECD in Paris.

The opening plenary was organised as a “Davos style” discussion which involved the Secretaries

General of the OECD and UNCTAD, the Prime Minister of Peru, Ministers from Morocco, Uganda, Costa Rica, India, and the Chairman of Egypt’s General Authority for Investment and Free Zones. GFI-7 attracted over 400 participants representing 73 economies.

All background documents are available on the conference website www.oecd.org/investment/GFI-7.



Supachai Panitchpakdi, UNCTAD Secretary General and Angel Gurría, OECD Secretary-General



Jorge Del Castillo, Prime Minister, Peru and Angel Gurría, OECD Secretary-General



THE OECD JOURNAL OF INVESTMENT POLICY

This new publication - formerly **International Investment Perspectives** - will focus on multidisciplinary empirical and analytical research of practical relevance for the global investment policy community.

Its mission is to support informed, fact-based policy dialogue, peer learning, and reforms aimed at improving investment climates worldwide.

Due out in the last quarter of 2008, the first issue will reproduce a selection of papers presented

during the seventh OECD Global Forum on International Investment, as well as two articles based upon original OECD research.

While all of the papers share the common theme of best practices in promoting investment for development, together they also illustrate the broad range of investment policy issues that governments need to consider as they pursue their objectives. The issues explored include the interface between foreign direct investment and innovation, the ‘social dimension’ of investment policy, and the role of the financial system. In addition, a research note highlights key developments and trends in the most recent annual FDI statistics released by OECD countries, as well as a forecast for 2008.

DID YOU KNOW...

that the recently released Economic Survey of Portugal recommends that the Policy Framework for Investment be used to improve the investment climate?

Find out more at:

www.oecd.org/eco/surveys/portugal



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.

FORTHCOMING:

OECD Investment Policy Reviews

The OECD has published Investment Policy Reviews for both member and non-member countries since 1993. The reviews present the results of peer examinations by the OECD Investment Committee of investment trends and policies in these countries. Investment policy areas covered include: approval mechanisms for foreign investment, real estate legislation, monopolies and concessions, measures taken for public order and essential security, investment protection and international agreements; taxation of foreign affiliates, and investment incentives.

The reviews also address outward direct investment policies, policies to encourage responsible investment conduct, trade, competition, infrastructure and other policies having a bearing on the investment climate.

The reviews are conducted using the Policy Framework for Investment and the OECD legal instruments for investment.

Reviews for four countries will be published in the second half of 2008:

- China
- Peru
- Russian Federation
- Vietnam

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

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CALENDAR OF EVENTS

23-25 JUNE 2008, PARIS, FRANCE

OECD-ILO Conference on Corporate Social Responsibility

Jointly organised by OECD and ILO, this conference will be devoted to the theme of "Employment and Industrial Relations: Promoting Responsible Business Conduct in a Globalising Economy". Discussions will focus on wider dissemination of good corporate labour practices and better understanding and use of the OECD and ILO instruments. This event aims to foster mutual understanding and trust between relevant actors in developed and emerging markets on approaches to promote responsible business conduct.

Employment and Industrial Relations

Annual meeting of the National Contact Points (NCPs) for the OECD Guidelines for Multinational Enterprises

National Contact Points will meet for the eighth time since the 2000 Review of the Guidelines to review their experiences in performing and promoting the implementation of the Guidelines. This meeting will be held back-to-back with the conference on corporate social responsibility.

Further information on the conference and NCP meeting can be found at: www.oecd.org/daf/investment/guidelines.

Contact: Marie-France Houde
Tel: +33(0)145249126

26-27 JUNE 2008, PARIS, FRANCE

OECD-China Multi-Stakeholder Symposium on government approaches to encouraging responsible business conduct

Chinese and OECD government, business, labour and civil society representatives will review China's recent progress in encouraging responsible business conduct (RBC), examine remaining challenges and offer proposals for advancing work in this area.

OECD-China Seminar on Promoting Responsible Environmental Conduct



Chinese government agencies, OECD government and business representatives and other stakeholders will meet to initiate a continuing dialogue and establish a network for sharing information on best practices of environmentally responsible business conduct among Chinese enterprises.

Further information on the symposium and seminar can be found at: www.oecd.org/daf/investment/china.

Contact: Ken Davies
Tel: +33(0)145241974

8 OCTOBER 2008, PARIS, FRANCE

Eighth OECD Roundtable on Freedom of Investment, National Security and 'Strategic' Industries

This roundtable will focus on strengthening peer monitoring of recipient country policies, accountability in applying national-security investment safeguards and foreign government-controlled investment.

Launched in early 2006 within the framework of the Investment Committee's freedom of investment project, these roundtables provide a forum for intergovernmental dialogue on how governments can reconcile the need to preserve and expand an open international investment environment with their duty to safeguard the essential security interests of their people.

Participants are the OECD members, the 10 non-members adhering to the OECD Declaration on International Investment and Multinational Enterprises and the other major emerging economies, as well as the European Commission.

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NEWS IN BRIEF

OECD COUNTRIES AGREE ON FURTHER LIBERALISATION COMMITMENTS IN INSURANCE AND PRIVATE PENSIONS

OECD countries have agreed on further liberalisation commitments in the areas of insurance and private pensions. The OECD Code of Liberalisation of Current Invisible Operations has been amended to broaden the insurance obligations of the Code and introduce new obligations on private pensions, thereby establishing a new, high standard for cross-border trade in insurance and private pensions services.

The Code of Liberalisation of Capital Movements and the Code of Liberalisation of Current Invisible Operations constitute legally binding rules, stipulating progressive, non-discriminatory liberalisation of capital movements and international services. Implementation of the Codes, in particular by removal of restrictions on cross-border capital flows and trade in services and the concomitant lifting of country reservations against the Codes, involves "peer pressure" exercised through country examinations to encourage unilateral rather than negotiated liberalisation. OECD countries have accepted under the Codes that they may not introduce new barriers. This means that countries can evolve only in the direction of progressive liberalisation.

For further reading on this topic:

The full text of the report and information about the OECD codes of liberalisation can be found at: www.oecd.org/daf/investment/instruments.